The Impact of USMCA on Investor-State Disputes and the Energy Industry

January 04, 2019

After months of prolonged and often heated negotiations, Canada, the United States and Mexico unveiled, at the end of September, a new trilateral trade deal that will replace the North American Free Trade Agreement (NAFTA). The United States-Mexico-Canada Agreement (USMCA) brings resolution to some of the sticking points that prevented an earlier agreement. Our colleagues have highlighted some key provisions of the USMCA in a previous article. This article addresses the elimination of the Chapter 11 investor-state dispute settlement mechanism as between Canada and the United States.

Investor-State Dispute Settlement under NAFTA

Among the most controversial elements of NAFTA, Chapter 11, which contains obligations with respect to the treatment of the other Parties' investors and their investments, enables those investors to bring claims against a host Party for breach of those obligations, under a mechanism known as investor-state dispute settlement (ISDS). ISDS, which is available under many bilateral investment treaties and some other free trade agreements, is intended, among other things, to encourage foreign investment by allowing investors to seek damages through binding arbitration, for a host state's failure to abide by its treaty commitments, including commitments to treat them fairly, not to discriminate against investors or their investments, and not to expropriate investments or take measures amounting to expropriation without paying adequate compensation.

How Canada has Fared

The inclusion of Chapter 11 in NAFTA was the first time that ISDS was incorporated into a free trade agreement. Chapter 11 was introduced mainly to protect Canadian and American investors seeking to invest in Mexico. During the history of NAFTA, however, Canada has been the subject of most of the investor claims under Chapter 11. The United States, on the other hand, has never lost a case and never paid a dollar in damages.

NAFTA Negotiations

The Trump Administration was a vocal opponent of the NAFTA dispute settlement mechanisms during the negotiations. The United States Trade Representative, Robert Lighthizer, explained the United States' opposition of Chapter 11 in part on the basis that it promoted outsourcing of jobs and investments. Although American investors have reaped benefits under Chapter 11, there is no guarantee that the government will continue its winning streak in the investor claims. Although the United States did not oppose the state-to-state dispute settlement provisions found in Chapter 20 of NAFTA, it sought to dilute these provisions considerably. The United States also sought, successfully but somewhat contradictorily, to make the labour and environmental obligations in the agreement subject to state-to-state dispute settlement. The opposition to Chapter 11, and the other dispute resolution measures, appeared in line with the current American protectionist trade policies and general antipathy towards being subjected to any form of binding international dispute settlement.

Foreign Affairs Minister, Chrystia Freeland, Canada's lead representative in the negotiations, has expressed skepticism about the value of ISDS. Reforms to the ISDS process were listed among Canada's negotiation objectives, such that "governments have an unassailable right to regulate in the public interest".

During the lengthy negotiations process, Mexico stood with Canada in pushing the United States to decide whether it wanted to commit to ISDS, indicating a willingness to proceed with a bilaterally agreed ISDS mechanism, if necessary. Of the proposals put forth by Canada and Mexico, Mexico's proposal was closer to the existing ISDS framework under NAFTA while Canada's proposal was modelled after the ISDS mechanism in its Comprehensive Economic and Trade Agreement with the European Union.

ISDS Under the USMCA

Investment obligations and ISDS will be governed in the USMCA by Chapter 14. The USMCA entirely eliminates ISDS with respect to Canada: American and Mexican investors will no longer be able to bring investor claims against the Canadian government, and Canadian investors will no longer be able to bring investor claims against the government of either of the other trading partners. Canada and the United States have agreed to a three-year phase-out: for claims in respect of investments made while NAFTA has been in force, investors can bring their claims for three years after the USMCA comes into force, after which investors' protection will be limited to only causes of action available in domestic law, if any, such as indirect expropriation. For investor-state disputes between Canada and Mexico, investors will have recourse through the traditional NAFTA-like ISDS mechanism in the Comprehensive and Progressive Agreement for Trans-Pacific Partnership after it enters into force on December 30, 2018.

As between the United States and Mexico, traditional ISDS is preserved but with considerable restrictions relative to NAFTA, particularly if the claim does not arise out of an investment contract with the host state to either provide public services in certain covered sectors (power generation, telecommunications, transportation and infrastructure) or to engage in activities controlled by the host state in the oil and gas sector. For investors in other sectors, Chapter 14 further curtails ISDS by limiting the types of claims that these investors may bring, allowing only for claims of alleged post-establishment breaches of the non-discrimination obligations (national treatment and most-favoured-nation treatment) and for claims of direct expropriation. Also precluded from making Chapter 14 claims are those investors owned or controlled by a non-US or Mexican persons from what the host state considers to be a "non-market economy" (e.g. China).

Potential Implications for the Oil and Gas Industry

For investors in the oil and gas industry or other sectors that may have been affected by the government action of a host state, investor claims under NAFTA may be an available remedy. Investors with potential ISDS challenges should bring their claims prior to the earlier noted three-year expiry period.

Investor claims have been used in the oil and gas industry. Consider, for example, the $15-billion NAFTA investor claim initiated by TransCanada Corporation in 2016 after former President Barack Obama rejected its application for a presidential permit to approve the construction of Keystone XL in the United States. TransCanada argued that the rejection was politically motivated and in breach of the United States' NAFTA commitment to protect Canadian investments with respect to national treatment, most-favoured-nation treatment, minimum standard of treatment and expropriation. TransCanada's claim was withdrawn after President Trump reversed the decision and issued a presidential permit authorizing the construction of the project.

In 2015, ExxonMobil and Murphy Oil successfully claimed for damages against the government of Canada on the basis that requirements imposed by Canada and Newfoundland and Labrador for the companies to pay a percentage of their offshore revenues into research and training in Newfoundland constituted performance requirements contrary to NAFTA. More recently, Lone Pine Resources has brought a $250-million NAFTA claim against the government of Canada after Quebec introduced a moratorium on fracking under the St. Lawrence River.

Investors from other natural resource sectors have also brought claims under Chapter 11. For example, in 2011, American forestry company AbitibiBowater Inc. (now Resolute Forest Products) obtained a $130-million settlement against Canada for Newfoundland and Labrador's expropriation of its water and timber rights and hydroelectric generation facilities.

With respect to the energy sector, in 2016, U.S.-based Windstream Energy was awarded more than $25 million in compensation because Ontario issued a moratorium on offshore wind development after Windstream had secured a contract with the province under its feed-in-tariff program.

Recently, U.S.-based Westmoreland Coal Company, which has several coal mines in Canada, has indicated its intention to pursue remedies against the government of Canada related to Chapter 11 of NAFTA for US$380-million over alleged discrimination related to the government of Alberta's Climate Leadership Plan strategy to phase-out coal-fired electricity generation pollution by 2030.

Given the elimination of ISDS between Canada and the United States, investors may find protection only through causes of action that are available in the domestic law of the host state. In this article, we wrote about Canada's recognition of the common law cause of action for de facto or disguised expropriation, one of the potential domestic claims that investors may seek against the government of Canada. This common law cause of action will remain available as a form of recourse through local courts and has been used previously to compensate interest holders for the effective taking away of those interests by government actions. It is available to both domestic parties and foreign investors. For instance, it is being used by LGX Oil & Gas Inc. ("LGX") regarding the government of Canada's emergency order issued to protect the greater sage-grouse habitat in southern Alberta and Saskatchewan, which LGX claims has inhibited its operations to such an extent that its oil and gas interests were effectively taken. As there continues to be contemplation of a Canadian plan related to the protection of woodland caribou under the *Species at Risk Act*,[1] and in particular for Alberta and British Columbia, similar claims may arise.

1 SC 2002, c 29.

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