

NAFTA Arbitration Substitutes May Spur Issues Of Their Own

By **Caroline Simson**

Law360 (April 11, 2018, 6:14 PM EDT) -- Alternatives to investor-state arbitration that the U.S. trade representative proposed for a renegotiated North American Free Trade Agreement could repoliticize disputes and lessen protection for investors, former U.S. government officials told Law360.

Confirming months of speculation, USTR Robert Lighthizer told lawmakers during a congressional hearing last month that the Trump administration intends to opt out of investor-state dispute settlement, or ISDS, in a renegotiated NAFTA.

The ambassador suggested that investors could instead resort to a state-to-state dispute settlement mechanism already in place in NAFTA or incorporate arbitration clauses in their own contracts, presumably with governments or state-owned entities.

But experts told Law360 that there's a reason why ISDS has become the dispute resolution mechanism of choice for international businesses and nations that include arbitration clauses in their trade agreements.

"I think the main problem with his proposed solutions is that they're all limited in scope, and so there's very serious enforcement gaps," said Marney Cheek, co-chair of Covington & Burling LLP's international arbitration practice, who was formerly an associate general counsel at the USTR's office.

The ambassador's comments during the hearing came in response to pressure from House Ways and Means Committee Chairman Kevin Brady, R-Texas, who had referenced a letter written by a group of more than 100 Republican lawmakers who have called on U.S. trade negotiators to keep in place NAFTA's ISDS provision, citing its important protection of American businesses. The letter ominously warned that NAFTA "will lose key congressional support" if ISDS protections are abandoned.

There's been conjecture for months that Lighthizer would look to nix ISDS from NAFTA, following comments he made last year that ISDS encourages companies to invest abroad rather than domestically. He reiterated this point during the congressional hearing and expanded on his anti-ISDS stance, telling lawmakers that allowing foreign investors to access investor-state arbitration and bypass U.S. courts undermines American sovereignty. He also cited the "regulatory chill" effect, which many liberal critics of ISDS argue precludes nations from passing certain regulations over fears of facing an investor-state claim.

Lighthizer's first proposal as an alternative to incorporating a traditional ISDS clause in NAFTA is to have U.S. companies investing abroad resort to NAFTA's state-to-state dispute settlement mechanism, known as Chapter 20. Under Chapter 20, U.S. companies that encounter issues when investing in Canada or Mexico may petition the U.S. government to reach out to that government to try to resolve the issue.

But international arbitration attorneys say it's not an ideal solution. Investor-state arbitration has always been meant to depoliticize disputes, and relying on Chapter 20 would have the opposite effect.

"Under state-to-state dispute settlement, even if the investor has a valid claim, it's subject to the broader political dynamics between the U.S. and that host country," Cheek said. "The U.S. government might have many reasons for not wanting to bring a dispute, even if it's a meritorious dispute."

A good example of this is the relationship between the U.S. and Russia, she said. Because there is no investment treaty protecting American investors in Russia, they must ask the U.S. to invoke the state-to-state dispute settlement mechanism to receive any relief if they believe their investment is being treated unfairly. But Cheek noted she has clients who have been waiting since 2008 for the U.S. Department of State to decide whether to do so in such a dispute with Russia.

Moreover, in his comments to lawmakers last month, Lighthizer suggested that it's not the job of the U.S. government to protect American companies abroad. That makes his suggestion that they could instead resort to state-to-state dispute settlement somewhat ironic, according to Bart Legum, head of Dentons' investment treaty arbitration practice and a former chief of the NAFTA arbitration division in the State Department.

"One can't help but wonder how effective that approach would be under this administration," Legum said.

The second alternative suggested by Lighthizer is for companies to incorporate arbitration clauses in their contracts, presumably with foreign governments or state-owned entities.

"If you go to any one of these companies and ask them why do you need [ISDS], why don't you put in place an arbitration provision in your contract, they'll all say, 'Well, we could do that,'" the ambassador said. "Indeed, they did do it before we had ISDS."

But there too, Cheek and Legum told Law360, things are not that simple. Although there are situations where a U.S. investor would sign a contract with a foreign government, such as a concession agreement, there are many other situations where an investor would not have such a pact.

Moreover, such agreements would likely provide less protection to the investor. For example, a country may decide to change a law that applies to the investor. Assuming the contract signed by the investor and the country is governed by that country's law, the investor wouldn't be protected.

Only if the country and the investor agreed to include a stabilization clause — meaning that the applicable law will be the one in force at the time the contract is signed — would the investor be protected in that instance, and such clauses are rare, according to Legum.

Nevertheless, despite these potential issues, Lighthizer seems to have made up his mind on investor-state arbitration, at least when it comes to NAFTA. What remains unclear at this point is whether Republican threats to pull support from a renegotiated NAFTA without ISDS are mere political posturing,

or whether a renegotiated NAFTA without ISDS would really be doomed.

It's also unclear if Lighthizer might secure additional support from Democrats by proposing a renegotiated NAFTA without ISDS, since many Democrats have historically opposed ISDS.

"It's pretty clear he's got a view on this and he's got reasons for it, and he can articulate them," said Simon Lester, a trade policy analyst at the Cato Institute. "Is it really possible that the congressional Republicans would reject a NAFTA without ISDS? I don't know, but Lighthizer has made it clear he feels strongly about this."

--Editing by Pamela Wilkinson and Edrienne Su.