The ISDS provisions of the original North American Free Trade Agreement (NAFTA) – Chapter 11-B – are eliminated in NAFTA 2.0. Hundreds of millions of dollars in taxpayer funds have been awarded to corporations using NAFTA’s ISDS regime to attack domestic environmental and health policies.

ISDS between the United States and Canada is altogether terminated three years after NAFTA 2.0 goes into effect. Given high levels of U.S.-Canada cross investment, this change would prevent numerous future ISDS attacks. All but one of the past NAFTA ISDS payouts that related to environmental issues involved U.S. firms attacking Canadian toxics bans and timber, energy, mining and other policies. Termination U.S.-Canada ISDS eliminates 92 percent of U.S. ISDS liability under NAFTA and most U.S. ISDS exposure overall.

With respect to Mexico, ISDS is replaced by a new approach that reflects some longstanding progressive demands. The new approach, enumerated in Annex 14-D, “Mexico-United States Investment Disputes,” eliminates the extreme investor rights relied on for almost all ISDS payouts: Minimum Standard of Treatment (MST) and the related Fair and Equitable Treatment (FET) standard, Indirect Expropriation, Performance Requirements, Transfers and pre-establishment “rights to invest.” It also includes remedies to several major procedural problems with the old ISDS regime by banning inherently speculative damages and forbidding lawyers in the system from “judging” cases while suing governments on behalf of corporations. The new process requires investors to first use domestic courts or administrative bodies and exhaust the domestic remedies available to resolve their dispute with a government – or try to do so for 30 months. Only then may a review be filed and only for Direct Expropriation or post-establishment discrimination (National Treatment or Most Favored Nation).

This new approach is a significant scale back of investor power relative to governments in contrast to the approach pursued by the European Union and Canada, which only addresses procedural issues while preserving expansive investor rights. What is otherwise real improvement on reining in the threats posed by ISDS has one significant loophole that must be closed. A very problematic secondary U.S.-Mexico Annex (14-E) provides special rights for nine U.S. firms that obtained 13 contracts during the recent partial privatization of Mexico’s oil and gas sector by the outgoing government if their contracts are cancelled without cause. Access to the full, expansive, substantive ISDS rights is carved in for these firms as long as Mexico provides such rights in agreements with other countries. None of the nine firms has used ISDS to attack Mexico in the past, but two have done so against Canada. While this annex is narrow in application, any access, much less for oil companies, to the broad ISDS rights is clearly problematic.

What Is Real Progress Against ISDS:

- **NAFTA Chapter 11-B – the original NAFTA ISDS – is eliminated.** This more fulsome approach replaces an initial U.S. proposal to retain the ISDS provisions, but “opt out” of them with the prospect that a future administration could opt back in.

- **NAFTA ISDS rights between Canada and the United States are terminated** three years after NAFTA 2.0 goes into effect. U.S. and Canadian firms in investment disputes with the other government will only have recourse to domestic courts and administrative bodies to settle investment disputes with the other government.
- This change alone would eliminate almost 90 percent of total investment between the NAFTA nations from being exposed to ISDS attacks.

- This change will significantly limit future ISDS attacks given the large amount of U.S.-Canada cross investment. To date, Canadian investors instigated 19 of 21 NAFTA ISDS cases against the United States. There is $453 billion in Canadian investment here relative to $18 billion from Mexico. To date, U.S. investors instigated 39 of 40 NAFTA ISDS cases against Canada. There is $391 billion in U.S. investment in Canada relative to $2 billion from Mexico.

- To date, all but one of the NAFTA ISDS payouts implicating environmental and health issues have involved U.S. firms challenging Canadian policies.

- However, even as this change will prevent many ISDS attacks over the long term, the three-year period before ISDS is terminated poses serious risks of more corporate attacks on environmental and health policies before the old NAFTA ISDS rules are terminated.

- With respect to Mexico, NAFTA 2.0 provides a new approach that replaces ISDS and can be used only after exhaustion of domestic remedies for limited claims.

- A new “Mexico-United States Investment Disputes Annex” does not include any of the extreme investor rights that have been the basis of almost all NAFTA ISDS payouts to corporations. There is no Minimum Standard of Treatment, no Fair and Equitable Treatment and no Indirect Expropriation. And no pre-establishment claims are allowed, meaning the “right to invest” is eliminated. So, unlike NAFTA ISDS, if the United States or Mexico decides not to authorize a new mine, for instance, there is no basis for a claim.

  - The final text goes beyond the initial U.S. proposal to also eliminate investor rights related to Performance Requirements and Transfers of capital.

  - The annex is limited to claims, after domestic remedies have been exhausted, for Direct Expropriation, which is defined as when “an investment is nationalized or otherwise directly expropriated through formal transfer of title or outright seizure,” and post-establishment National Treatment and Most Favored Nation.

  - Interests defending ISDS claim it is necessary to provide compensation when governments nationalize or expropriate foreign investments. That concern is addressed in the Annex, yet the Business Roundtable, American Enterprise Institute and the Wall Street Journal editorial board have attacked the new approach as making NAFTA 2.0 “worse” than NAFTA. This spotlights the real purpose of the ISDS regime: granting a wide array of extraordinary rights and powers for investors and a way around having to comply with domestic laws or face domestic courts.

- The annex explicitly states that the expansive substantive rights found in other trade or investment pacts may not be brought back into NAFTA via Most Favored Nation claims. It specifies that the treatment referred to in its Most Favored Nation standard is limited to the actual policies and practices of a country with respect to other foreign investors and “excludes the provisions in other international trade or investment agreements.”

- The annex remedies these major procedural problems with the old ISDS regime:
- ISDS allows foreign investors to skirt domestic courts. The new process requires exhaustion of domestic remedies: An investor is required to initiate domestic remedies and see them through until a final decision or 30 months (2.5 years) pass with no decision. Only after satisfying that requirement may a review be initiated for the limited claims allowed.

- The people adjudicating claims in this system cannot be simultaneously representing corporations suing governments and must meet specifically enumerated ethical rules forbidding direct or indirect conflicts of interest.

- Damages that are “inherently speculative” are excluded. The annex specifies that investors may be compensated only for losses that they can prove on the “basis of satisfactory evidence” and that are “not inherently speculative” to counter awards of enormous sums that investors claim would be their expected future profits but for a challenged policy or act.

- The annex explicitly limits the authority and powers of any tribunal hearing cases to only ordering compensation for an investor and prohibits ordering countries “to take or not take other actions, including the amendment, repeal, adoption, or implementation of a law or regulation.” This would prevent decisions like that in the recent Chevron v. Ecuador ISDS case, in which an ISDS tribunal ordered Ecuador’s president to violate Ecuador’s constitutional separation of powers by halting implementation of a ruling by the country’s highest court and stopping enforcement of the court’s decision by the indigenous communities that won damages in a case related to Chevron’s Amazon pollution, including by “attachment, arrest, interim injunction, execution or howsoever.”

- The annex explicitly states that procedures, including ISDS itself, or elements of other pacts’ ISDS procedures, may not be brought back in via Most Favored Nation claims.

- Defenders of ISDS may find the new system provided in the main U.S.-Mexico Investment Annex to be a worse outcome than simply eliminating NAFTA’s Chapter 11-B ISDS system. That is because the annex provides a new, fair means of redress that prioritizes domestic remedy for a legitimate prospective problem – uncompensated direct expropriation of an investment – that ISDS defenders use as the excuse to claim the entire ISDS regime is needed. And, by creating a new review process to replace the old NAFTA ISDS procedures, the annex makes clear that this change is not temporary.

- The new annex would only go into effective three years after NAFTA 2.0 is enacted, posing serious risks of additional ISDS attacks in the interim.

**What Can Never Be Replicated in Any Future Agreement:**

- NAFTA 2.0 includes a secondary U.S.-Mexico Investment Annex (14-E) that is NOT a model for future U.S. agreements and that, while narrow in its practical application, is highly problematic. This annex would allow the nine U.S. investors that have obtained 13 contracts with the Mexican federal government for oil and gas concessions during the recent partial privatization of the sector by the outgoing government to bring disputes using the full set of investor protections found in past agreements if Mexico provides these rights under other agreements, which it currently does.

- The way the annex is written, it appears to expose the United States to challenge and also provide rights to investors engaged in other sectors. To qualify for this carve-in, an investor must have a “covered government contract” with the federal government in a specific listed sector. But the annex narrowly defines what is a covered contract by making explicit that “a unilateral act of an administrative or judicial authority, such as a permit, license, authorization, certificate, approval,
or similar instrument issued by a Party in its regulatory capacity, or a subsidy or grant, or a decree, order or judgment, standing alone and an administrative or judicial consent decree or order” is not included. While providing the broader rights to the covered oil firms is in itself problematic, the carve-in is available only to investors with concession contracts with a federal government and their corporate subsidiaries in the country operating in the same sector.

- The listing of the oil and gas sector does not expose the United States to challenge under the expanded rights because the U.S. federal government does not issue contracts for oil and gas concessions, and U.S. federal permits for oil exploration are excluded from the narrow definition of “covered government contract.” But the Mexican Hydrocarbon’s Authority, the agency with which the U.S. firms have their contracts, is covered.

- In addition to oil and gas, listed sectors include “the supply of telecommunications services to the public on behalf of an Annex Party,” “the supply of transportation services to the public on behalf of an Annex Party,” “the ownership or management of infrastructure, such as roads, railways, bridges, canals, or dams, that are not for the exclusive or predominant use and benefit of the government...” In practice, the inclusion of these other sectors is largely irrelevant given that neither the U.S. nor Mexican federal government uses concession contracts for them.

  - Both governments use licenses and authorizations in the telecommunications sector, which are not covered. More research is required on Mexican practice in the transportation sector. The U.S. federal government does not issue contracts to provide such services to the public.

  - Some sub-federal governments use contracts for electricity generation for sale to the public and in their arrangements with firms managing roads, bridges, railroads, dams or canals. But the carve-in only applies to investors with contracts with federal governments.

  - However, the opened-ended nature of the exemplary list in the clause relating to infrastructure provides problematic flexibility for investors to argue that more investments qualify for the carve-in. Providing any discretion for current or future contracts in other infrastructure sectors to be dragged in under this carve-in creates unnecessary risks of exposure to claims.

- Procedural reforms in the main Mexico-United States Investment Disputes Annex with respect to tribunalists’ double-hatting and conflicts of interest, limits on inherently speculative damages and limitations on the authority of the tribunal apply to claims under the secondary annex.

- While no past NAFTA ISDS cases would have qualified for the carve-in, nor have the nine oil and gas firms used NAFTA ISDS against Mexico to date, three of them have used ISDS previously, and two have done so against Canada using NAFTA.

- This secondary annex should be eliminated or at least altered to ensure that only uncompensated cancellations of Mexican oil and gas contracts, not environmental and health policies, are subject to review.

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