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Investment Arbitration and the USMCA

In view that the USMCA becomes effective as of today, it is appropiate to analyze the mechanism established therein for Investor-State dispute settlement, known as Investment Arbitration, and its differences with respect to the provisions of the NAFTA.

To this end, this article will review the historical background, the provisions contained in the NAFTA and now in the USMCA, and will finalize with brief conclusions.

Historical background

The Investment Arbitration is an established procedure to resolve disputes between foreign investors and host States (also called Investor-State dispute settlement or ISDS). The possibility for a foreign investor to sue a host State is a guarantee to the foreign investor that, in the event of a dispute, will have access to independent and qualified arbitrators who will resolve the dispute and issue an enforceable award.

The Diplomatic Protection, the Calvo Doctrine and the new law might be considered as background of the Investment Arbitration.

1. Diplomatic protection. It is the evolution of the Letter of Marque and Reprisal. Diplomatic protection is triggered by the damage suffered by a person residing in a foreign State, caused by a violation of an obligation under international law, therefore, the individual goes to his own State in order for the later to exercise the State to State diplomatic protection to obtain fulfillment or repair of the damage caused.

There are certain elements for the diplomatic protection to be granted to the petitioner, (requirements two, three and four are conditions of customary law):

1. The existence of a violation of an obligation under international law.
2. The petitioner must have the nationality of the State that will provide it, with two sub-conditions:
    i. The nationality must be held from the beginning of the claim, and,
    ii. The nationality must be preserved during the dispute.
3. Clean hands: Implies that there is no unlawful conduct on behalf of the individual who will receive the protection.
4. Exhaustion of internal resources.

2. Calvo Doctrine. This doctrine marked the history of twentieth century, since all the Latin American States adopted it and had a great impact on international relations. It is named

after the author Carlos Calvo, an Argentinean lawyer and writer of several international law books.

In consists in that the foreigner must be submitted to the national jurisdiction and law. It differs from the Calvo clause (which implies the waiver of diplomatic protection and is used predominantly in contracts).

America was the first continent to initiate the unification of its laws through international treaties. The Calvo doctrine was proposed at the conferences of 1899 and 1901 and the American States signed it, although the United States of America opposed to the doctrine since it considered that the foreigner had superior protection than the national.

The Calvo doctrine was implemented at the Havana conference of 1928, and was consecrated that same year, as well as in the Montevideo conference five years later; such consecration was reflected in the resolutions adopted at those conferences.

The main relevance of the doctrine took place in Bogota in 1948, where it was agreed that the law applied to both nationals and foreigners and that the latter were subject to the law and jurisdiction of the State, that is, the principle of equality was protected, which led to the institution of the principle of national treatment; however, this principle tended to be effective only in those States that have a high standard of law (democracy, legality, respect for human rights, etc.)

The decline of the Calvo Doctrine coincides with globalization. In Latin America it was marked in the nineties, characterized by two events: the first is that a State contract was allowed to be governed by a law other than the national one; and the second, international arbitration for State contracts was adopted.

3. The new right. It was developed in the sixties, as a consequence of much of Africa and Asia becoming independent and forming new states, as well as a new society that originated new rules for the resolution of controversies in international matters, such as the Porter Convention, which declared illegal the use of force to execute judgements.

The new international order was reflected in all areas, for example:

In the Law of Treaties, in the Vienna Convention, all the States parties proposed the creation of the figure "ius cogens", which consisted of annulling the treaties that the weak States had signed with their former colonies.

In the Law of the Sea, it was prohibited exploiting the resources of the plains and seabed by the countries with the capacity of doing so, establishing that it shall be done in favor of all the States, and delimiting the marine and submarine areas, in favor of the States to which they belonged.

In the matter of the celestial bodies, it affected that no State could claim sovereignty over the Moon or celestial bodies.

In economic matters, resolution 1803/63 on permanent sovereignty of material resources was approved, which had an impact on oil arbitrations, establishing that the concession on the oil resource was made on a precarious basis, implying the possibility that the grantor would request to the concessionaire the restitution of the concession.

The new international economic order influenced the development law, generating a law oriented towards real equality of States and not only formal. The Principle of Symmetry was created, with the objective that developing States could tie with developed States through mechanisms and figures such as the forgiveness of public debt, the conception of soft loans, etc.

These three elements laid the foundations for the creation of Investment Arbitration.

How did Investment Arbitration arise?

To understand this, different governmental, non-governmental and institutional efforts must be distinguished, as well as the background for their codification.

Codification efforts that were made from the procedural and substantive point of view. Within this stage, the main topics discussed were: what is the treatment that should be given to the foreigner in relation to the national? What is the treatment that should be given to expropriation?

Can compensation be given and under what conditions?

Various documents were produced that did not prosper in the attempt to codify investment arbitration for a reason, mainly, the substantial differences between the capital importing and exporting countries regarding the treatment given to investors, since they demanded equal treatment. Within these documents are; a) The 1929 draft known as the "Harvard draft" by the Harvard Law School; b) A draft with 29 articles made in 1929 in the Convention on "Treatment of Foreigners" in Paris; c) In Latin America, at the seventh Conference of American States of Montevideo in 1933, on the Rights and Obligations of States, it was established that nationals and foreigners should have the same rights and protection, but it was partially adopted; d) The Havana Charter.

Efforts of non-governmental entities. Likewise, there were "drafts" documents that did not become international conventions but, nevertheless, are cited as a reference and source in terms of investment.

Within this background are: a) The "draft" document of the International Chamber of Commerce, which proposed a treatment code for foreign investors establishing a national treatment, that is, a more favored, fair and equitable treatment, among other aspects; b) The draft document prepared by the International Law Association, proposed a statute for an investment arbitration tribunal; c) The Convention prepared in 1959, which established protection for foreigners in investment matters and defined the "Minimum Level of Treatment" as adequate and equitable compensation, and was also the first draft that expressly contemplated the possibility of submitting a dispute to investment arbitration; d) The 1961 Harvard draft, which updated the 1929 document.

Distinction between investment arbitration and commercial arbitration. In parallel to these attempts to codify a substantive investment framework, arbitration is being developed to resolve conflicts between traders, who sought, through the contractual channel, to agree on adequate clauses for the protection of their investments and, on the other hand, to agree the arbitration clause.

The New York Convention of 1958 was relevant to both commercial arbitration and investment arbitration, considered without a doubt one of the most successful international instruments as it is ratified by the vast majority of countries in the world and allows the recognition and execution of foreign awards, also allowing the arbitration agreements to be defended when a controversy is submitted to an arbitration judge.

Creation of investment arbitration. In 1961 the Legal Director of the World Bank considered convenient to create a mechanism to resolve investment arbitrations in an independent, neutral, depoliticized forum that allows investors to claim directly to a State. This transcended into two substantial elements of investment arbitration:

1. The investor was granted Use Standing International, that is, the possibility of suing a State other than his own outside the courts of that State.

2. The scope of ICSID (as defined below) jurisdiction was defined, thus establishing the disputes that it will address: "Article 25. For differences of a legal nature that arise directly from an investment, between a Contracting State and the national of another Contracting State and that the parties have consented being submitted to the institute".

Finally, in 1965 the Washington Convention that creates the ICSID -International Center for the Settlement of Investor Disputes- is materialised.

Similarly, other investment arbitration institutions were created, for example: the International Chamber of Commerce (ICC); the United Nations Commission on International Trade Law, UNCITRAL was created by the United Nations General Assembly (UNCITRAL); and Courts of the State receiving the investment.

In 1978 ICSID created the complementary mechanism, allowing to submit to Arbitration disputes arising from an investment in which any of the States is not a party to the Convention or to submit to arbitration discussions that do not arise directly from an investment. This complementary mechanism was ratified by the United States of America, Mexico and Canada, therefore, different controversies arising under NAFTA were resolved with this mechanism.

The evolution of the Investment Arbitration has been an effort to reform the regulations of ICSID and UNCITRAL to achieve an adequate arbitration system to discuss public policy issues for States, a system conceived for them and to begin distinguishing it from the rules that govern commercial arbitration.

Arbitration in NAFTA

Chapter 11 on Investment in NAFTA established the mechanism for the settlement of investment disputes.

Its scope was wide; this procedure had to follow the procedural rules of one of the following three arbitration systems:

a) The International Center for Settlement of Investment Disputes (ICSID),
b) The ICSID Complementary Mechanism, or
c) The United Nations Commission on International Trade Law (UNCITRAL).

The NAFTA provided stages for the settlement of disputes, which consisted of:

1st Phase (consultations): The disputing parties should first try to settle the controversy through consultation or negotiation.

2nd Phase (intervention of an ad hoc arbitral tribunal): A NAFTA investor who alleges that a host government had violated its investment obligations acquired under Chapter 11, could submit the claim to arbitration.

3rd Phase (revision of the award): Any of the parties could request the revision or annulment of the award issued by the arbitral tribunal, that followed the procedural rules established in the chosen arbitration mechanism.

4th Phase (compliance with the award): The award issued by the court was limited to the repair of damages or restitution of property or its equivalent in money.

The ruling was binding only for the disputing parties and only with respect to the specific case. The party could only comply with the award after the period for filing the appeal for review or annulment.

Non-compliance with the award: In the event of non-compliance with the final award, the Commission would form an "arbitration panel".

Provisional protection measures: The court could order a provisional protection measure to preserve the rights of the disputing party or to ensure that the court's jurisdiction had full effect, including to preserve evidence that was in the possession or control of a disputing party.

Arbitration at the USMCA

The Investment Chapter is divided into two sections:

a) Disciplines for investment protection.

It contains the foreign investment protection disciplines that are binding for Mexico, the USA, and Canada.

The investment protection disciplines envisaged are the result of a review and update of the protection standards provided by NAFTA, in order to improve and clarify their scope. The negotiation of this chapter benefited from the experience of the Parties in the Investor-State cases that they have faced in the framework of the NAFTA Investment Chapter.

The Investment Chapter of the USMCA does not limit the Parties in their capacity to adopt public policies necessary for the protection of health, safety or the environment, among others.

Some main differences are:
1. The definition of investment is broader compared to that of NAFTA.
2. In the provision on the minimum level of treatment, aspects were included to give greater certainty, such as "fair and equitable treatment" and "security and full protection".

3. The most favored nation and national treatment provisions avoid discriminatory treatment for investors from any of the countries.
4. Expropriation and compensation grants legal certainty to investors and guarantees adequate, non-discriminatory treatment and effective compensation.

5. In the case of transfers, these may be made by investors freely and without delay to their countries of origin.
6. The denial of benefits contemplates the conditions by which a member country may not grant the benefits of the Chapter to an investor.

b) Investor-State dispute settlement mechanism.

It contains the investment arbitration mechanism (Investor-State), binding only between Mexico and the US (which is considered to be discriminatory for Mexico), for the following types of investment claims:

1. The investors of a Party may claim the violation of the obligations of National Treatment, Most Favored Nation and Direct Expropriation; and
2. Claim the violation of any provision of the investment chapter, when the investor or his investment is part of a contract in the hydrocarbons and gas, telecommunications, power generation, transportation and infrastructure projects sectors.

The arbitration mechanism was updated incorporating new provisions, such as:

1. The transparency of the arbitration procedure, both in written and oral proceedings;
2. The application of the most recent arbitration rules of the United Nations Commission on International Trade Law (UNCITRAL);
3. The issuance of a draft of the arbitration award to give the parties an opportunity to submit comments; and
4. The incorporation of ethical rules that the arbitrators must observe, more expeditious procedures to settle jurisdiction matters, rules for the participation of non-disputing parties, as well as for the termination of arbitration for procedural inactivity.

Conclusions

The new trade agreement between Mexico, the United States and Canada, called USMCA, increases protectionism in North America, promotes a fairer and more equitable treatment, which generates greater security and protection, protects from discriminatory treatment, facilitates transactions, includes procedural guarantees such as transparency in the arbitration development, as well as ethical rules and a kind of hearing right before the issuance of the final award.

While this new version reduces uncertainty, it does not actually eliminate it, since some of its changes may have detrimental impact on trade, investment, or even value chains.

The USMCA updated NAFTA disciplines on investor protection in North America. It limits the scope by which foreign investors can sue governments using the Investor-State dispute settlement mechanism.

There are grounds to argue that in light of the content of Chapter 33 of the USMCA, autonomy is lost in terms of monetary policy control. The USMCA may be a small setback in the economic integration of the region, especially when compared to NAFTA.

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