AS NAFTA LEGACY CLAIMS WINDOW CLOSES, CANADIAN BUSINESSES WITH INVESTMENTS IN MEXICO MAINTAIN IMPORTANT PROTECTIONS UNDER CPTPP

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Introduction

As of June 30, 2023, eligible foreign investors will no longer be able to challenge measures by the governments of Canada, the United States or Mexico under the legacy investment protections and investor-state dispute settlement ("**ISDS**") provisions of the North American Free Trade Agreement ("**NAFTA**"). For Canadian businesses with investments in the United States, this means they will no longer have access to ISDS against the US and will have to resort to the protections of US law, or rely on the Canadian government to seek remedies on their behalf against the US government under the Canada-United States-Mexico Agreement ("**CUSMA**").

Canadian investors in Mexico, however, will continue to have access to investment protections and ISDS against the government of Mexico under the Comprehensive and Progressive Agreement for Trans-Pacific Partnership ("**CPTPP**"). As Mexico continues to implement legislative changes to its energy and mining sectors in ways that may adversely affect the interests of Canadian investors, the protections of the CPTPP may be critical to obtain a direct remedy against the Mexican government. Consultations concerning energy sector measures have already begun, albeit under the state-to-state dispute settlement provisions of CUSMA.

Below we explain the upcoming changes to investment protections under the North American framework before discussing the CPTPP and claims that may arise from regulatory reforms in Mexico.

Time is Running Out to file NAFTA Legacy Claims

ISDS under NAFTA was a controversial yet frequently used mechanism for American investors seeking remedies against allegedly unfair actions by the governments of Canada and Mexico damaging their investments in those jurisdictions. It was also used on occasion, and with less success, by Canadian investors with investment disputes against the governments of either the US or Mexico.

CUSMA, which replaced NAFTA on July 1, 2020, reformed and narrowed investment protections and the ISDS

mechanism. Notably, Canada is not a party to CUSMA's ISDS provisions, which are only in force between the US and Mexico.

Despite NAFTA's demise, eligible North American investors – including Canadian ones – who made investments in another NAFTA jurisdiction while NAFTA was in force may bring NAFTA-based investment claims (so-called "legacy claims") until June 30, 2023. Those investors should serve notice of their intent to do so on the responding NAFTA party at least 90 days before submitting the claim, i.e., by April 1, 2023.[1] The approaching deadline is critical for all eligible North American investors wishing to benefit from the broader protections of NAFTA. But it is of particular importance for Canadian investors with US investments, and American investors in Canada, as ISDS between Canada and the US will expire completely thereafter. Those investors will need to have their American or Canadian subsidiaries, as the case may be, rely on local court systems to challenge government measures thereafter. Their only other alternative would be to petition their home government to bring a CUSMA state-to-state claim against the host government.

The CPTPP Remains Available to Canadian Investors for Claims against Mexico

For Canadian investors with potential claims against Mexico, however, access to ISDS remains available under the CPTPP.[2] The CPTPP contains investment protections that are substantively similar to those contained in NAFTA, including the typical core obligations found in investment agreements such non-discrimination (national and most-favoured nation treatment), fair and equitable treatment, and protections against expropriation.

However, the CPTPP also contains certain more modern elements that tend to narrow protections for investors in comparison to NAFTA. This includes an acknowledgement that governments have a right to regulate investments in a manner sensitive to environmental, health or other regulatory objectives,[3] as well as an updated set of party-specific exceptions termed "non-conforming measures".[4] For example, Mexico identified and negotiated several non-conforming measures in its energy sector,[5] including the right in certain circumstances to impose restrictions on investments related to the transmission and distribution of electricity.[6] While Mexico also reserves the right to be the exclusive supplier of electricity under NAFTA, this reservation is subject to the "ratchet rule" whereby future liberalizations cannot be reversed.

Mexican Regulatory Changes May Lead To Investment Claims

The scope and availability of investment protections under the CPTPP could grow in importance for Canadian investors given the imminent loss of ISDS under NAFTA and recent legislative changes in Mexico's energy and mining sectors.

Reforms to Mexico's energy sector have generally aimed to reverse liberalizations that occurred in 2013, when

Mexico permitted foreign investment and subjected its national power company, the Federal Electricity Commission ("**CFE**"), to market competition. These reforms include March 2021 amendments to Mexico's Electricity Industry Law that grant priority to the CFE over private investors in the transmission of energy to Mexico's electricity grid. For example, the amendments would require Mexico's energy operator to prioritize the dispatch of power generated by plants owned by the CFE over private power companies, regardless of cost-efficiency and sustainability implications, which were guiding criteria for dispatch priority under the previous laws. The amendments also affect clean energy certificates,[7] power generation permits,[8] and self-supply and independent power arrangements[9] in ways that could adversely affect foreign investors.

These amendments have already led to consultations between the three CUSMA parties and could develop into a state-led challenge under CUSMA's Chapter 31.[10] Notably, in their requests for consultations, Canada and the US cite, among other provisions, a potential breach of CUSMA's national treatment (i.e., non-discrimination) obligation.[11]

In addition to these energy sector reforms, on April 20, 2022, Mexico introduced amendments to its Mining Law that nationalize its lithium mining industry. The amendments declare the exploration and exploitation of lithium to be of "public utility", and give exclusive responsibility for exploration and exploitation to the state through a new decentralized public body. The amendments indicate that no concessions, licenses, contracts, permits or authorizations will be granted. However, it remains unclear what will become of existing concessions, licenses and authorizations held by investors related to Mexico's lithium deposits, for example in the Sonora region.

Canadian investors may have investment claims under NAFTA's legacy provisions or the CPTPP concerning these measures, though no claims have yet come to light. For example, similar to the allegations in the CUSMA state-to-state consultation requests, a claim may arise under the non-discrimination obligation to the extent an investor can show it was treated less favourably than a similarly situated Mexican entity. A caveat is that Canadian investors claiming discriminatory treatment under the CPTPP will need to consider the impact of Mexico's negotiated non-conforming measures, such as Mexico's energy reservations outlined above. Nevertheless, remedies could also be available through other protections such as the obligation to afford fair and equitable treatment or the requirement to provide compensation for expropriation, under either NAFTA or CPTPP, depending on the circumstances.

Key Takeaways for Canadian Businesses

Time is running out for investors to launch NAFTA legacy claims. This is particularly important for Canadian investors with US investments, or American ones with Canadian investments, as they will lose the ability to seek ISDS remedies on June 30, 2023. However, Canadian claimants will continue to have access to ISDS

against Mexico under the CPTPP, which offers substantially similar protections to those contained in NAFTA, albeit with important limitations. These investment protections and the CPTPP's ISDS mechanism could grow in relevance as Mexico moves forward with energy and mining sector reforms. More broadly, they remain a potentially viable path for Canadian investors seeking to obtain a remedy for substandard or discriminatory treatment, or the expropriation of their assets, whether in Mexico or another CPTPP counterparty.

[1] A six-month notice is required for expropriation claims related to taxation measures. This notice period has already expired. See NAFTA Article 2103.6.
[2] The CPTPP is currently in force between Canada, Australia, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, and Vietnam. See here. Once fully implemented, the CPTPP will also include Brunei and possibly the United Kingdom, which formally applied to join the CPTPP on 1 February 2021 and began accession negotiations in June 2021. See here.
[3] This is broader than NAFTA's Article 1114, which only applies to "environmental concerns".
[4] While non-conforming measures existed under NAFTA, Party-specific non-conforming measures have evolved under CPTPP and must be taken into consideration by investors who may wish to bring a claim.
[5] Non-conforming measures are contained in a Party's Annex I and Annex II. Annex I is for existing non-conforming measures and is subject to the limitation that any amendment must not decrease conformity with non-discrimination obligations (the "ratchet rule"). Annex II is generally for future non-conforming measures and is not subject to the ratchet rule. Mexico's Annex I and Annex II can be found here and here.
[6] Interestingly, while Mexico has placed this non-conforming measure in its Annex II, it indicates that it shall be deemed an Annex I non-conforming measure.
[7] Mexico's Ministry of Energy requires a certain percentage of electricity to be supplied by clean power sources certified by Clean Energy Certificates. Prior to the amendments, these certificates were only given to new (i.e., post-2014) clean power plants. Most CFE-owned plants pre-date 2014 and had to purchase certificates from eligible providers, creating a market in the certificates. The amendments make all plants eligible, likely leading to an oversupply and decrease in value of privately held certificates.
[8] Prior to the amendments, all participants meeting certain specified requirements were entitled to obtain a power generation permit. The amendments make granting such permits subject to the planning criteria of the National Electric System, which arguably lack transparency and could reduce access for private enterprises.
[9] Prior to the amendments, existing self-supply, cogeneration and independent power producer permits could be governed by the pre-2014 laws under a "grandfathering" framework. The amendments require Mexico's Energy Regulatory Commission to review these permits and revoke those that were granted in "fraud of the law".
[10] For more on dispute settlement under CUSMA, see McMillan's CUSMA Dispute Settlement Scoreboard here.

[11] CUSMA Article 2.3.

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A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.