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Research Report

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NAFTA 2.0: a way forward for the investment chapter*

by

Mélida Hodgson**

As the fractious NAFTA negotiations hurtle forward, it is clear that the negotiations are not about investment protections—or, more specifically, investor-state dispute settlement (ISDS). Nevertheless, the Office of the US Trade Representative (USTR), having still not tabled proposed text at the fourth round of negotiations,¹ created some consternation in late August by floating an “opt-in” model for ISDS.² Arguably, the US floated this proposal as a way to improve its negotiating position on issues that this renegotiation *is* really about for the Trump Administration, namely a revision of automotive rules of origin and more favorable agriculture, supply chain, digital commerce, and sugar provisions.

The outcry from the US business community to the proposal was swift, threatening to withhold support for the deal before Congress.³ On the other hand, there is bipartisan support for eliminating the NAFTA investment chapter.

On the theory that the Trump Administration will not deny the business community ISDS, there is room to bridge the gap by modernizing the chapter. Below are some ideas as to how that can be achieved. These ideas are consistent with the one overarching goal expressed for the investment chapter by the US before the modernization negotiations began – “no greater substantive rights” for foreign investors – which has been the guiding principle since the George W. Bush Administration’s free trade agreement negotiations. The proposal is essentially an enhanced Trans-Pacific Partnership (TPP).⁴ Any comparison of the NAFTA and TPP investment chapters leads to the conclusion that the latter is a substantial improvement over the former from the government’s perspective, and at least offers clarity for investors.

Accordingly, USTR could start by replacing the NAFTA text with the TPP text, incorporating improvements such as:

- modern expropriation provisions that constrain findings of indirect expropriation in the context of regulations concerning public health and safety and the environment;
- a minimum-standard-of-treatment/fair-and-equitable-treatment provision that does not cover investors' expectations;
- guidance on the concept of the "in like circumstances" required for a violation of the national-treatment and most-favored-nation provisions;
- the circumscription of MST and expropriation claims related to subsidies;
- procedures to dispose of frivolous claims at an early stage, on an expedited basis;
- provisions related to the governing law and Free Trade Commission interpretations;
- exceptions that preserve financial and prudential regulatory space, including through the limitation of certain (i.e., debt restructuring) claims; and
- significant transparency provisions (e.g., non-disputing party and *amicus curiae* submissions, publication of pleadings and awards, open hearings).⁵

But civil society groups felt TPP was not sufficiently protective of sovereign interests. So how can the NAFTA investment chapter be an enhanced TPP?

Let us start by imagining that an administration embarking on a grand infrastructure initiative would want to avoid all claims related to subsidies, not just minimum-standard-of-treatment and expropriation claims. In addition, although generally opposed to environmental regulation, this administration would presumably want to preserve its sovereign discretion with respect to health and public welfare policy, as well as the environment. One way to do this would be to strengthen regulatory discretion by excluding regulatory claims from ISDS, or requiring that any such claims be subject to the same restrictions placed on claims based on tax measures.⁶ Other provisions that could appease skeptics would:

- prohibit the importation of substantive and procedural obligations of other agreements through the operation of the most-favored-nation provision;⁷
- a right to counter claims for states;
- require the bifurcation of damages claims;
- adopt a code of conduct for ISDS that applies to arbitrators and counsel (this is not novel—NAFTA already has a code of conduct for other types of arbitral proceedings);
- complete the roster of arbitrators foreseen in NAFTA (Art. 1124.4);
- require that challenges to arbitrators be decided by an administering institution without suspension of the proceedings;
- require disclosure of third-party funding arrangements; and
- require the negotiation of an appellate mechanism.

Certainly, these further enhancements will not satisfy those opposed to any investment protections or ISDS. But it is arguably a fairer balancing of national interests. Because,

while the NAFTA modernization is “not about” the investment chapter, the opt-in proposal reveals the chapter’s vulnerability.

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¹ It is rumored that, at the third round in mid-September 2017, Canada tabled a “EU-Canada Comprehensive Economic and Trade Agreement (CETA) light” investment chapter, but details are scarce.

² This is not as radical as some may think: there is no ISDS in the Australia FTA (2005). But that was a new agreement. See <https://ustr.gov/sites/default/files/uploads/agreements/fta/australia>.

³ Letter from the National Association of Manufacturers, the Business Roundtable and the U.S. Chamber of Commerce, Aug. 23, 2017, at www.nam.org (Association CEO Letter on ISDS in NAFTA).

⁴ TPP’s investment provisions were acceptable to Canada, México and the US business community. Although it was largely not acceptable to those opposed to investment protections (particularly ISDS), to the extent the Trump Administration can get concessions on the issues that the renegotiation is really about, opponents may have to live with ISDS.

⁵ See <https://ustr.gov/trade-agreements/free-trade-agreements/trans-pacific-partnership/tpp-full-text> (Chapter 9).

⁶ See, e.g. the Korea-United States Free Trade Agreement, Art. 23.3 (Exceptions-Taxation), at <https://ustr.gov/trade-agreements/free-trade-agreements/korus-fta/final-text>.

⁷ Similar to CETA Art. 8.7.4.

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