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The New Face of Investment Arbitration: NAFTA Chapter 11

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Introduction

Like many other industrialized nations, the United States has traditionally favored arbitration for resolution of investment disputes with foreign host states, particularly with respect to expropriation claims. The past decade, however, has seen a noticeable sea change in outlook. Congress has enacted trade legislation giving evidence of an intention to restrict arbitration in investment treaties. And open criticism of investment arbitration has been voiced by significant elements of the media, as well as advocacy groups that focus on environmental and regulatory issues.

The cause of this attitude shift is not difficult to find. In 1994 the North American Free Trade Agreement (NAFTA) entered into force,[1] bringing with it an adjudicatory regime that gives investors the right to require arbitration of disputes arising out of investments in another member country, in connection with matters such as expropriation, discrimination and unfair treatment. The United States and Canada each became respondents pursuant to claims brought by investors from the other country.[2]

The result was an awareness of the down-side of arbitration, including the prospect that key economic and political matters would be decided in confidential

[1] North American Free Trade Agreement, 32 I.L.M. 289, 1993 WL 574441. NAFTA was enacted in the U.S. on 8 December 1993, 107 Stat. 2057.

[2] Thus far Mexico seems to have been principally on the receiving end of investment claims. The one well-known arbitration that Mexico did initiate against the United States (In the Matter of Cross-Border Trucking Services) was brought under the provisions of NAFTA Chapter 20, relating to state-to-state arbitration, rather than the Chapter 11 mechanism (discussed infra) for claims brought by private investors. See Final Report, NAFTA Panel Established Pursuant to Chapter Twenty in the Matter of Cross-Border Trucking Services (Secretariat File No. USA-MEX-98-2008-01), 6 February 2001.

proceedings by a tribunal consisting in majority of foreigners. In the United States, however, the new face of investment arbitration caused a shiver of apprehension. Media attacks and legislative initiatives were launched with the aim of hobbling the neutral adjudicatory process which for years had served to underpin investor confidence in the protection of investments abroad.

This Article suggests that arbitration under investment treaties such as NAFTA will enhance the type of asset protection that facilitates wealth-creating cross-border capital flows, bringing net gains for both host state and foreign investor. While there may be benefits from minor tinkering with this investment protection regime, general attacks on investment arbitration are likely to backfire, creating for all countries involved more problems than they solve.

I. The Contours of Investment Arbitration

A. Historical Context

NAFTA brings investment arbitration full circle, to a time more than two centuries ago when the United States was principally a debtor nation. In 1794 the so-called "Jay Treaty" (named for its American negotiator John Jay, later Chief Justice of the U.S. Supreme Court) gave British creditors the right to arbitrate claims of alleged despoliation by American citizens and residents.[3]

[3] Treaty of Amity, Commerce and Navigation, London, 19 November 1794, U.S.-U.K., 8 Stat. 116. The treaty addressed difficulties arising from the 1783 Treaty of Paris ending the American Revolution. Under Article 6, damages for British creditors were to be determined by five Commissioners. Two were appointed by the British and two by the United States, with the fifth chosen unanimously by the others, in default of which selection would be by lot from between two candidates, one proposed by each side. For an intriguing comparison of modern investment arbitration and the Jay Treaty, see Barton Legum, *Federalism, NAFTA Chapter Eleven and the Jay Treaty of 1794*, 18 ICSID News (Spring 2001) (Remarks presented at panel discussion on "Investment Disputes and

More recently, however, it was African and Latin American nations that were required by multinational corporations to submit investment disputes to arbitration, either through arbitration clauses contained in custom-tailored concession agreements or through bilateral and multilateral investment treaties.[4] Such arbitration has often implicated natural resources and elements of industrial infrastructure no less critical to the economic sovereignty and well-being of those countries than the NAFTA cases that have caused controversy in the United States and Canada.

During the late 19th and early 20th century, developing countries often perceived investment arbitration as little more than an extension of gunboat diplomacy. Investor nations were seen to control the arbitral process in a way that permitted it to be used simply as a tool for extracting concessions from the host country. In state-to-state proceedings, private investors participated only vicariously through their governments. Latin American states were often forced to submit disputes to European sovereigns such as Britain's Queen Victoria, Russia's Tsar Alexander II, Germany's Kaiser Wilhelm II

NAFTA Chapter 11" at 95th Annual Meeting of the American Society of International Law, Washington, D.C., 4-7 April 2001. . The best known of these arbitrations was the Alabama Claims case. In 1872 an arbitral tribunal composed of five arbitrators (American, British, Italian, Swiss and Brazilian) awarded more than $ 15 million dollars to the United States for damages caused by Britain's violation of the laws of war in allowing its nationals to build warships in British ports for the Southern Confederacy during the American Civil War. *Alabama Claims Case, Decision and Award* (14 Sept. 1872), reprinted in THOMAS WILLING BALCH, THE ALABAMA ARBITRATION 131 app. (1900) See generally, J. L. BRIERLY, THE LAW OF NATIONS 285-288 (1963)

[4] Treaty-based arbitration might take place under the auspices of the World Bank's International Centre for the Settlement of Investment Disputes (discussed *infra*) or one of the many Bilateral Investment Treaties. *See generally* RUDOLF DOLZER & MARGRETE STEVENS, BILATERAL INVESTMENT TREATIES (1995); Eloïse Obadia, *ICSID, Investment Treaties and Arbitration: Current and Emerging Issues*, 18 NEWS FROM ICSID 14 (Autumn 2001); Matthew Cobb, *Development of Arbitration in Foreign Investment*, 16 INT'L ARB. REP. 48 (April 2001); Kazutake Okuma, *Investment Disputes Settlement*, 34 SEINAN LAW REVIEW 75 (2002).

and King Léopold I of Belgium, whose predispositions and sympathies did not always inspire confidence among developing countries.[5]

Not surprisingly, host states reacted to what they perceived as foreign control of their economies. Invoking principles articulated by the 19th century Argentine jurist Carlos Calvo, Latin American countries came to require similar treatment for foreign and domestic investors.[6] This effectively eliminated as options both diplomatic protection[7] and arbitration. In 1974 the Calvo doctrine was pushed further in the so-called "New International Economic Order" adopted by the United Nations General Assembly in an attempt (unsuccessful as history has shown[8]) to require host state courts rather than international arbitrators to determine the measure of compensation for expropriated property.[9]

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[5] *See* survey in Lionel M. Summers, *Arbitration and Latin America*, 3 CAL. W. L. J. 1 (2001), at 6-7.

[6] Calvo first announced his doctrine in 1868, in LE DROIT INTERNATIONAL THÉORIQUE ET PRATIQUE. The principle that foreign nations should not intervene in South America to protect private property and debts included several elements: investor submission to local jurisdiction and local law, waiver of home state protection and surrender of rights under customary public international law. S*ee generally*, Kurt Lipstein, *The Place of the Calvo Clause in International Law*, 1945 BRITISH YEAR BOOK OF INTERNATIONAL LAW 130 (concluding at 145 that "before international tribunals the Calvo Clause is ineffective").

[7] See discussion *supra* at --.

[8] Thomas Waelde, *Requiem for New International Order*, in LIBER AMICORUM FOR I. SEIDL-HOHENVELDERN 771 (G. Hafner et al. eds. 1998).

[9] Charter of Rights and Duties of States, Article 2(2)(c), provides that compensation should be "appropriate" as determined under "the domestic law of the nationalizing State and by its tribunals." *See* William W. Park, *Legal Issues in the Third World's Economic Development*, 61 B. U. L. REV. 1321 (1981). This principle was rejected in *Texaco Overseas Petroleum Co. (TOPCO)/California Asiatic Oil Co. (CALASIATIC) v. Libya*, 17 I.L.M. 1 (1978). *See also Libyan American Oil Co (LIAMCO) v. Libya*, 482 F. Supp. 1175 (D.D.C. 1980*), vac'd without op.*, 684 F.2d 1032 (D.C. Cir. 1981).

Ultimately an increasing number of capital importing countries came to realize that their self-interest was served by agreeing to arbitrate investment disputes. Equally as significant, arbitration became a fairer process. Representatives from developing countries began to participate more actively in international arbitral institutions such as the ICC, ICSID and the LCIA, as well as in the formulation of new procedural rules such as those of the United Nations Commission on International Trade Law (UNCITRAL).[10]

Developing countries also came to realize that the greater the risk, the higher the cost of investment. Untrustworthy enforcement mechanisms tend to chill cross-border economic cooperation to the detriment of those countries that depend most on foreign capital for development. To the extent that arbitration promotes respect for implicit bargains between investor and host country, it came to commend itself to developing countries as a matter of sound international economic policy.

B. Double Standards

To some observers a double standard toward investment arbitration seems to be creeping into American attitudes toward investment arbitration.[11] Arbitration is good

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[10] See Chapter 36, W. LAURENCE CRAIG, WILLIAM W. PARK & JAN PAULSSON, INTERNATIONAL CHAMBER OF COMMERCE ARBITRATION 661-678) (3d Ed., 2000). On the working of UNCITRAL, see HOWARD HOLTZMANN & JOSEPH E. NEUHAUS, A GUIDE TO THE UNCITRAL MODEL LAW ON INTERNATIONAL COMMERCIAL ARBITRATION 4-6 (1989).

[11] Some may be reminded of the Jules Romains character who liked honesty "but only in others." The French novelist described a foreign emissary who helped himself to a share of the bribes his government paid newspapers, but was shocked that intermediaries had skimmed from these payments. Romains writes, "M. Choubersky, lequel sans doute se charge de prélever sur ces millions une gorgée abondante, semble trouver mauvais que les intermédiaires aient une soif parente de la sienne. C'est un homme qui aime l'honnêteté d'autrui." ("Mr. Choubersky, who doubtlessly undertook to deduct from these millions a large mouthful for himself, seemed to take it ill that the intermediaries had a thirst equal to his own. He is a man who likes honesty in others. ") JULES

when it corrects misbehavior by foreign host states, but not so desirable when claims are filed for alleged wrongdoing by the United States. Many business and political leaders still support arbitration as the preferred method to resolve disputes between host countries and foreign investors. However, recent trade legislation has significantly impaired the vigor of future treaty-based arbitration of investment disputes, with the United States pursuing a course and a tone quite different from when negotiating NAFTA.[12] Moreover, vocal opposition to investment arbitration has been expressed by important segments of the media and several non-governmental organizations.

Traditionally, American multinationals imposed arbitration as the mechanism for settling investment disputes with foreign countries, particularly in Latin America. Arbitration was justified as a way to level the playing field and to reduce the prospect of host state "home town justice," thereby safeguarding assets from expropriation without compensation. Foreign investment was seen as a net good for both investor and host state, helping to reduce poverty through international economic cooperation. And arbitration was perceived as one way to promote respect for the rule of law underpinning investment stability.

The argument ran as follows. No supranational courts possess mandatory jurisdiction to decide the appropriate indemnity for nationalized assets.[13] Absent

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ROMAINS, LES HOMMES DE BONNE VOLONTE (1958), Part 9 (*Montée des Périls*) Section XXX (*Réponse de Marc Strigelius*) (Robert Laffont Edition, 1988, Volume II, at 335).

[12] See discussion *infra* of Trade Act of 2002. See also Edward Allen, "Washington Alters Line on US Investor Protection," Financial Times, 2 October 2002, at 13, describing how the United States in its bilateral trade negotiations with Chile and Singapore has attempted to limit the legal recourse available to investors who believe their property has been expropriated without compensation by foreign host states.

[13] The experience of the International Court of Justice ("ICJ") is limited both by tradition and by jurisdictional constraints. For one commercial case that did reach the ICJ, see

assertions of diplomatic protection,[14] litigation in the expropriating country remains the default mechanism for adjudicating investment disputes.[15] Consequently, the real or imagined bias of host country judges can create an anxiety that inhibits wealth-creating transactions and discourages cross-border economic cooperation,[16] and will inevitably either thwart cross-border economic cooperation or add to its cost.[17]

Arbitration responds to this apprehension by providing a forum that is more neutral than host country courts, both politically and procedurally. The relative impartiality of international tribunals bolsters investor confidence and inspires greater certainty that the contract will be interpreted in line with the parties' shared *ex ante* expectations.

Elettronica Sicula SPA (ELSI) (United States v. Italy), 1989 I.C.J. 15 (1989) (finding no illegal taking of property when Italy requisitioned plant and equipment owned by US nationals in order to prevent planned liquidation).

[14] Diplomatic protection involves state-to-state claims in which a foreign investor invokes his country's intervention against the host state. Traditional perspectives on diplomatic protection are discussed in J. L. BRIERLY, THE LAW OF NATIONS 285-288 (1963); IAN BROWNLIE, PRINCIPLES OF PUBLIC INTERNATIONAL LAW 465-95 (2d ed. 1972).

[15] In most cases one would expect investors to prefer arbitration to the more cumbersome process of having their country assert diplomatic protection. Exceptions might arise when the legal basis of the claim was weak and the investor state had a degree of clout with the host country.

[16] The perception of litigation bias may be as significant as its reality. A study of US federal civil actions between 1986 and 1994 found that foreigners actually fared better than domestic parties. *See* Kevin Clermont and Theodore Eisenberg, *Xenophilia in American Courts*, 109 HARV. L. REV. 1122, 1133–34 (1996). One explanation for this finding lies in a fear of judicial and jury partiality that leads foreign litigants to settle rather than continue to final judgment unless their cases are particularly strong.

[17] To illustrate, imagine an attractive investment abroad in Country X where there is doubt that local courts will be fair to a foreign party, and another efficient opportunity in the investor's home country. Depending on the size of the disparity between the expected returns, many risk-averse merchants will choose the lower return coupled with the fairer legal system. *See generally* William W. Park, *Neutrality, Predictability and Economic Cooperation*, 12 (No. 4) J. INT'L ARB. 99 (1995).

When NAFTA came into force, however, the rifle sights were turned in the opposite direction, and the United States and Canada became respondents in cases brought by investors based in other NAFTA countries.[18] After claims for unfair treatment were filed *against* the United States government, arbitration looked different than when American companies were the investors.[19] This was a new experience, since NAFTA represented the first time two of the so-called "G-7" industrialized countries[20] entered into mandatory arbitration arrangements with each other.[21]

Interestingly, role reversal for the United States and Canada occurred not because investors from Mexico (a traditional host state) began bringing claims against its northern neighbors. Rather, it was Canada and the United States that began attacking each other, with claims by Canadian investors against the American government, and claims by American investors against Canada.[22]

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[18] NAFTA Chapter 11 protects "investors of another Party" (Article 1101), defined in Article 1139 to include "a national or an enterprise of such Party." See also general definitions of Article 201, including as an "enterprise of a Party" an enterprise "constituted or organized under the law of a Party."

[19] *See* Charles Brower & Lee Steven, *Who Then Should Judge?: Developing the International Rule of Law under NAFTA Chapter 11*, 2 CHI. J. INT'L. L. 93 (2001); Charles H. Brower, II, *Investor-State Disputes Under NAFTA: A Tale of Fear and Equilibrium*, 29 PEPPERDINE L. REV. 43 (2001); Charles H. Brower, II, *Structure, Legitimacy and NAFTA's Investment Chapter*, 36 VANDERBILT J. TRANSN'L L. 37 (2003).

[20] Beginning in 1986, the finance ministers and central bank governors of seven major industrialized countries (Canada, France, Germany, Italy Japan, the United States and the United Kingdom) began meeting in order to improve communication and cooperation on matters related to economic and financial growth, inflation and currency developments. In 1997 the summit became known as the G-8 to reflect Russia's participation, particularly in discussions on ways to combat the financing of terrorism.

[21] Prior to NAFTA, investment arbitration implicated claims by nationals of industrialized countries against developing nations pursuant to bilateral investment treaties. Although the treaty obligations flowed both ways, the investment did not.

[22] See discussion *infra*.

As Americans and Canadians began to understand the host state perspective, praise for arbitration's neutrality began to have competition in the form of complaints about infringement of national sovereignty and democracy. The level playing field no longer appeared as an unalloyed benefit. Environmental and consumer groups, as well as the media and Congress, began taking the position that NAFTA undermined legitimate governmental regulations, challenged legislative prerogatives and opened decision-making to ill-informed foreign tribunals.[23]

The NAFTA process was attacked for the confidentiality of its proceedings ("lack of transparency"), uncertainty and absence of accountability to domestic constituents. A dispute resolution process that had been fair for the rest of the world came to be seen as a tool to put business before public interest.

In the present climate of public opinion, many Americans and Canadians fail to understand why arbitration should be available for foreign investors. Taking for granted the fairness of their own judicial systems, Americans in particular are often surprised that not everyone feels comfortable with civil juries and the prospect of large punitive damages.[24]

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[23] See discussion *infra*.

[24] For evidence of foreign fear of litigation bias in American courts, see discussion *infra* of the *Loewen* case and findings reported in Kevin Clermont & Theodore Eisenberg, discussed *supra*. American commentators have also expressed doubts and concerns about civil juries and punitive damages. See, e.g., Robert A. Klinck, *The Punitive Damage Debate*, 38 HARV. J. LEGIS. 469 (2001); Theodore Eisenberg, Neil LaFountain, Brian Ostrom, David Rottman & Martin T. Wells, *Juries, Judges and Punitive Damages: An Empirical Study*, 87 CORNELL L. REV. 743 (2003); David A. Schkade, *Erratic by Design: A Task Analysis of Punitive Damages Assessment*, 39 HARV. J. LEGIS. 121 (2002); Stephen J. Ware, *Consumer and Employment Arbitration Law in Comparative Perspective: The Importance of the Civil Jury*, 56 U. MIAMI L. REV. 865 (2002); Richard W. Murphy, *Punitive Damages, Explanatory Verdicts and the Hard Look*, 76 WASH. L. REV. 995 (2001); Lisa Litwiller, *Has the Supreme Court Sounded the Death Knell for*

Regardless of whether such self-perceptions are valid, the fact remains that when NAFTA was being negotiated, it was the United States that insisted on arbitration as a protection for foreign investment. The business community's longstanding hesitation toward foreign litigation made it vital to bolster confidence that investors would receive a "fair shake" in the event of controversy with the host government.

NAFTA also stipulated substantive standards of investor protection that would require interpretation. Reciprocal lack of trust among the three countries made it unlikely that host state courts would be acceptable to construe and apply these standards.

Understandably, this investor protection scheme was based upon equality of treatment among the three countries. For Mexico to accept arbitration of investment disputes within its borders, Canada and the United States had to respect a similar dispute resolution process. It would have been unwise and unworkable for Chapter 11 to be applied by American and Canadian courts when claims were brought against the United States and Canada, but to have arbitrators appointed for claims against Mexico.

Jury Assessed Punitive Damages? A Critical Re-Examination of the American Jury, 36 U.S.F.L. REV. 411 (2002); W. Kip Viscusi, *Punitive Damages: How Jurors Fail to Promote Efficiency*, 39 HARV. J. LEGIS. 139 (2002); John J. Kircher, *Punitive Damages and Business Organizations: A Pathetic Fallacy*, 67 Tenn. Rev. 971 (2000); Perry E. Casazza, *Nevada's Mastrobuono: How the 2001 Legislature Threw Another Wrench into the Punitive Damages Machines of Arbitration Law*, 51 DRAKE L. REV. 189 (2002); Michelle L. Hartmann, *Is It a Short Trip Back to Manor Farm? A Study of Judicial Attitudes and Behaviors Concerning the Civil Jury System*, 54 S.M.U.L. REV. 1827 (2001); Valerie P. Hans, *U.S. Jury Reform: The Active Jury and the Adversarial Ideal*, 21 ST. LOUIS U. PUB. L. REV. 85 (2002); Valerie P. Hans, *The Illusions and Realities of Jurors' Treatment of Corporate Defendants*, 48 DEPAUL L. REV. 327 (1998).

II. NAFTA Chapter 11

A. Safeguarding Cross-Border Investment[25]

NAFTA Chapter 11 gives business managers from a member country the opportunity to arbitrate investment grievances with the government of another NAFTA country, regardless of whether an agreement to arbitrate actually exists in a negotiated investment concession.[26] This private right to direct action eliminates recourse to traditional state-to-state negotiations, in which a foreign investor asks for his country's intervention against the host state.

The first part of Chapter 11 (Section A) imposes the substantive norms for cross-border investment, forbidding discrimination against investors from another member country,[27] and requiring "fair and equitable" treatment as well as compensation for

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[25] *See generally* Henri C. Alvarez, *Arbitration Under the North American Free Trade Agreement*, 16 ARB. INT'L 393 (2000); Axelle Lemaire, *Le Nouveau visage de l'arbitrage entre état et investisseur étranger: le chapitre 11 de l'ALENA*, 2001 REV. ARB. 43; Todd Weiler, *Substantive Law Developments in NAFTA Arbitration*, 16 INT'L ARB. REP. 69 (December 2001); Leon Trakman, *Arbitrating Investment Disputes Under NAFTA*, 18(4) J. INT'L ARB. 385 (2001); William S. Dodge, *National Courts and International Arbitration: Exhaustion of Remedies and Res Judicata Under Chapter Eleven of NAFTA*, 23 HASTINGS INT'L & COMP. L. REV. 357 (2000); Patrick Dumberry, *The NAFTA Investment Dispute Settlement Mechanism: A Review of the Latest Case Law*, 2 J. WORLD INVESTMENT 151 (2001); Todd Weiler, *NAFTA Investment Arbitration and the Growth of International Economic Law*, 36 CANADIAN BUS. L. J. 405 (2002); Chris Tollefson, *Games Without Frontiers: Investor Claims and Citizen Submissions Under the NAFTA Regime*, 27 YALE J. INT'L L. 141 (2002).

[26] See generally Todd Weiler, *The Ethyl Arbitration: First of Its Kind and a Harbinger of Things to Come*, 11 AM. REV. INT'L ARB. 187 (2000).

[27] Each member country must treat NAFTA investors and their investments no less favorably that its own investors (Article 1102, concerning National Treatment) and investors of other countries (Article 1103, concerning Most-Favored-Nation Treatment). In *S.D. Myers, Inc. v. Government of Canada* a Partial Award of 13 November 2000 articulated the national treatment standard to require consideration as to whether the NAFTA investor is in the same "economic and business sector" as the national investor. A measure breaches the national treatment standard if (i) it creates a disproportionate benefit for nationals over non-nationals, (ii) the measure, on its face, appears to favor

nationalized property.[28] An entity incorporated and with substantial business activities[29] in a NAFTA country qualifies as an investor without regard to any "origin of capital" limitations.[30] Thus a Mexican corporation owned by French shareholders qualifies as an investor under NAFTA Chapter 11.

The compensation criteria adopted by NAFTA Chapter 11 were intended to be compatible with standards traditionally advocated by the United States.[31] Expropriation

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nationals over non-nationals and (iii) there must be a practical impact required, not merely motive or intent. Political subdivisions must provide foreign investors no less favorable treatment than the best treatment accorded to investors of the country to which the subdivision belongs. For example, Massachusetts must treat investors from Québec no less favorably than it treats investors from New York or Pennsylvania.

[28] Article 1102 prohibits discrimination by requiring "national treatment," while Article 1105 requires respect for international law, including "fair and equitable treatment" as a minimum standard. Proper compensation for nationalized property is mandated by Article 1110.

[29] See article 1113(2).

[30] See definitions in Articles 201 and 1139. Moreover, standing to bring a claim may be based on citizenship regardless of residence. See interim award in Feldman (a.k.a. Karpa) v. United Mexican States, 40 I.L.M. 615 (2001), which determined *inter alia* that permanent residence in Mexico did not deprive a US citizen of the right to arbitrate claims concerning tobacco export tax rebates.

[31] While the terms "prompt, adequate and effective" do not appear in the text of Chapter 11, some observers consider the combination of Article 1110 factors ("paid without delay," "fair market value" and "fully realizable") to amount to the same result. See Restatement (Third) Foreign Relations Law § 712, comments c and d, and Reporter's note 2 (1987) stating that for compensation to be "just" it must be "paid at the time of taking," "in an amount equivalent to the value of the property taken" and "in a form economically usable by the foreign national." The expression "prompt, adequate and effective" originates in a communication to Mexico from US Secretary of State Cordell Hull on 22 August 1938. *See* Banco Nacional de Cuba v. Chase Manhattan Bank, 658 F.2d 875, 888 (2d Cir. 1981). Compare the standard under Restatement § 712 with the United Nations' Charter of Rights and Duties of States Art 2(2)(c), providing that compensation should be "appropriate" as determined under "the domestic law of the nationalizing State and by its tribunals." *See* William W. Park, *Legal Issues in the Third World's Economic Development*, 61 B.U. L. REV. 1321 (1981).

must be justified by a public purpose and applied on a non-discriminatory basis.[32] Compensation must be "equivalent to the fair market value" of the investment at the date of expropriation, must be "paid without delay and be fully realizable," and must bear interest at a commercially reasonable rate until the date of actual payment. If paid other than in a hard currency,[33] compensation must be in an amount which, at market rates of exchange, would convert into a sum no less than the hard currency equivalent of market value on the payment date. Compensation will not be affected because market awareness of the pending expropriation drove down the property's price.[34]

The second portion of Chapter 11 (Section B) goes on to provide arbitration as a remedy for a host state's breach of its duties. An aggrieved investor[35] may choose either (i) arbitration supervised by the International Centre for Settlement of Investment Disputes ("ICSID") (part of the World Bank group),[36] or (ii) a proceeding conducted

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[32] NAFTA Article 1110(1) adopts a four-part structure, requiring that the expropriation (1) have a public purpose, (2) be applied on a non-discriminatory basis, (3) "in accordance with due process of law and Article 1105(1)" ["fair and equitable treatment"] and (4) result in "payment of compensation in accordance with paragraphs 2 through 6 [of Article 1110]," which adopt the fair market value standard.

[33] NAFTA Article 1110 speaks of a "G-7 currency," which includes the currencies of Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States. 32 I.L.M. at 641. For France, Germany, and Italy, members of the European Union's common currency union, the currency would now be the Euro. By contrast, the United Kingdom at present maintains its own currency.

[34] NAFTA Article 1110(2) provides that fair market value "shall not reflect any change in value occurring because the intended expropriation had become known earlier."

[35] Claims may be made either directly or on behalf of an enterprise owned by the investor under NAFTA Article 1116.

[36] Established under the 1965 Washington Convention ("Convention"), ICSID normally has jurisdiction over investment disputes between a state that is a party to the Convention and an investor from another Convention State. The Convention on the Settlement of Investment Disputes Between States and Nationals of Other States, 18 March 1965, entered into force 14 October 1966. *See generally* RUDOLF DOLZER AND MARGRETE STEVENS, BILATERAL INVESTMENT TREATIES 130-46 (1995); Abby Cohen Smutny,

under arbitration rules adopted by the United Nations Commission on International Trade Law ("UNCITRAL").[37] Disputes raising common questions of fact or law may be consolidated into a single arbitration.[38]

Should the investor want ICSID arbitration there is a slight limitation. Neither Mexico nor Canada is yet party to the Washington Convention establishing ICSID. Consequently ICSID-style arbitration must proceed under the so-called ICSID Additional Facility designed for cases in which the Washington Convention does not apply. As discussed below, this will have significant consequences when one side wishes to mount a challenge to the arbitration.

B. The Role of the Arbitral Situs

1. Current Alternatives

When a dissatisfied loser in NAFTA arbitration seeks to have an award set aside, the choice of arbitral forum may have a significant impact on the role played by courts at the arbitral situs.[39] To understand the impact of local law, a brief contrast might be helpful. Under "pure" ICSID arbitration, the Washington Convention forecloses

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Arbitration Before the International Centre for Investment Disputes, 3 BUSINESS LAW INT'L 367 (September 2002).

[37] NAFTA Article 1120. Unless otherwise agreed, the place of arbitration must be in the territory of a country that is a party to both NAFTA and the New York Arbitration Convention. See NAFTA Article 1130, referring to a "Party [a NAFTA member] that is a party to the New York Convention."

[38] Article 1126.

[39] See generally David Williams, *Challenging Investment Treaaty Arbitration Awards: Issues Concerning the Forum*, presented at ICCA Congress XVI (London, 15 May 2002).

challenge to awards on normal statutory grounds[40] in favor of ICSID's special system of quality control under its own internal challenge procedure.[41]

However, since Canada and Mexico are not parties to the Washington Convention, investors currently have only two options for arbitral procedure: (i) the United Nations' UNCITRAL Rules, which is entirely *ad hoc*, and (ii) the ICSID Additional Facility, supervised by ICSID but *outside* its treaty framework.

Whether under the UNCITRAL or Additional Facility Rules, arbitration will go forward within the framework of either the New York Convention[42] or the Panama Convention,[43] both of which require deference to valid arbitration agreements and awards but say nothing about proper or improper annulment standards.[44] In contrast to ICSID,

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[40] For ICSID arbitration in the United States, this rule has never been tested in a court action raising the conflict between the Federal Arbitration Act (allowing motions to vacate awards) and the Washington Convention (which excludes such vacatur). The US Constitution in Article VI (2) lists both treaties and federal statutes as the "supreme Law of the Land," without establishing a hierarchy. On some matters statutes clearly override treaties. See, e.g., Pub. L. No. 96-499 § 1125, providing that no treaty shall require "exemption from (or reduction of) any tax imposed" on gains from disposition of US realty. When Congress is silent courts look to canons of statutory interpretation such as "last in time prevails" or "specific restricts general." *See* Detlev Vagts, *The United States and its Treaties: Observance and Breach*, 95 AM. J. INT'L L. 313 (2001).

[41] *See* Convention on the Settlement of Investment Disputes Between States and Nationals of Other States Article 52, ICSID Basic Documents 25 (1985). *See generally* W. MICHAEL REISMAN, SYSTEMS OF CONTROL IN INTERNATIONAL ADJUDICATION AND ARBITRATION 46–50 (Duke 1992).

[42] Convention on the Recognition and Enforcement of Foreign Arbitral Awards, 330 U.N.T.S. 38, 21 U.S.T. 2517, T.I.A.S. No. 6997 (1958).

[43] Inter-American Convention on International Commercial Arbitration of 1975, set forth in 9 U.S.C. Chapter III.

[44] At present the United States and Mexico, but not Canada, are parties to the Panama Convention. In the United States, when both Conventions are applicable, the Panama Convention prevails. See 9 U.S.C. § 305. While similar in their basic structure, the New York and Panama Conventions differ in significant respects. For example, the Panama Convention does not require judges to refer parties to arbitration, or set forth conditions that must be satisfied by the party seeking award enforcement. Moreover, only the

the New York and Panama Conventions leave each country free to establish its own grounds for vacating awards made within its territory.

The consequence of arbitration under the rules of UNCITRAL or the Additional Facility is that NAFTA awards are now subject to the judicial review mechanisms that exist at the place of arbitration.[45] NAFTA Article 1136(3)(b) explicitly contemplates such review. Award enforcement for arbitration under "Additional Facility" or UNCITRAL rules may not be sought until a court either dismisses or allows an application to revise, set aside, or annul the award and there is no further appeal, or three months have elapsed without such application being made.

2. Metalclad

The much-discussed *Metalclad* case[46] illustrates the role currently given to the arbitral situs, by which judicial scrutiny of awards varies in function of the monitoring

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Panama Convention contains reference to arbitration rules (those of the Inter-American Commercial Arbitration Commission) that apply in default of party choice. See generally Albert Jan van den Berg, *The New York Convention 1958 and Panama Convention 1975: Redundancy or Compatibility?*, 4 ARB. INT'L 229 (1989); John Bowman, *The Panama Convention and Its Implementation under the Federal Arbitration Act*, 11 AM. REV. INT'L ARB. 116 (2000).

[45] In the United States award "finality" has been interpreted to mean final as allowed under relevant arbitration laws. *See, for example, M&C Corp. v. Erwin Behr GmbH & Co.*, KG, 87 F.3d 844, 847 (6th Cir. 1996); *Iran Aircraft Industries v. Avco Corp*., 980 F.2d 141, 145 (2d Cir. 1992). Compare the situation in Ontario. In *Noble China Inc. v. Lei*, 42 Ont. Rep. (3d) 69, 87 (1998) the UNCITRAL Model Law exclusion of judicial review was deemed to foreclose a motion to set aside an award, although the court noted that evidence of bias might have led to a different result. The authors are not aware of any analogous interpretations of award "finality" in Mexico, which adopted the UNCITRAL Model Law in June 1993.

[46] See *Metalclad v. United Mexican States*, ICSID Case No. ARB(AF)/97/1, Award of 30 August 2000, reprinted in 16 INT'L ARB. REP. 62 (January 2001), finding expropriation without adequate compensation where a U.S.-owned company was prevented by a Mexican municipality from operating a hazardous waste facility in Mexico. *See* Clyde Pearce & Jack Coe, *Arbitration under NAFTA Chapter 11—Some Pragmatic Reflections Upon the First Case Filed Against Mexico*, 23 HASTINGS INT'L &

standards deemed appropriate by the relevant court. An "Additional Facility" award had granted damages to an American company for expropriation of a hazardous waste disposal facility. Regulatory action by a Mexican municipality had prevented a subsidiary of a US company from operating. Arbitrators had found that Mexican regulatory action denied "fair and equitable treatment" and constituted expropriation without adequate compensation. Mexico then petitioned to have the award set aside by the British Columbia Supreme Court, which had jurisdiction by virtue of the arbitration's official situs fixed in Vancouver.[47]

As a preliminary matter the court had to decide between application of two different provincial arbitration statutes. The International Commercial Arbitration Act (based on the UNCITRAL Model Law) provides a relatively narrow scope of review, while the Commercial Arbitration Act (which catches arbitration excluded from the International Act) allows a more generous role for court intervention, including appeal on points of law.

Surprisingly, the choice turned on the meaning of "commercial" rather than "international." The International Act requires that the arbitration be commercial as well as international. Mexico argued against application of the International Act on the ground that the arbitration related to a regulatory rather than commercial relationship.

COMP. L. REV. 311 (2001); Todd Weiler, *Metalclad v. Mexico: A Play in Three Parts*, 2 J. WORLD INVESTMENT 685 (2001). For the British Columbia decision on vacatur, see *United Mexican States v. Metalclad*, Vancouver Court Registry Case No. L 002904, Mr. Justice Tysoe, decided 2 May 2001, reprinted in 16 INT'L ARB. REP. A-1 (May 2001).

[47] For convenience, hearings had been held in Washington D.C.

The court disagreed, finding that the arbitration was commercial in the sense that it "arose out of a relationship of investing."[48] Characterizing the arbitration by reference to the underlying transaction (a cross-border investment) placed the dispute within the terms of the International Act, which meant that court scrutiny focused on whether the award exceeded the arbitrators' powers or violated public policy.

As to the substance of the challenge, the Canadian court found that some but not all of the arbitrators' findings exceeded their jurisdiction. In particular, the court held that the tribunal went beyond its authority in finding that Mexico breached a NAFTA requirement of "transparency" in the sense that investment requirements should be knowable and free from doubt. In finding a transparency requirement, the arbitral tribunal "did not simply interpret the wording of Article 1105 [but] misstated the applicable law ... and then made its decision on [that] basis."[49] Nevertheless, the court upheld the bulk of the award, given that one prong of the arbitrators' reasoning fell within their jurisdiction.[50] Consequently, only a portion of the award (dealing with interest) was set aside and remitted for recalculation.[51]

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[48] See British Columbia Slip Opinion at para. 44.

[49] *Id.*, para. 70. This aspect of the case presents an example of how the line between excess of jurisdiction and simple error of law is often quite thin. The concept of transparency had been defined earlier in the decision at para. 28.

[50] The court agreed that the arbitrators were correct in resting their decision on an "ecological decree" as tantamount to expropriation. Thus excess of authority was deemed to exist in only two out of the three breaches of NAFTA found by the arbitrators.

[51] This decision has caused some scholars to argue in favor of a supra-national appellate mechanism to replace review of awards by national courts. *See* Jack J. Coe, Jr., *Domestic Court Control of Investment Awards -- Necessary Evil or Achilles Heel within NAFTA and the Proposed FTAA*, 19 J. INT'L ARB. 185 (2002); William S. Dodge, *Metalclad Corp. v. Mexico*, 95 AM. J. INT'L L. 910 (2001), at 918.

The practical lesson to be learned from *Metalclad* is that courts at the place of arbitration will have the last word in an arbitration. Consequently, care should be taken in selecting a venue where judges exercise a control function over the arbitration's basic procedural integrity (looking at matters such as bias, excess of authority and due process), but do not second guess the arbitrator on the substantive merits of the dispute.[52]

From the American perspective, the decision in *Metalclad* seemed quite normal. An investor from the United States was found to have been treated unfairly by a political subdivision of Mexico. Thus the proper way to resolve the dispute was the relatively neutral mechanism of arbitration rather than Mexican courts. As discussed below, however,[53] when the shoe is on the other foot perceptions of fairness may be quite different.

C. Investor Protection in Practice

Considerable grist for the arbitration mill has been supplied by two particular aspects of Chapter 11: the matters of (i) "minimum standard of treatment" and (ii) compensation standards for expropriation. Several recent cases illustrate the way NAFTA has been applied in practice in these areas.

1. Minimum Standards of Treatment

NAFTA Article 1105 (1) requires each country to "accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security." Although the meaning of

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[52] *See* William W. Park, *Duty and Discretion in International Arbitration*, 93 AM. J. INT'L L. 805 (1999).

[53] See discussion *infra*.

"international law" has been the object of controversy, [54] at least two conclusions seem warranted. First, the "fair and equitable standard" has not been met simply by an extension of national or most favored nation treatment to NAFTA investors. Second, reference to "full protection and security" adopts the settled principle that a nation is liable for failure to exercise due diligence to prevent injuries to an investor caused by third parties.[55]

In *Metalclad*[56] Mexico was held to be in breach of Article 1105(1) as a result of a lack of "orderly process" and "timely disposition" in relation to a NAFTA investor acting under the expectation that it would be treated fairly and justly in accordance with NAFTA. In *S.D. Myers*[57] treatment of NAFTA investors was held to fall below this minimum standard of treatment even in a situation where government conduct was not discriminatory. A breach of Article 1105(1) thus occurs when the NAFTA investor is treated in such an unjust or arbitrary manner as to rise to a level unacceptable from the international perspective.

It is worth noting that several aspects of what might loosely be considered fair treatment are the subject of separate NAFTA provisions. For example, under Article 1106 a NAFTA country may not "impose or enforce 'performance requirements' in

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[54] See discussion of Free Trade Commission *Notes of Interpretation, infra*.

[55] IAN BROWNLIE, SYSTEM OF THE LAW OF NATIONS: STATE RESPONSIBILITY (1983) at 161; ICSID Case ARB/87/3.

[56] *Metalclad Corporation v. Government of the United Mexican States,* Award of 25 August 2000, discussed *supra*.

[57] *S.D. Myers, Inc. v. Government of Canada,* Partial Award of 13 November 2000, reprinted in 40 I.L.M. 1408 (2001). U.S. investor hoped to capture a large portion of the Canadian market for destruction of PCBs by sending materials to Ohio facilities, a competitive advantage over Canadian facilities further away. Canadian environmental

connection with investments in its territory," which include achievement of export levels, domestic procurement requirements, minimum local content, trade balancing, product mandating or the transfer of technology.[58] NAFTA also grants investors an explicit right to choose senior managers (Article 1107) and the right to convert local currency into foreign currency at the prevailing market rate of exchange, in order to repatriate earnings, proceeds of a sale, loan repayments or other investment-related transactions (Article 1109).

2. Expropriation

NAFTA Article 1110 extends protection against un-compensated expropriation to measures "tantamount to nationalization or expropriation," thus encompassing takings that have often been referred to as "creeping" expropriation. [59] In all cases compensation for expropriation must be paid without delay, be equal to the fair market value of the investment prior to the expropriation, include interest, and be fully realizable and freely transferable.

While "tantamount to expropriation" is not defined in NAFTA, this well-established concept has been applied to cover not only openly avowed state takings of property, but also "other actions that have the effect of 'taking' the property, in whole or

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authorities responded to Canadian lobbying with an emergency ban preventing export of PCB waste.

[58] In two early cases testing this requirement, arbitral tribunals hearing claims against Canada have failed to find improper imposition of performance requirements. See *Pope & Talbot, Inc. v. Government of Canada*, Interim Award on Merits of 26 June 2000; final award 31 May 2002 (U.S. investor claimed damages in connection with Canadian softwood export prohibitions; the tribunal dismissed all but the claim that Canada had engaged in denial of fair treatment); *S.D. Myers, Inc. v. Government of Canada*, Partial Award of 13 November 2000 (tribunal found that the export ban in question was not a requirement on "the conduct or operation of the investment").

[59] See discussion *infra*.

in large part, outright or in stages [including] when [a state] subjects alien property to taxation, regulation, or other action that is confiscatory, or that prevents, unreasonably interferes with, or unduly delays, effective enjoyment of an alien's property."[60] An indirect expropriation may occur if the investor's expected entitlement to the benefits are impaired by host state interference, even if property is not legally taken by the State,[61] or when the host state itself acquires nothing of value but "at least has been the instrument of distribution."[62]

Several Chapter 11 arbitrations have addressed the question of what constitutes expropriation, including *Azinian*,[63] *Metalclad*,[64] *Pope & Talbot*, [65] and *S.D. Myers*.[66] Thus far none have departed from traditional notions of customary international law.

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[60] Restatement (Third) of Foreign Relations Law of the United States, Section 712. ICSID cases that have addressed indirect expropriation include *Amco Asia Corp. v. Republic of Indonesia*, ARB/81/1; *Liberian E. Timber Corp. v. Government of Liberia*, ARB/83/2 and *Southern Pacific Properties Ltd. v. Arab Republic of Egypt*, ARB/84/3. See generally references to works by Dolzer, Higgins and Weston cited *infra*.

[61] Istvan Posgany, *Bilateral Investment Treaties: Some Recent Examples*, 1987 FOREIGN INVESTMENT LAW JOURNAL 964.

[62] ALLAHYAR MOURI, THE INTERNATIONAL LAW OF EXPROPRIATION AS REFLECTED IN THE WORK OF THE IRAN-U.S. CLAIMS TRIBUNAL (1994) at 66; Poehlmann v. Spinnerei AG, 3 U.S. Ct. Rest. App. 701, 702-04, 710 (1952).

[63] *Robert Azinian v. United Mexican States*, Award on Merits, 1 November 1999, 14 ICSID REVIEW / FOREIGN INVESTMENT LAW REVIEW 568. U.S. investors contracted with a local municipality to provide waste treatment services. The tribunal concluded that the claimant had not shown the Mexican actions to be illegal under international law.

[64] *Metalclad Corporation v. Government of the United Mexican States*, Award on Merits of 25 August 2000. The Tribunal ruled that "Expropriation under NAFTA includes not only open, deliberate and acknowledged takings of property, such as outright seizure or formal or obligatory transfer of title in favor of the host State, but also covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use or reasonably-to-be-expected economic benefit of the property even if not necessarily to the obvious benefit of the host State." At 33, para. 103. The Tribunal also applied an "effects" test and held that the motivation or intent of the adoption of an environmental decree was not relevant to a determination under NAFTA article 1110.

III. Arbitration and the New Host States

A. Three Illustrations

Three Canadian claims against the United States illustrate how a traditional investor country has seen the tables turned by mandatory arbitration with foreign investors.[67] Each case involves complaints about an American state rather than the federal government. In *Methanex* California banned gasoline additives manufactured from a feedstock produced by a Canadian company; in *Loewen* a Mississippi jury awarded $500 million against a Manitoba funeral director; and in *Mondev* the Supreme Judicial Court of Massachusetts upheld the city of Boston in refusing to sell land to a Montreal real estate developer.

In all three cases American interests were subject to adjudication outside American courts. As discussed later, this question of forum lies at the heart of American disquiet over NAFTA Chapter 11.

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[65] *Pope & Talbot, Inc. v. Government of Canada*, Interim Award on Merits of 26 June 2000; final award 31 May 2002. In the Interim Award of June 2000 the Tribunal dismissed all but the claim that Canada had denied fair treatment under Article 1105, but indicated that "creeping expropriation could be conducted by regulation, and a blanket exception for regulatory measures would create a gaping loophole in the international protection against expropriation." Id at 35, para. 99. On whether there was an expropriation, the Arbitral Tribunal indicated that the test is "whether the interference is sufficiently restricted to support a conclusion that the property has been *taken* from the owner." See generally, Patrick Dumberry, *The Quest to Define "Fair and Equitable Treatment" for Investors under International Law*, 3 J. WORLD INVESTMENT 657 (2002).

[66] *S.D. Myers, Inc. v. Government of Canada*, Partial Award of 13 November 2000. The tribunal decided that the term "tantamount" in NAFTA article 1110 means "equivalent" and is intended to capture acts of creeping expropriation but does not broaden the scope of expropriation under customary international law.

[67] The fourth claim against the United States, filed on 19 July 2000 by ADF Group of Québec, involved a "Buy American" requirement of the Federal Highway Administration that interfered with participation in a Virginia highway project by a Canadian manufacturer of complex steel components.

The protest is pregnant with irony when one remembers how often the United States has imposed arbitration on other countries,[68] and how American negotiators advocated arbitration to promote the security of foreign investment over Mexico's longstanding opposition.[69]

Two of the cases (*Loewen* and *Mondev*) are of particular significance, in that court decisions serve as the hook on which to found a NAFTA claim. NAFTA not only prohibits any "measure" tantamount to expropriation,[70] but also gives the term "measure" an understandably broad scope, to include "any law, regulation, procedure, requirement or practice."[71] Such a reading of the concept of measure is entirely consistent with the American position in connection with bilateral investment treaties.[72]

By implicating the judiciary, NAFTA arbitrations obviously touch an especially sensitive nerve. However, such actions follow a long line of "denial of justice" claims

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[68] *See* W. LAURENCE CRAIG, WILLIAM W. PARK & JAN PAULSSON, INTERNATIONAL CHAMBER OF COMMERCE ARBITRATION (3d ed. 2000), Chapter 36.

[69] The NAFTA Statement of Administrative Action makes this point: "The NAFTA provides a historic investor-state dispute settlement mechanism, so that individual U.S. companies no longer face an unbalanced environment in an investment dispute with the Mexican government but can seek arbitration outside Mexico by an independent body." See NORTH AMERICAN FREE TRADE AGREEMENT, TEXTS OF AGREEMENT, IMPLEMENTING BILL, STATEMENT OF ADMINISTRATIVE ACTION AND REQUIRED SUPPORTING STATEMENTS, House Document 103-159, Vol. 1, at 685.

[70] NAFTA Article 1110.

[71] NAFTA Article 201. Both *Loewen* and *Azinian* (discussed *supra*) rejected the suggestion that a judicial action constituted an exclusion to such a broadly defined notion of governmental measure.

[72] See VANDEVELDE, UNITED STATES INVESTMENT TREATIES: POLICY AND PRACTICE, Appendix C, at 166, noting the State Department position that bilateral investment treaty prohibitions on expropriations apply to "essentially any measure regardless of form" which may deprive an investor of important property rights.

traditionally brought against developing countries[73] and recently made by an American investor against Mexico under NAFTA.[74]

1. Methanex[75]

When California became concerned about risks to drinking water as a result of leakage from underground fuel storage tanks, its Governor banned gasoline containing a methanol-based gasoline additive called "MTBE."[76] A Canadian corporation producing feedstock for this additive responded by filing an arbitration claim arguing

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[73] See BRIERLY, *supra*, at pages 286-87, noting two different views on what constitutes a denial of justice, also sometimes referred to as *déni de justice*. The narrower interpretation (on occasion adopted by Latin American scholars) contends that denial of justice exists only when foreigners have been denied access to courts. The broader view (embraced in much English, American and Continental writing) includes substandard judicial acts such as corruption, dishonesty, unwarranted delay and decisions imposed by the executive. See also BROWNLIE, *supra*, at pages 514-16.

[74] See Calmark Commercial Development, Inc. v. United States of Mexico, Notice of Intent to Commence Arbitration filed 11 January 2002. In a case whose beginning brings to mind the real estate development in Mondev, an American corporation which had agreed to develop a tourist attraction in Mexico ended up paying for land which was transferred to a third party. A lawsuit in the courts of the State of Baja California failed to recover the misplaced investment, due to what the American claimant alleged were procedural improprieties such as failure to give notice of defendant's submissions, disregard of evidence and "blatantly wrongful and unjust conclusion" in the matter. Id., para. 52. The NAFTA claim was based on Article 1105: "treatment in accordance with international law, including fair and equitable treatment and full protection and security." Supporting authorities cited by the American claimant included the Loewen case (discussed infra) and a 1927 American claim against Mexico, United States (Laura Janes) v. Mexico (Opinions of Commissioners 108, 1927 General Claims Commission 1926) in which non punishment was deemed to constitute approval of wrongdoing.

[75] Methanex Corp. v. USA, Amended Claim filed 12 February 2001 by Jones, Day, Reavis & Pogue, Washington, D.C. Available through www.naftaclaims.com.

[76] It is significant that the Claimant Methanex does not produce MTBE (Methyl tertiary butyl ether), but rather the feedstock (methanol) for the banned additive. This fact seems to have played a part in the recent partial award in this case. The arbitral tribunal appears to have posited that the connection between methanol and the ban was too remote in the context of NAFTA Article 1101, since the government measure did not apply to the investor's product itself. The ban was effective 31 December 2001. See Exec. Order No. D-5-99 promulgated by Governor Gray Davis.

discrimination, denial of minimum standard of treatment and improper expropriation of its investment.[77]

The filing of the claim led to protests by environmentalists and the U.S. Environmental Protection Agency (EPA). Charges were made that NAFTA Chapter 11, by allowing corporations to recover for unfair treatment, favored corporate profits over legitimate exercise of sovereignty by local governments. This arbitral process was attacked as undemocratic, cloaked in secrecy, lacking adequate rights of appeal and protection for equally injured domestic producers. NAFTA was further criticized as denying the American public a right to protect its water and air.[78]

2. Loewen

In *Loewen v. USA*,[79] a Mississippi jury verdict led to claims of failure to grant "fair and equitable treatment" and expropriation without adequate compensation. The

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[77] Violations were alleged with respect to NAFTA Articles 1102, 1105 and 1110. Methanex Corp. Notice of Intent to Submit a Claim to Arbitration Under Article 1119, Section B, Chapter 11 of NAFTA, filed 2 July 1999. The arbitration proceeding was brought under the UNCITRAL Rules and has already resulted in an interim ruling. See Methanex Corp v. United States, 15 January 2001, 16 Int'l Arb. Rep. D-1 (Jan. 2001), Decision on Authority to Accept Amicus Submissions, finding that it "could be appropriate" for an environmental group to make submissions. UNCITRAL Rules Article 15(1) permits conduct of the proceedings "in such manner as [the tribunal] considers appropriate." Amicus briefs from NAFTA member countries are permitted under NAFTA Article 1128, which authorizes submissions on questions related to interpretation of NAFTA.

[78] For a survey of the criticisms of NAFTA provoked by Methanex, see generally Lucien J. Dhooge, The Revenge of the Trail Smelter: Environmental Regulation as Expropriation Pursuant to the North American Free Trade Agreement, 38 Am. Bus. L. J. 475 (2001), at 478-479, notes 18-25.

[79] Loewen Group, Inc. v. U.S.A., ICSID Case No. ARB (AF)/98/3, Final Award 26 June 2003 (Anthony Mason, Abner J. Mikva and Michael Mustill arbs.), 42 I.L.M. 811 (2003), available at www.nafftaclaims.com; Interim Award on Jurisdiction, 5 January 2001. Based on NAFTA Articles 1105 and 1110, the claim arose out of the $500 million verdict that included $400 million in punitive damages. Appeal required a bond of 125% The rich tapestry of this dispute is set forth in Jonathan Harr, The Burial, The New Yorker, 1

jury had awarded half a billion dollars in favor of a Mississippi funeral director who claimed that a Canadian buyer had breached a contract for the purchase of his funeral parlors. When the Canadian attempted to appeal, he found that state law required the posting of a bond as security for payment of the judgment equal to 125% of the amount awarded. In this case the sum would have been $ 625 million, high enough to force a substantial settlement.

The Canadian company then filed a NAFTA Chapter 11 claim against the United States in an ICSID Additional Facility arbitration. The investor claimed that there had been a denial of justice in a trial involving flagrant attempts to inflame jurors by casting the Canadian party as an outsider due to differences in race, nationality and class. An interim award decided that a court judgment can be considered a governmental "measure" that might give rise to liability for discrimination, failure to grant "fair and equitable treatment" and expropriation without adequate compensation. However, the final award denied compensation due to failure to exhaust local remedies, and a change of the Canadian claimant's national identity following a bankruptcy reorganization as an American entity.

3. Mondev

In the final example, a Quebec corporation commenced arbitration arising from a decision by the Massachusetts Supreme Judicial Court dismissing an action against the city of Boston for breach of a contract to sell property in connection with municipal redevelopment, and against the Boston Redevelopment Authority for tortious interference

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November 1999, at 70, describing the backgrounds of the Mississippi plaintiff, Jeremiah O'Keefe, his Florida lawyer, Willy Gary, the allegedly xenophobic comments to the jury, and the circumstances surrounding the $ 175 million settlement.

with contractual relations.[80] The developers had entered into an agreement with Boston to acquire a parcel of downtown real estate. When the city balked at going through with the transfer, the failure was ultimately excused on the basis that the Canadian investment vehicle did not "follow the steps" required under the agreement, since its offer to buy the parcel had not manifested a "precise time and place for passing papers."[81] The claim against the Boston Redevelopment Authority was dismissed on the basis that this public body was immune from tort liability under the Massachusetts Tort Claims Act.[82]

Aggrieved by the court decision, the Montreal investor brought a $50 million claim under the ICSID Additional Facility alleging discrimination, expropriation without compensation and denial of "fair and equitable treatment." The decision of the Massachusetts Supreme Judicial Court endorsing the denial of the developer's right to purchase the land was described as "unprincipled" and "arbitrary."[83]

One can understand that such a proceeding might surprise many Americans. Imagine, however, the reverse situation, in which rights of similarly situated Boston

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[80] Mondev International Ltd. v. United States of America, ICSID Case No. ARB (AF)/99/2; Award of 11 October 2002 published in 42 I.L.M. 85 (2003). The arbitral tribunal dismissed Mondev's claims, finding that the American court decisions "did not involve any violation of Article 1105(1) of NAFTA or otherwise." The party-nominated arbitrators were James Crawford (for Claimant) and Stephen Schwebel (for Respondent US), and the Presiding Arbitrator is Ninian Stephen. See also Lafayette Place Associates v. Boston Redevelopment Authority, 427 Mass. 509, 694 N.E.2d 820 (1998). Operating in Boston through the limited partnership, Mondev had agreed to participate in a project originating in an attempt to rehabilitate the so-called "combat zone," a dilapidated area near Boston's downtown shopping district. Although the Supreme Judicial Court found the contract with Boston to be enforceable, the developers were deemed to have forfeited their rights due to lack of evidence that they were ready, able and willing to close the sale.

[81] Id. at 520.

[82] Id. at 531-533. See MGL, c. 258, §§ 1, 10(c).

investors are rebuffed by a foreign court. It is not hard to imagine New England voices crying foul play.[84]

B. Reactions and Complaints

As the first Chapter 11 cases were filed against the United States and Canada,[85] voices began to be heard saying that investment arbitration infringes national prerogatives. Investor protection has been presented by activists as a subterfuge to challenge laws simply because they have a negative impact on the foreign capitalist.[86] In one *New York Times* article NAFTA arbitration was thus described, "Their meetings are secret. Their members are generally unknown. The decisions they reach need not be fully disclosed. Yet the way a small group of international tribunals handles disputes between

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[83] Mondev International Ltd. v. USA, Notice of Arbitration, 1 September 1999, at page 74. ICSID Case No. ARB(AF)/99/2.

[84] The story in the Boston newspapers might read something like this: "Xenophobic judge in Ruritania refused to enforce a promise to sell property to an American company. Investor asks why it should take the trouble of entering into contracts when local judiciary excuses breach of agreement on a technicality, citing nothing more than absence of a 'precise time and place for passing papers.' The seller was granted total immunity from liability."

[85] Thus far twenty-seven notices of intent (not all of which have been followed by claims) have been brought under Chapter 11: nine against Canada (Ethyl, S.D. Myers, Sun Belt, Pope & Talbot, UPS, Ketcham Investments, Crompton, Trammel Crow and Signa); ten against Mexico (Metalclad, Karpa (a.k.a. Feldman), Adams, Azinian, Waste Management Services I and II, Calmark Commercial Development, Halchette, GAMI Investments Inc. and Fireman's Fund); eight against the United States (Loewen, Methanex, Mondev, ADF Group, Canfor, Tembec, Kenex and Doman). Cases raising environment issues include Metalclad, Methanex, Ethyl, S.D. Myers and Crompton.

[86] See generally, Charles N. Brower & Lee A. Steven, Who Then Should Judge?: Developing the International Rule of Law under NAFTA Chapter 11, 2 Chi. J. Int'l. L. 193, 198 (2001); Daniel M. Price, Some Observations on Chapter Eleven of NAFTA, 23 Hastings Int'l. & Comp. L. Rev. 421 (2000); Frederick M. Abbott, The Political Economy of NAFTA Chapter Eleven: Equality Before the Law and the Boundaries of North American Integration, 23 Hastings Int'l & Comp. L. Rev. 303, 306 (2000).

investors and foreign governments has led to national laws being revoked, justice systems questioned and environmental regulations challenged."[87]

Among the most negative reactions to investment arbitration, a December 2001 advertisement in the *Washington Post* attacked investment arbitration under the headline "Fast Track Attack on America's Values," which appeared against the background of the preamble to the US Constitution ("We the people...") with captions that read: "Secret Courts for Corporations" and "Taxpayer Dollars for Foreign Polluters."[88]
The full-page advertisement urged rejection of the trade bill (ultimately passed by one vote in the House of Representatives) giving the President "fast track" authority to negotiate agreements in the Free Trade Area of the Americas (FTAA). These agreements could extend to thirty-four Western Hemisphere countries based on the NAFTA model.

In one well-publicized television show hosted by Bill Moyers, NAFTA was labeled a "sophisticated extortion racket," and "an end-run around the Constitution" in

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[87] See, e.g., Anthony De Palma, NAFTA's Powerful Little Secret, New York Times, Sunday Late Edition, 11 March 2001, Section 3, at 1. For an attempt at a more broad-based rebuttal of claims that international trade undermines governmental regulatory structures, see Ronald A Cass and John R. Haring, *Domestic Regulation and International Trade: Where's the Race? -- Lessons from Telecommunications and Export Controls*, in THE POLITICAL ECONOMY OF INTERNATIONAL TRADE LAW: ESSAYS IN HONOR OF ROBERT E. HUDEC 111 (Daniel L.M. Kennedy & James D. Southwick eds., Cambridge University Press 2002); also published in 11 JOURNAL DES ÉCONOMISTES ET DES ÉTUDES HUMAINES 531 (2001).

[88] Sponsored by Ralph Nader's "Public Citizen's Global Trade Watch," the publication referred to possible extension of a NAFTA provision permitting "foreign corporations to sue the federal government in secret tribunals, demanding our tax dollars as payment for complying with U.S. health, safety and pollution laws." The advertisement continued that foreign manufacturers of toxic chemicals could use "private courts" (i.e., arbitration) "to sue U.S. taxpayers . . . if zoning rules kept them from building a chemical plant near a school." Referring to arbitration's confidentiality, the advertisement said that "even the identity of judges can be kept secret indefinitely," ending with the rhetorical question, "Whose side is Congress on--foreign corporations or the American people?" See

which "secret NAFTA tribunals can force taxpayers to pay billions of dollars in lawsuits."[89]

Environmentalists have been particularly vocal in saying that NAFTA makes it possible to undermine legitimate governmental regulations.[90] Chapter 11 arbitration is portrayed as a forum insulated from rightful domestic political and legal safeguards.[91] The World Wildlife Fund and the Institute for Sustainable Development published a report entitled *Private Rights, Public Problems* which labels NAFTA Chapter 11 arbitration as "one-sided" and "lacking transparency," and concludes that arbitration is "shockingly unsuited to the task of balancing private rights against public goods."[92]

Washington Post, 5 December 2001, at A-5, placed by the Global Trade Watch division of Public Citizen (www.citizen.org).

[89] The transcript of the PBS special series "Trading Democracy," which aired on 1 February 2002, can be obtained on www.pbs.org/now/transcript.

[90] No administrative veto prohibits arbitration of disputes implicating environmental measures. NAFTA simply provides that nothing in Chapter 11 shall be construed as preventing adoption of measures "to ensure that investment activity … is undertaken in a manner sensitive to environmental concerns." See NAFTA Article 1114.

[91] See, e.g., comments at "Public Citizen" web page (www.citizen.org). See also Howard Mann and Konrad von Moltke, NAFTA's Chapter 11 and the Environment: Addressing the Impacts of the Investor-State Process on the Environment, International Institute for Sustainable Development Working Paper (1999) (http://iisd1.iisd.ca/pdf/nafta.pdf). Complaints include the "virtually unfettered right of foreign investors to initiate direct actions against their host governments" and the "aggressive use of this process to challenge public policy and public welfare measures." The authors complain about "uncertainty and unpredictability for environmental regulations," lack of procedural or public interest safeguards, "non-transparent, secretive and non-appealable" arbitration, all of which mean that host governments must "pay foreign investors in order to be able to effectively regulate the environment." See also Todd Weiler, A First Look at the Interim Merits Award in S.D. Myers v. Canada: It Is Possible to Balance Legitimate Environmental Concerns with Investment Protection, 24 Hastings Int'l & Comp. L. Rev. 173 (2001); Joseph de Pencier, Investment, Environment and Dispute Settlement: Arbitration Under NAFTA Chapter Eleven, 23 Hastings Int'l & Comp. L. Rev. 409 (2000).

[92] Howard Mann, Private Rights, Public Goods (International Institute for Sustainable Development and World Wildlife Fund, 2001), at 46. The report by Dr. Mann, a lawyer

Members of Congress also complain that NAFTA tribunals override health and labor laws, and express alarm that the United States federal government might be held liable for the idiosyncratic acts of local authorities and state courts.[93] During debate on an appropriations bill, a Congressman lamented that the Justice Department might have to sue local governments to enforce NAFTA decisions, and in a burst of fervor proclaimed, "This is nuts! ... We must stand together to protect the sovereignty of American laws."[94]

A recent indication of American discontent with the NAFTA model for investment dispute resolution came in response to legislative efforts to extend trade benefits to Latin American countries. The Chairman of the Senate Finance Committee

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based in Ottawa, led to follow-up commentary in Canada and the United States that furthered the negative characterization of NAFTA. See Mark Thomsen, Companies Using NAFTA to Undermine Legitimate Regulations, 12 June 2001, reported at www.socialfunds.com/news; Chantal Blouin, NAFTA Goes Too Far on Investor Protection, North-South Institute, 31 August 2001, reported at www.nsi-ins.ca/ensi/news.

[93] See debate on HR 2670, an appropriations bill for the Commerce, Justice and State Departments, at 145 Cong. Rec., HR, 106th Congress, 1st Session, 5 August 1999, at H-7368. Federal statute prohibits challenge of state laws inconsistent with NAFTA, "except in an action brought by the United States [i.e., the federal government] for the purposes of declaring such law or application invalid." 19 U.S.C. § 3312(b)(2), codifying § 102(b) of NAFTA Implementation Act. Similar protections apply to state laws in conflict with Uruguay Round trade agreements. 19 U.S.C. § 3512(b)(2). An amendment to the bill offered by Rep. Kucinich (Ohio) would have prohibited the Department of Justice from using appropriated funds to challenge state laws that run afoul of NAFTA, for example the Mississippi bond requirement in Loewen. The amendment failed 196 to 226.

[94] 145 Cong. Rec., HR, 106th Congress, 1st Session, 5 August 1999, at H-7368. Congressman Tierney (Massachusetts) expressed concern that the pace of globalization might result in "sacrificing state and local laws at the altar of ill-defined international investor rights." Congressman Shows (Mississippi) opposed allowing "American taxpayer dollars [to] pay American lawyers to help a foreign corporation fight American state laws in court." Id. Congressman Bonior (Michigan) added, "The question ... is very clear: Should the rights of an investor come before the rights to enact a chemical ban to prevent cancer?" Id. Observers will note, of course, that NAFTA prohibits discrimination, not the right to ban carcinogens. The essence of the concern would seem to be that arbitrators hearing anti-discrimination claims might strike down otherwise valid health regulations.

wrote to the Bush Administration endorsing attempts to deny foreign investors any substantive rights not given to American investors, to establish an appellate review of NAFTA awards,[95] and to support government screening of arbitration requests to reduce the prospect that they are ever considered by arbitrators.[96]

While not all legislators accepted the wisdom of such measures,[97] some went even further. Senator Kerry of Massachusetts proposed amendments to the Andean Trade Preferences Act which would have given the investor state[98] the right to prohibit arbitration on the basis that the claim "lacks legal merit" and established a "single appellate body" to review decisions in investment arbitration.[99]

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[95] Letter of 26 March 2002 from Max Baucus to Trade Representative Robert Zoellick, discussed in Rossella Brevetti, Baucus Welcomes Options Administration Is Considering on Investor-State Disputes, BNA Int'l Trade, Vol. 19, No. 13 at 529 (28 March 2002).

[96] A similar screening mechanism already exists with respect to expropriation claims that implicate tax measures. See NAFTA Article 2103(6), discussed infra.

[97] On 28 March 2002 the Senate Finance Committee's ranking Republican Charles Grassley urged Trade Representative Zoellick to reject such screening. See Rosella Brevetti, Grassley Urges Zoellick to Reject Government Screening for Investor Suits, Regulation Law & Economics, No. 62, 1 April 2002, at A-6. Industry groups, including the National Association of Manufacturers, have also expressed concern for the preservation of investor protections for American-owned businesses abroad. See Brevetti, 26 March 2002, supra. See also discussion of HR 3005 in Chris Rugaber and Rossella Brevetti, In Partisan Markup, House Ways and Means Approves TPA Legislation, International Trade Reporter Current Reports, 11 October 2001.

[98] While some might imagine that this veto right would be given to the host state, in fact the Kerry proposals accorded this to the "competent authority in the investor's country." See SA 3430, proposed Section 2102(b)(3)(H)(i) & (ii). This approach follows the lines of traditional practice in matters of state responsibility, with a capital exporting country espousing its national's claim in order to assert protection of the investor's foreign assets.

[99] The Kerry proposals would also have modified the substantive contours of what NAFTA arbitrators could award, requiring inter alia that trade agreements with investment provisions (i) ensure that foreign investors receive no greater legal rights than American citizens; (ii) exclude compensation for regulatory measures that cause "mere diminution" in the value of property; and (iii) ensure that standards for minimum treatment grant foreigners no greater legal rights than possessed by American citizens under the Constitution's due process clause. See Kerry amendment to Andean Trade

As finally enacted, last year's trade legislation includes several provisions designed to restrict the type of arbitration provisions normally found in investment treaties. After a self-congratulatory preamble to the effect that the United States "provides a high level of protection for investment", the Trade Act of 2002 defines American trade negotiating objectives to include making sure that foreign investors receive no "greater substantive rights with respect to investment protections" than domestic investors – thus echoing objections to investment arbitration long propounded by developing countries. The Act sets forth the means to this end, including an improvement of investor/host state dispute resolution through "mechanisms to eliminate frivolous claims," and "an appellate body … to "provide coherence to interpretations of investment provisions in trade agreements" as well as a mandate to make public all investment arbitration proceedings and to allow *amicus curiae* submissions from business, labor and non-governmental organizations.[100]

Some groups in Canada have likewise complained bitterly about NAFTA, alleging that it serves "to limit the legitimate rights of governments to regulate."[101] An

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Preference Expansion Act, H. R. 3009 (107th Cong. 2nd Sess.), Senate Amendment 3430 to Section 2102(b) of the Andean Trade Preferences Act, Cong. Rec. 16 May 2002 S 4504. The amendment was tabled 21 May 2002

[100] See Section 2102(b)(3) of Trade Act of 2002 (P.L. 107-210), 16 Stat. 933, codified 19 U.S.C. 3802.

[101] See Nihal Sherif, Canadian Memo Identifies Options for Changing NAFTA Investment Rules, Inside US Trade at 20 (12 February 1999) (commenting upon a memo of the Canadian Department of Foreign Affairs and International Trade). See also discussion of Pope & Talbot v. Canada, Award of 26 June 2000 (discussed 16 Int'l Arb. Rep. 20, July 2001), finding that Canadian export controls on softwood lumber discriminated against an Oregon investor; final award 31 May 2002. See also Todd Weiler, A First Look at the Interim Merits Award in S.D. Myers v. Canada: It Is Possible to Balance Legitimate Environmental Concerns with Investment Protection, 24 Hastings Int'l & Comp. L. Rev. 173 (2001); Joseph de Pencier, Investment, Environment and

editorial in the Toronto *Globe and Mail* criticized the confidentiality inherent in arbitration as a "cone of silence," claiming that "lawsuits against the Canadian government under NAFTA's Chapter 11 end up being composed almost entirely of rumor and leaks rather than official documents."[102]

C. Understandable Concerns

Many host state concerns about NAFTA arbitration are understandable. Considerable ambiguity exists with respect to what constitutes "fair and equitable" treatment. The law on expropriation is also relatively malleable, with little consensus on the standards that determine when administrative regulations give rise to a governmental taking that requires compensation. Must a claimant show an abuse of power by the host government? Must the nationalization include an element of bad faith? May a foreign investor recover in circumstances where the claim of a domestic owner would fail?

The crux of the problem is that not all discrimination is outright and abrupt. Arbitrary taking of property may occur in a gradual fashion through abusive manipulation of the legal system. Various names have been applied to such *de facto* nationalization: "creeping expropriation," "indirect expropriation," and "constructive expropriation," as

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Dispute Settlement: Arbitration Under NAFTA Chapter Eleven, 23 Hastings Int'l & Comp. L. Rev. 409 (2000).

[102] NAFTA Cone of Silence, Toronto Globe and Mail, 26 August 1998, at A-14. Responses to this editorial include letters to the editor by Sergio Marchi (Canadian Trade Minister), who asserted that investor rights must not "inhibit the sovereign responsibility of governments to legislate and regulate in the public interest" (Globe and Mail, 31 August 1998, at A-12) and Maude Barlow, who asserted that NAFTA was the "first international treaty in history to grant foreign investors the right to bypass their own governments in a trade dispute and sue the government of another country for cash compensation" and that NAFTA arbitrators were all "trade bureaucrats." (Globe and Mail, 5 September 1998, at D-7).

well as measures "tantamount to" or "equivalent to" expropriation.[103] Indirect nationalization through improper administrative measures has long served as a back door to deprive the investor of its assets.[104] In some cases a taking might occur through non-action, as when a state refuses to interfere with popular seizure of foreign property or fails to fulfill a contractual obligation to grant fiscal benefits.

Expropriation under the guise of otherwise valid regulations is often easier to recognize than to define, as illustrated by the practice of the Overseas Private Investment Corporation (OPIC).[105] A federally chartered agency of the United States government, OPIC insures American investors against expropriation and currency inconvertibility in connection with their foreign investments.[106] Notwithstanding OPIC's broad definition of expropriation,[107] the experience of investors seeking reimbursement has not always

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[103] See generally Burns H. Weston, Constructive Takings under International Law: A Modest Foray into the Problem of "Creeping Expropriation," 16 Va. J. Int'l L. 103 (1975); Rosalyn Higgins, The Taking of Property by the State: Recent Developments in International Law, 176 Recueil des Cours (Hague 1982), at 259; Rudolf Dolzer, Indirect Expropriation of Alien Property, 1 ICSID Rev./FILJ 41 (1986). See also discussion of Overseas Private Investment Corporation (OPIC) *infra*. See generally, Markham Ball, *Assessing Damages in Claims by Investors Against States*, 16 ICSID REVIEW/FOREIGN INVESTMENT LAW J. 408 (2001).

[104] See, e.g., Barcelona Traction, Light and Power Co., Ltd. (Belgium v. Spain) (2d Phase), 1970 I.C.J. 3, 9 I.L.M. 227 (1970). By refusal to authorize transfer of foreign currency to pay Sterling bond interest, Spain allegedly engineered the bankruptcy of a Canadian owned company as a way to deprive the parent of its property. See also V.V. Veeder, The Lena Goldfields Arbitration: The Historical Roots of Three Ideas, 47 Int'l & Comp. L. Q. 747 (1998) (discussion of Goldfields v. USSR, Judgment of 3 September 1930).

[105] See generally Vance Koven, Expropriation and the "Jurisprudence" of OPIC, 22 Harvard Int'l L. J. 269 (1981); Wolfgang Peter, Arbitration and Renegotiation of International Investment Agreements (2d ed. 1995), at 348-357.

[106] The Contract of Insurance provides for controversies between OPIC and the investor to be settled by arbitration.

[107] OPIC's current Program Handbook (available at www.opic.gov) defines expropriation coverage as protection against "nationalization, confiscation or

been consistent.[108] In many instances jurists will find difficulty establishing intellectually rigorous standards, and thus will be consigned to a "we-know-it-when-we-see-it" attitude toward *de facto* takings.

Not all scholars see the case law of expropriation as a threat to environmental regulations. One thoughtful study of regulatory takings has identified a number of standards applied in nationalization cases, such as proportionality, necessity and non-discrimination.[109] Not every governmental measure that diminishes the worth of an investment will require compensation, and some balance must be struck between the right to regulate and the preservation of property values. At the least, the investor has the right to be concerned with uncertainty and surprise and breaches of prior commitments.[110]

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expropriation of an enterprise, including "creeping" expropriation – unlawful government actions that deprive the investor of fundamental rights in a project" but excluding losses due to "lawful regulation or taxation" and "actions provoked or instigated by the investor." Id. at 11. See also www.opic.gov/finance/products/expropriation.htm; Jonathan Haddon, PLI Presentation February 1999, 784 PLI/Comm 271.

[108] In one case OPIC acknowledged that rights could be denied through a "chain of conduct," but found that the investor's control over its assets continued even after it lost managerial and shareholder control of the investment vehicle. See Cabot Int'l Capital Corp., Contract 8383, Memorandum of Determination (27 December 1980). See also Revere Copper & Brass, Inc. v. OPIC, American Arbitration Association Award reprinted in 17 Int'l Legal Mats. 1321 (1978), motion to vacate denied, D.C. Cir. (26 February 1980), cert. denied, 100 S.Ct. 2964 (1980). At that time the OPIC Contract of Insurance defines "expropriatory action" to include actions that prevent (a) payment of amounts due in respect of securities, (b) effective exercise of fundamental rights, (c) disposition of securities, (d) exercise of effective control or (e) repatriation of earnings.

[109] See Thomas Waelde & Abba Kolo, Environmental Regulation, Investment Protection and 'Regulatory Taking' in International Law, 50 Int'l & Comp. L. Q. 811 (2001).

[110] Waelde and Kolo conclude, "[I]t is unlikely that courts or arbitrators will find a compensable expropriation in cases where governments issue environmental regulation for legitimate purposes in accordance with the state of scientific knowledge and accepted international guidelines." Id. at 846. The authors remain optimistic that regulatory taking would be found "only when the environment becomes a pretext for domestic protectionism and when elements of discrimination or breach of governmental

To some extent the United States may have become a victim of its own success. In the past, Americans sometimes persuaded arbitrators to adopt broad standards providing "protection and security" that might override otherwise legitimate domestic laws.[111] Regulations which in a domestic context constituted normal protection of the public interest appeared in a cross-border transaction as violations of international law. Thus Americans were, in Shakespeare's words, "hoist with their own petard,"[112] having contributed to the creation of pro-investor substantive standards applied by international tribunals, and to a blurring of distinctions between state-private proceedings ("mixed arbitration") and commercial arbitration exclusively among private parties.[113]

D. Limiting the Scope of Investment Arbitration

1. Compromises to Reconcile Competing Goals

NAFTA's drafters recognized that they were combining a trade agreement with an investment treaty, and that arbitration of investment disputes might have a disruptive effect on other NAFTA commitments including trade in goods and procurement.

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commitments or [when regulation has been used] to extract benefits unrelated to the legitimate purpose of the regulation...." Id.

[111] See, e.g., American Mfg. & Trading (AMT). v. Zaire, 36 I.L.M. 1531 (1997), arising under the US-Zaire 1984 Bilateral Investment Treaty and involving damage to property of an American subsidiary by the Zaire army. Referring to the host state's "obligation of vigilance" to "ensure the full enjoyment of protection and security of [the US company's] investment," the arbitral tribunal stated that Zaire "should not be permitted to invoke its own legislation to detract from any such obligation." Id. at 1548. The case is cited in Methanex Amended Claim (12 February 2001) at 65.

[112] See Hamlet, Act III, Scene 4 ("for 'tis sport to have the engineer hoist with his own petard"), in which the Prince of Denmark makes plans to catch the conspirators in his father's murder.

[113] For a comparison of stricter and more flexible approaches to long-term cross-border contracts, see Nagla Nassar, Security of Contracts Revisited (1995).

Moreover, there was recognition that investment arbitration posed special problems with respect to vital national prerogatives in tax and financial services.

Multiple compromises were made to reconcile NAFTA's competing goals. For example, inconsistencies between Chapter 11 and other NAFTA chapters are resolved in favor of the latter,[114] and investment is limited by a definition *numerus clausus* indicating what "investment means" rather than what "investment includes."[115] Excluded from the definition of investment are loans to state enterprises and money claims arising solely from contracts for the sale of goods or services or the extension of commercial credit.[116] The creation of intellectual property rights will generally not give rise to rights to claim compensation for expropriation,[117] and non-discriminatory measures of general application will not be considered tantamount to expropriation of a loan or debt security merely because they impose an increased cost that causes debtor default.[118]

Of particular interest are the limitations on investment arbitration that implicate tax and finance, two areas of particular sensitivity to economic sovereignty. As discussed below, member states have the right in certain circumstances to block or to modify Chapter 11 arbitration in both of these domains.

2. Expropriation Through Fiscal Measures

a) Distinguishing Abusive Taxation

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[114] Article 1112.

[115] Article 1138.

[116] Article 11389.

[117] Article 1110 does not apply to the creation or limitation of intellectual property rights to the extent consistent with Chapter XVII, which addresses intellectual property explicitly.

[118] Article 1110(8).

Few areas illustrate the complex interaction of arbitration and sovereignty concerns more sharply than taxation. The power to raise revenue by forced levies is an attribute of sovereignty that is less negotiable than others.[119] Yet uncompensated nationalization often takes the form of excessive fiscal measures, designed either to force the foreign owner to abandon the investment by taxing away its economic value, or to subject an investor's competitors to a more favorable tax regime. While escaping precise definition, such subtler forms of expropriation can deprive an investor of wealth arbitrarily as effectively as explicit nationalization.

Evaluating such "creeping expropriation" does not lend itself to facile analysis. Distinctions must be made between normal and excessive taxation, a task that implicates culturally influenced notions of the "right" level of tax.[120] From one perspective taxation constitutes a form of asset seizure (echoed in the American catch phrase "the power to tax is the power to destroy"[121]) in which fiscal authorities take money from its current owner (the taxpayer) and give it to someone else (the state).

The competing characterizations of tax may be distinctions without a difference, however. Fiscal measures inevitably involve an element of expropriation. The only

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[119] One remembers that it was a tax revolt that forced King John of England to sign the Magna Charta in 1215. And few scholars challenge Lord Mansfield's "Revenue Rule" preventing enforcement of foreign tax judgments. See Holman v. Johnson, 98 Engl. Rep. 1120 (K.B. 1775). For later articulations of this principle, see HM Queen v. Gilbertson, 597 F.2d 1161 (9th Cir. 1979); United States v. Boots, 80 F.3d 580 (1st Cir. 1996).

[120] Justice Holmes distinguished between a penalty intended as a "discouragement" to behavior and a tax that "may be part of an encouragement [to actions] when seen in its organic connection with the whole." Compañía General de Tabaco de Filipinas v. Collector of Internal Revenue, 275 U.S. 87 (1927), at 100.

[121] The original US Supreme Court citation was: "An unlimited power to tax involves, necessarily, a power to destroy; because there is a limit beyond which no institution and no property can bear taxation." McCulloch v. Maryland, 17 U.S. (4 Wheat.) 316, 327 (1819), striking down a state tax on a federally chartered bank.

question is whether they are "normal" taxes or are the type of punitive measure intended to confiscate foreign investment.

The problematic nature of using arbitration to settle claims that taxation constitutes "creeping expropriation" was foreseen when NAFTA was drafted. The Chapter 11 dispute resolution process would be misused and corrupted if "ordinary" fiscal measures gave rise to expropriation claims. Consequently, the fiscal administrations of host and investor countries have been given the task of making a preliminary cut between normal and abnormal taxes.

If an alleged expropriation is accomplished through "taxation measures," the competent fiscal authorities of the relevant states may veto the investor's right to arbitrate.[122] At the time of advising the host state of its intention to commence arbitration, the investor must also submit the tax measure to the appropriate fiscal authorities. The investor may proceed to arbitration only if the competent authorities "do not agree to consider the issue or, having agreed to consider it, fail to agree that the measure is not an expropriation."[123]

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[122] NAFTA Article 2103(6) states that Article 1110 provisions concerning expropriation "shall apply to taxation measures except that no investor may invoke that Article as the basis for a claim [for investment dispute resolution], where it has been determined pursuant to this paragraph that the measure is not an expropriation." Thus far, at least one case (the Karpa claim against Mexico) implicated tax measures. The competent authorities agreed that one of the three measures was not an expropriation, and thus the arbitration did not go forward on that question. As to two other measures, however, there was no agreement, and thus for those issues the arbitration proceeded.

[123] It is uncertain whether an investor's disregard of reference to the competent authorities (either in bad faith or due to an innocent misunderstanding) would provide an opportunity for sua sponte intervention by tax authorities. Whether or not permitted, state intervention would not seem mandated. Rather, without an opinion from the relevant fiscal authorities, an expropriation claim would lie beyond the arbitrators' jurisdiction.

This awkwardly drafted "negative deadlock" provision gives the competent authorities six months to decide the question, failing which the investor may proceed to arbitration.[124] In attempting to distinguish normal from excessive taxation, fiscal authorities inevitably can be expected to rely on culturally influenced notions of tax.[125]

NAFTA does not suggest that tax matters cannot be arbitrated. Rather, the treaty says that fiscal authorities in host *and* investor states together may block the arbitral proceedings by agreeing "that the [tax] measure is not an expropriation."[126] Thus if the United States is accused of expropriating a Canadian investor's property, investment arbitration would be barred only if both the US Department of the Treasury and the Canadian Department of Finance concluded that no expropriation had taken place.[127]

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[124] The English language version contains a slight ambiguity, providing for arbitration to go forward "[i]f the competent authorities do not agree to consider the issue or, having agreed to consider it, fail to agree that the measure is not an expropriation within a period of six months of such referral [by the investor]." To interpret the six month limit as applying only to competent authorities who agreed to hear the matter (as contrasted to ignoring or refusing to consider the investor's request), would make little sense in this context.

[125] For example, Americans can be expected to look to the U.S. tax system, based on the same approach used to characterize "income tax" for purposes of the foreign tax credit. See, e.g., Treas. Reg. § 901-2(a); Bank of America Nat'l Trust & Savings Ass'n v. United States, 459 F.2d 513, 515 (Ct. Cl. 1972) ("It is now settled that the question of whether a foreign tax is an 'income tax' ... must be decided under criteria established by our revenue laws and court decisions, and that the foreign tax must be the substantial equivalent of an income tax as the term is understood in the United States").

[126] The text of NAFTA, Article 2103(6) does not make clear whether a "tax veto" requires unanimity of all three competent authorities, or only from the tax administrations of the investor and host state. In practice only the latter two administrations would be directly concerned, although the third country might argue for inclusion on the theory that such decisions have policy implications affecting all NAFTA members.

[127] See NAFTA Annex 2103(6). The competent authority for the United States would be the Assistant Secretary of the Treasury (Tax Policy), for Canada it would be the Assistant Deputy Minister for Tax Policy, and for Mexico it would be the Deputy Minister of Revenue of the Secretaría de Hacienda y Crédito Público (Ministry of Finance and Public Credit).

Presumably the Canadian authorities would hesitate to acquiesce in the plundering of its citizens merely because such theft was dressed in fiscal garb. Thus the capital exporter's government is given a protective role, in that refusal to join the veto authorizes arbitration.

The tax veto by its terms applies only to claims of improper expropriation under NAFTA Article 1110. By contrast, claims for breaches of other host state duties, such as "fair and equitable treatment", might possibly escape the jurisdiction of the respective national fiscal authorities.

b) Impact of NAFTA Concerns on Tax Treaty Arbitration

Before moving on, it is worth noting that the perception of arbitration as an abdication of sovereignty will likely affect attempts to eliminate another barrier to cross-border investment arbitration: asymmetrical transfer pricing adjustments by national tax authorities. When two countries disagree on how to interpret an income tax treaty, the task of resolving the difference falls either to national court actions or to joint efforts by the tax administrations to work out differences on a voluntary basis. Neither alternative is satisfactory. Judicial proceedings lack political neutrality and yield inconsistent results. And the process for "mutual agreement" among competent fiscal authorities is fraught with delays and uncertainty.

The problem is particularly acute when the tax treatment of a company in one country (in the form of deductions, for example) does not accord with that of an affiliate in the other (where items of income might be included). The lack of fiscal symmetry creates an economic double taxation that distorts cross-border capital flows.

In response, scholars and non-governmental organizations have suggested arbitration as a means to address income tax treaty disputes.[128] To date, however, income tax treaty arbitration remains more aspiration than reality.[129] While some treaties include language raising the prospect of arbitration, these provisions operate only if the two countries agree after a controversy arises. Such provisions have never been implemented, due to the contracting states' inability to reach accord when a dispute actually occurs. Only the new Austro-German treaty imposes a duty to arbitrate treaty differences without further negotiation.

To remedy this, the International Chamber of Commerce[130] and the Organization for Economic Cooperation and Development have issued policy papers suggesting arbitration to resolve inconsistency tax treaty application. [131] The International Fiscal

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[128] See, e.g., William W. Park, *Income Tax Treaty Arbitration*, 31 TAX MANAGEMENT INT'L J. 219 (May 2002); GUSTAF LINDENCRONA & NILS MATTSON, ARBITRATION IN TAXATION (1981); Jean-Marie Henckaerts, *EC Arbitration Convention for Transfer Pricing Disputes*, 10 J INT' ARB. 111 (Sept 1993); Paul R. McDaniel, *NAFTA and Formulary Apportionment,* in Alpert and van Raad *supra,* at 293 (cited in this note); William W. Park, *Finality and Fairness in Tax Arbitration*, 11 J INT'L ARB. 19 (June 1994).

[129] One practitioner has remarked a bit whimsically that ever since 1981, tax arbitration is "an idea whose time is about to come." David R. Tillinghast, *Choice of Issues to be Submitted to Arbitration Under Income Tax Conventions*, in ESSAYS ON INTERNATIONAL TAXATION 349 (H. Alpert and K. van Raad, eds, 1993).

[130] ICC Commission on Taxation, Arbitration in International Tax Matters, Doc. No. 180/438 (3 May 2000) (www.iccwbo.org/home/statements_rules/statements/2000/arbitration_tax.asp); ICC Commerce Commission on Taxation, Arbitration in International Tax Matters, Draft Bilateral Convention Article, Doc. No. 180/455 Rev. (10 September 2001).

[131] In 1995 the Organization for Economic Cooperation and Development (OECD) issued a confidential study on the topic, whose conclusions are being reconsidered as this paper is drafted. Although its contents have not been made public, the paper has been the object of considerable informal discussion among international tax lawyers. See OECD, Committee on Fiscal Affairs, The Role of Arbitration Procedures in Resolving Tax Disputes (11 January 1995), DAFFE/CFA (95) 12.

Association (IFA) has sponsored a study on the topic.[132] Discussion of the topic has been organized by both the Tax Council Policy Institute[133] and the American Society of International Law.[134]

Objections to these sensible suggestions include the alleged infringement of sovereignty constituted by arbitration, with much of the argument echoing a less sophisticated version of the complaints voiced about NAFTA Chapter 11. However, as Rudyard Kipling might write, this is another story for another day.

3. Financial Services

NAFTA provisions on financial services generally trump inconsistent stipulations in Chapter 11. [135] Under Chapter 14, the host state can invoke prudential concerns related to protection of depositors, financial markets and the maintenance of safe and sound financial institutions.[136] On request of a member state, arbitrators must refer the matter to the NAFTA Financial Services Committee ("Committee") for a decision on whether the

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[132] See also International Fiscal Association, Resolution of Tax Treaty Conflicts by Arbitration, 18e IFA Congress Seminar Series (Kluwer 1993).

[133] Proceedings of Conference held 8 February 2002, forthcoming in George Mason Law Review, Volume 10, No. 4.

[134] American Society of International Law, 97th Annual Meeting, 3 April 2003, Washington, D.C., *Arbitration of Disputes Under Income Tax Treaties* (H.J. Ault, D.R. Tillinghast & W.W. Park).

[135] Article 1101(3) provides that Chapter 11 "does not apply to measures adopted or maintained by a [NAFTA country] to the extent that they are covered by Chapter Fourteen (Financial Services)." Under Article 1401, the "minimum standard of treatment" provisions (Article 1105) do not apply to investment in financial services.

[136] Pursuant to Article 1410, none of the investment protections prevent a NAFTA Party from adopting reasonable measures for prudential reasons such as "protection of investors, depositors … financial market participants, … the maintenance of the safety [and] soundness … of financial institutions, and ensuring the integrity and stability of a [country's] financial system," nor from taking non-discriminatory measure of general application in pursuit of monetary and credit or exchange rate policies.

prudential concerns are valid defenses to an investor's claim, which decision is binding on the tribunal.[137]

If the Committee makes no decision within sixty days, the host state or the investor's country may request establishment of an arbitral panel convened under NAFTA's institutional (state-to-state) dispute resolution provisions.[138] The panel's report, like the Committee's decision, binds the arbitrators. If no request for such dispute resolution has been made within ten days of the expiration of the sixty days for panel action, the arbitral tribunal may proceed to adjudicate the claim.

IV. Old Problems, New Perspectives

A. International Commercial Decision-making

Most of the current questions about investment arbitration did not originate with NAFTA. Rather, the perceived novelty of the rhetoric derives from a change in the angle from which arbitration is observed. Misgivings are new only in that Canada and the United States now articulate variations on themes long advanced by Latin American and African countries forced to arbitrate disputes over natural resources, the environment and other vital elements of national life. Changing hats from a capital exporter's fedora to a

[137] See NAFTA Article 1415(2). The term "Committee" is defined in annex 2001.2(A). The term "Tribunal" carries over the Chapter 11 taxonomy for the body of arbitrators deciding a particular dispute.

[138]See NAFTA Article 1415(3) and 2008 et seq. Such an arbitral panel is to be constituted in accordance with Article 1414 (see Article 1415(3)) , chosen from a special financial services roster to render a decision

host state's sombrero, the United States has come to a new appreciation of the predicaments experienced by capital importers.[139]

The debate is essentially about control of the dispute resolution process: not just *what* standards apply to matters such as expropriation, but *who* (courts or arbitrators) decides questions with a direct effect on the economic interests of both the investor and the host state. The substantive norms governing expropriation and treatment of aliens remain basically unchanged, in that international law has long held states liable for injury to aliens. The unique aspect of NAFTA lies in its creation of a private right of action by which foreign investors bypass the political hurdles to obtaining the diplomatic protection of their home country.

To some observers, NAFTA arbitral tribunals appear as courts of appeal on vital regulatory matters that discriminate against foreign investment or constitute illegal taking of an alien-owned property. In fact, however, Chapter 11 tribunals have no such power, but may review only government measures that violate the NAFTA treaty obligations.[140]

Consequently, disquiet arises over the prospect that arbitrators may decide differently than would national judges. In some instances this means that foreign claimants will receive better treatment than domestic courts give similarly situated local

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[139] See M. SORNARAJAH, THE SETTLEMENT OF FOREIGN INVESTMENT DISPUTES (2000); WOLFGANG PETER, ARBITRATION AND RENEGOTIATION OF INTERNATIONAL INVESTMENT AGREEMENTS (2d ed. 1995).

[140] In a Chapter 11 arbitration brought by American investors against Mexico, the arbitral tribunal noted, "The possibility of holding a State internationally liable for judicial decisions does not, however, entitle a claimant to seek international review of the national court decisions as though the international jurisdiction seised has plenary jurisdiction. This is not true generally, and it is not true for NAFTA. What must be shown is that the court decision itself constitutes a violation of the treaty…..Claimants must show either a denial of justice, or a pretence of form to achieve an internationally

claimants. Such differences should not be surprising. Business managers have traditionally favored arbitration in overseas transactions precisely because an arbitrator may see things more dispassionately than a host state judge. Moreover, investors from industrialized countries have long insisted on fair dealing for themselves, regardless of how poorly a host state might treat its own people.

Anti-NAFTA concerns rest in part on what has traditionally been considered a strong point of international arbitration: the general predisposition of those chosen to arbitrate international disputes. Experienced commercial arbitrators generally will see their mandate as giving effect to the parties' shared *ex ante* expectations, finding the facts and applying the law in the most dispassionate and correct fashion possible. Quite understandably, arbitrators do not normally see themselves as guardians of the public interest.[141] In the context of NAFTA Chapter 11, these arbitral virtues may at some point be affected by the more public dimensions of the controverted investments.

Ironically, NAFTA Chapter 11 gives ingenious lawyers the opportunity to present on an international level the type of "due process" and "equal protection" arguments

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unlawful end." Azinian v. United Mexican States (ICSID Case No. ARB(AF)/97/2) Award on Merits of 1 November 1999, paragraph 99, page 29.

[141] This does not mean, however, that an arbitrator can ignore mandatory public norms (lois de police) imposed by the place of contract performance. See Pierre Mayer, *Mandatory Rules of Law in International Arbitration*, 2 Arb. Int'l 274 (1986); Pierre Mayer, *Les Lois de Police Etrangères*, 1981 J. Dr. Int'l 277; Pierre Mayer, *Reflections on the International Arbitrator's Duty to Apply the Law*, 17 Arb. Int'l 235 (2001) (noting that "the relationship linking an arbitrator to the law is much more complex than the relationship that ties judges to it"). See generally Abul F.M. Maniruzzaman, *International Arbitrator and Mandatory Public Law Rules in the Context of State Contracts: An Overview*, 7 J. Int'l Arb. 53 (September 1999); Abul F.M. Maniruzzaman, *Internationalization of Foreign Investment Agreements*, 1 J. World Investment 293 (December 2000); Abul F.M. Maniruzzaman, *The Lex Mercatoria and International Contracts: A Challenge for International Commercial Arbitration*?, 14 Am. U. Int'l L. Rev. 659 (1999).

which in some ways are analogous to the principles invoked in the south of the United States during the civil rights era. Forty years ago, however, federal courts were invoking such principles to set aside rules that worked against African Americans. Now it is the Canadians who charge discrimination by state courts, and in an ironic role reversal the federal government has become the champion of states' rights.

Concerns expressed by opponents of NAFTA also overlap many misgivings raised in the so-called "globalization" debate, which has attracted so much attention by protests at international trade meetings from Seattle to Genoa. Not all observers today accept Riccardo's theory of comparative advantage, or share the assumption that cross-border trade and investment (the circulatory system of globalization) bring the world a net benefit. In particular such criticism is likely to be made by groups that in former times might have endorsed either socialism or the "New International Economic Order."[142] Such opposition was partly responsible for collapse of the OECD-sponsored Multilateral Agreement on Investment.[143]

Members of the U.S. Congress commend trading partners who accept international arbitration as a potential tool to address foreign trade violations.[144] Yet when the U.S. is on the receiving end of a request for arbitration, protests are heard about

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[142] See discussion of Charter of Economic Rights and Duties of States, in Park, *Legal Issues in the Third World's Economic Development*, *supra*.

[143] See Edward Graham, National Treatment of Foreign Investment: Exceptions and Conditions, 31 Cornell Int'l L. J. 599 (1998). In France, opposition to globalization under the slogan "L'AMI c'est l'ennemi" ("MAI is the enemy") built on the double entendre of AMI (the French acronym for MAI as well as the word for friend).

[144] See 134 Cong. Rec. 26930-32. Senator Jesse Helms (arch-opponent of restrictions on American power) urged the United States to withhold economic aid from Costa Rica until it agreed to arbitrate an expropriation dispute with an American citizen named J. Royal Parker. See also, 146 Cong. Rec. H3031, concerning Turkey's agreement to arbitrate investment disputes with foreigners.

"American laws being overridden" by NAFTA tribunals.[145] American legislators warn against "sacrificing state and local laws at the altar of ill-defined international investor rights"[146] and suggest that under NAFTA "the rights of an investor come before the rights to enact a chemical ban to prevent cancer."[147]

B. Playing by the Same Rules

Opposition to NAFTA by special interest groups within the United States has resulted in a retreat from the traditional level of American governmental support for binding arbitration as a means to protect foreign investment. This policy shift is highly problematic, and ultimately will cause significant harm to American interests abroad.

Arguments that a federal government is not responsible for acts of state authorities toward foreigners (as in the context of *Methanex*, *Loewen* and *Mondev*) are not convincing. The United States has long presumed that foreign governments must repair damage caused by political subdivisions.[148] Indeed, the complaints by the American investor in *Metalclad* arose from actions by a Mexican municipality, and in

[145] See 145 Cong. Rec. at H-7368. Statement by Rep. Shows (Mississippi) concerning amendment of HR 2670.

[146] Id., Statement by Rep. Tierney (Massachusetts).

[147] Id., Statement of Rep. Bonior (Michigan). In the same debate Rep. Ros-Lehtinen (Florida) asked rhetorically, "Are my colleagues to allow families' health and that of our children, our friends and neighbors to be threatened because of foreign bureaucrats?" Id. at H-7370.

[148] See Ian Brownlie, Principles of Public International Law (5th Edition) at 451, n. 107, giving examples of arbitrations in which federal states have been held responsible for acts of their constituent units, including the Youmans Claim (1926, RIAA IV at 110, the Mallen Claim (1927, RIAA IV at 173) and the Pellat Claim (1929, RIAA V at 534).

Calmark from actions before a Mexican state court.[149]] . Within the United States itself, notions of federal responsibility for local misdeeds have a long history.[150]

With delicate irony, a foreign claimant in at least one NAFTA case against the United States has noted the inconsistency between current American attitudes toward investment protection and longstanding efforts by the United States to promote "full protection and security" for the foreign assets of its nationals. In *Loewen*, the United States advocated narrower interpretations of the concept of governmental "measure" and more restrictive rules concerning "denial of justice" and exhaustion of local remedies rules. The Canadian investor's Reply Memorial pointed out that as far back as 1818 the United States, in a pronouncement of Secretary of State (later President) John Quincy Adams had declare that "no principle of the law of nations [is] more firmly established than that which entitles the property of strangers within the jurisdiction of a country in friendship with our own to the protection of its sovereign by all the efforts in his power."[151]

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[149] See discussion *supra*.

[150] In support of the so-called alienage jurisdiction of federal courts (covering disputes between aliens and American citizens), Alexander Hamilton argued that the "peace of the whole ought not to be left at the disposal of a part." Hamilton asserted, "The Union will undoubtedly be answerable to foreign powers for the conduct of its members." See Alexander Hamilton, James Madison & John Jay, The Federalist Papers (No. 18, at 476, C. Rossiter ed. 1961), quoted in Gary Born, International Civil Litigation in United States Courts (Third Ed. 1996) at 11.

[151] Letter to Mr. de Onis, Spanish Minister (1818), reprinted in John Basset Moore, 4 DIGEST OF INTERNATIONAL LAW, Section 535. See generally Loewen Group & Raymond L. Loewen v. Unitd States of America, Joint Reply of Claimant, 8 June 2001, at paragraphs 305-08 (available at www.naftaclaims.com) noting numerous pronouncements by the United States in the context of claims against Brazil, Mexico, Colombia, Iran and Zair emphasizing the affirmative obligation of the host state to ensure "full protection and security" to the property of American nationals.

Cynics might say that one should not be surprised at double standards. Selective application of procedural standards, however, can have profoundly disconcerting consequences for wealth creation and economic cooperation. American legal principles tend to be exported. Thus the United States should take special pains to project the qualities of fair play and evenhandedness that promote undistorted participation in the global marketplace. In today's heterogeneous world, cross-border investment will be chilled without a willingness of all countries to accept arbitration. Sauce for the goose ought to be sauce for the gander as well.[152] Promotion of procedural inequality can only backfire to injure the long-term commercial interests of investor states.

As a practical matter, the nature of anti-NAFTA rhetoric often captures popular sentiment more easily than the sound arguments against distortion of cross-border capital flows. The lobby that invokes "pure air and water" and "sovereignty" has a message with a more urgent ring than the theme of international economic cooperation, notwithstanding the unfortunate aggregate consequences that flow from measures that discourage transnational wealth creation.

C. The Free Trade Commission Notes of Interpretation

Initially the NAFTA countries had expected that the ebb and flow of arbitral wisdom would create a body of case law providing sound investment protection. However, NAFTA also included a safety valve that permitted member countries to interpret Chapter 11 through the Free Trade Commission.[153]

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[152] The French would say, one cannot have two sets of weights and measures: *On ne peux pas faire deux poids et deux mesures*.

[153] Article 1131(2) states, "An interpretation by the [Free Trade] Commission of a provision of this Agreement shall be binding on a Tribunal established under [Chapter 11 Section B]."

During the summer of 2001, however, the NAFTA Free Trade Commission issued *Notes of Interpretation* related to several matters currently *sub judice* in Chapter 11 cases. Under the *Notes of Interpretation*, the requirements of NAFTA Article 1105 were restated to indicate that a breach of another NAFTA provision or a separate international agreement will not in itself establish that "fair and equitable treatment" has been denied.[154] Moreover, the *Notes of Interpretation* limit the meaning of international law to "customary" minimum standards, [155] thus preventing recourse to other sources of international law that might either impose or relax restrictions on host State treatment of foreign investors.[156]

To some, these *Notes of Interpretation* constitute *de facto* modification of NAFTA that departs from the original meaning of Chapter 11, and thus require approval pursuant to Article 2202 in accordance with "applicable legal procedures of each Party."

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[154] See NAFTA Free Trade Commission, Notes of Interpretation of Certain Chapter 11 Provisions, 31 July 2001, Part B, reprinted in 13 World Trade & Arbitration Materials 139 (December 2001). In addition, the Notes of Interpretation address the criticism that Chapter 11 arbitration is not "transparent." Under the heading "Access to Documents" the Notes provide that "Nothing in the NAFTA imposes a general duty of confidentiality on the disputing parties to a Chapter Eleven arbitration." In this context, it is worth noting that for decades before NAFTA, expropriation claims against developing countries had been arbitrated in confidential proceedings under ICSID, UNCITRAL and ICC Rules without complaint from the industrialized investor nations.

[155] The Free Trade Commission stated inter alia that Article 1105 "prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to investments of investors of another Party" and that neither "fair and equitable treatment" nor "full protection and security" require "treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens."

[156] For example, a Multilateral Agreement on Investment (reached in the future within the OECD or the WTO) might refine concepts such as "regulatory taking" in a way different from customary international law. Or a WTO standards agreement might also become an issue. However, while such a standards agreement might constitute international law, it is unlikely that it would relate to investor protection in the context of NAFTA.

One award has suggested that *Notes of Interpretation* which fail to respect the text of NAFTA would not be binding on arbitrators deciding Chapter 11 disputes.[157]

To date no satisfactory way has been found to resolve the potential conflict between the requirements for amendment under Article 2202 and the provisions of Article 1131 that permit Free Trade Commission interpretations. If the requirement of proper approval for amendments is to make any sense, some limits must exist on the power of the Commission to change the meaning of the established text.

The conflict does not yield to easy analysis.[158] On the one hand, arbitrator disregard of Commission interpretations could result in different results by different tribunals, thus reducing the consistency and efficiency of investment arbitration. On the other hand, the Commission's *de facto* amendment of NAFTA would imperil the stability and predictability of the investor protection regime so laboriously negotiated in 1994.

Conclusion

Until recently, the world of investment arbitration knew fairly clear lines between host and investor states. Nations such as Libya and Mexico were the respondent host states; while the United States and Canada were the countries of the investor claimants. Today, however, the United States and Canada under NAFTA have tasted the flavor of

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[157] See Final Award in Pope & Talbot, 31 May 2001 (ordering Canada to pay $461,556 plus interest in damages). At footnote 37 (paragraph 47) the Award states, "[W]ere the Tribunal required to make a determination whether the [NAFTA Free Trade] Commission's action is an interpretation or an amendment, it would choose the latter." The Tribunal continued, however, that such a determination was "not required" and thus its analysis "proceeded on the basis that the Commission's action was an 'interpretation.'" Tribunal composed of Lord Dervaird, Presiding Arbitrator, Hon. Benjamin J. Greenberg and Mr. Murray J. Belman.

[158] Presumably attempts to address potential conflicts would require recourse to the Vienna Convention on the Law of Treaties, 23 May 1969, art. 31, U.N. Doc. A/Conf. 39/27, entered into force 27 Jan. 1980, 63 AJIL 875 (1969), 81 I.L.M. 679 (1969).

being respondent host states in investment arbitrations, with the concomitant negative side-effects for economic self-governance.

Traditionally the United States promoted arbitration on behalf of American investors abroad. However, NAFTA Chapter 11 has now made the country the object of attack in unwanted arbitrations brought by Canada. One consequence has been that media, environmentalists, politicians and consumer advocates have called into question whether investment arbitration is compatible with sovereignty. More significantly, discontent with the NAFTA has led to provisions in the Trade Act of 2002 aimed at restricting the type of arbitration provisions normally included in investment treaties.

As with any dispute resolution system, some elements of NAFTA investment arbitration may be open to improvement. Clarification and adjustment may be in order.

However, it would be fundamentally unsound to call into question the use of neutral binding arbitration itself as the preferred means for resolving cross-border investment disputes. Overly general critiques of investment arbitration risk doing more harm than good, in the end backfiring to injure both the long and short term national interests. Assertions of "sovereignty" may end up being slippery and unhelpful abstractions,[159] serving simply as a justification for the exercise of unfettered government power.[160]

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[159] Taken from the Latin *super* meaning "above," sovereignty reflects a power said to be above others, a formulation used in various languages: *au dessus des autres, die höchste Staatsgewalt* or *por encima de los demás*. Historians sometimes talk of "Westphalian" sovereignty, derived from the 1648 Treaty of Westphalia ending the Thirty Years' War in a way that granted substantial autonomy to local princes. Other uses of sovereignty include reference to autonomy of political subdivision on certain matters and recognition of one state by another. See generally W. Michael Reisman, *Sovereignty and Human Rights in Contemporary International Law*, in DEMOCRATIC GOVERNANCE AND INTERNATIONAL LAW 239 (G. Fox and B. Roth eds., 2000) (exploring sovereignty of

On occasion, the enhancement of national welfare through treaties facilitating economic cooperation will mean that domestic law must yield to international obligation. And at times arbitrators interpreting treaty provisions may render decisions with which national officials or special interest groups may disagree. Indeed, it would be quite startling if such were not the case, since treaties and arbitration by their nature supplement national legislative and adjudicatory jurisdiction. However, an occasional "wrong" decision is a small price for promoting aggregate gain to the public good through the type of broad cross-border investment fostered by arbitration, particularly during much of the last half century under the New York and Washington Conventions.[161]

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populations in contrast to that of rulers); Stephen D. Krasner, *Globalization and Sovereignty*, in STATES AND SOVEREIGNTY IN THE GLOBAL ECONOMY (D. Smith, D. Solinger, & S. Topik eds.,1999).

[160] One scholar has referred to sovereignty as "the unique character of governments." See W. Michael Reisman, *International Arbitration and Sovereignty*, 18 ARB. INT. 231, at 237 (2002), adapted from 12th Annual Workshop of Institute for Transnational Arbitration, 21 June 2001, Dallas, Texas. Professor Reisman writes, "[A]s students of international law learn early in their pupillage, the fundamental problems of law and society are usually insoluble and the most and the best one can expect are short-term experiments in solutions and accommodations, whose durability depends on many unpredictably variable factors. The unique character of governments is one of those predictably unpredictable variables."

[161] See generally, Jagdish Bhagwati & T.N. Srinivasan, *Trade and Poverty in the Poor Countries*, 92 AM. ECONOMIC REV. 183 (2002); Patricia Auger & Michael Gasiorek, Welfare Implications of Trade Liberalization between the Southern Mediterranean and the EU, University of Sussex at Brighton, Discussion Paper No. 80, at 22 (2001) (www.sussex.ac.uk/Units/economics/dp/dp.htm); Jagdish Bhagwati, Economic Freedom: Prosperity and Social Progress, 1999, delivered to the Conference on Economic Freedom and Development in Tokyo, at. 6-7 (www.columbia.edu/~jb38/papers.htm); Nicholas Stern, Globalization and Poverty, The World Bank (delivered to Institute of Economic and Social Research, Faculty of Economics, University of Indonesia) at 9-10 (2000) (http://www1.worldbank.org/economicpolicy/globalization/documents/Globalization-Indonesia%20Speech.pdf.); CAMPBELL R. MCCONNELL AND STANLEY L. BRUE, ECONOMICS: PRINCIPLES, PROBLEMS AND POLICIES (13th ed, 1996) at743; Paul A. Samuelson, *The Gains from International Trade Once Again*, 72 ECONOMIC JOURNAL

If investment arbitration is to fulfill its promise, however, some mechanism must be found to promote greater sensitivity to vital host state interest. Otherwise investor-government arbitration may fall prey to public pressure arising from a backlash against investor victories in some of the more visible NAFTA arbitrations.[162] In the larger picture, the ebb and flow of arbitration's wisdom may have to accommodate political reality.

As in other areas where law and policy interact, the devil is in the detail. It is less than self-evident what exactly should be done to reduce the prospect of harsh legislative

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(1962) reprinted in JAGDISH BHAGWATI, INTERNATIONAL TRADE 181-82 (1969); JAGDISH BHAGWATI AND T.N. SRINIVASAN, LECTURES ON INTERNATIONAL TRADE 160 (1983); MAX J. WASSERMAN, CHARLES W. HULTMAN & RAY M. WARE, MODERN INTERNATIONAL ECONOMICS 382 (1971); Konrad von Moltke, *An International Investment Regime? Issues of Sustainability* (IISD 2000) (reviewing the debate over the centrality of investment to the development process); Press Release, 9 October 1996, WTO Report: Trade and Foreign Direct Investment, by Richard Blackhurst, Director of Economic Research and Analysis Division, and Adrian Otten, Director of Intellectual Property and Investment Division. www.wto.org/english/news_e/pres96_e/pr057_e.htm, (examining the interaction of trade and foreign direct investment); Robert E. Lipsey, *Interpreting Developed Countries' Foreign Direct Investment*, working paper 7810, National Bureau of Economic Research, July 2000 (contesting the view that foreign direct investment is a major influence on capital formation, and suggesting that the primary role of foreign direct investment is to transfer assets and production from less efficient to more efficient owners and managers); Kala Krishna, Ataman Ozyildirim and Norman R. Swanson, *Trade, Investment and Growth: Nexus, Analysis, and Prognosis*, working paper 6861, National Bureau of Economic Research, December 1998 (examining patterns of causation between income, export, import, and investment growth for developing countries); Robert E. Lipsey, *The Role of Foreign Direct Investment in International Capital Flows*, working paper 7094, National Bureau of Economic Research, April 1999 (examining volatility and dependability of direct investment flows).

[162] See Michael Goldhaber, *Czech Mate*, in AMERICAN LAWYER 82 (MARCH 2002). While generally positive about investment arbitration (indicating how an American investor was able to vindicate an expropriation claim against the Czech Republic), the article quotes David Rivkin of the New York firm Debevoise & Plimpton as warning of a hostile reaction should the Canadian investor win in the *Loewen* arbitration, discussed *supra*.

responses to NAFTA arbitration.[163] Caution must remain a significant part of the process for bringing order to the resolution of investment disputes.

Governmental *Notes of Interpretation* of the type issued in the summer of 2001 by the three NAFTA member countries, may end up helping to promote reconciliation of the arbitral process and public interest. However, for the Free Trade Commission to engage in *de facto* amendment of NAFTA would imperil the stability of investor protection, and in some instances might provoke arbitrator disregard of Commission interpretations.[164] In all events, solutions that rely on government screening of an arbitration's substantive legal merits risk doing significant damage to the fabric of cross-border economic cooperation and wealth creation.[165]

[163] For one recent comment on the role of arbitration in cross-border investment, see Charles H. Brower, II, *Structure, Legitimacy and NAFTA's Investment Chapter*, *supra*, urging arbitration that would be subject to "review by a standing appellate tribunal, and supervised by an accountable, transparent, and publicly accessible Free Trade Commission…." *Id*. at 93-94.

[164] See footnote 37 of Final Award in Pope & Talbot (at para. 47) discussed *supra*. The process for amendment of NAFTA requires approval in accordance with "applicable legal procedures of each Party." See NAFTA Article 2202.

[165] See discussion *supra* of H.R. 3005 and H.R. 3009.

Appendix: Survey of NAFTA Cases

Cases against Canada

1. Crompton Corporation	6 November 2001.	$100,000,000	The investor filed an amendment to the Notice of Intent on 19 September 2002.	Articles 1102, 1105, 1106 and 1110.	Establishment of legal restrictions to the use of a chemical product for sowing.
2. Ethyl Corporation	14 April 1997	$251,000,000	In July 1998 the Parties settled the case. Canada paid Ethyl US$13 million. Canada withdrew the applicable prohibition to the international and provincial commerce of the MMT gasoline additive.	Articles 1102, 1106, 1110	A statute banning imports of the gasoline additive MMT.
3. Ketcham Investments Inc. & Tysa Investments Inc.	22 December 2000	$30,000,000	According to public information this arbitration was withdrew.	Articles. 1102, 1103, 1105, 1106 and 1110	Measures related with the establishment of export fees under the U.S.-Canada Softwood Lumber Agreement.

4. Pope & Talbot, Inc.	24 December 1998	$507,552,400	Interim award issued 26 June 2000. The Tribunal found no breach of NAFTA articles 1102, 1110 or 1106. Award on the merits issued 10 April 2001. The Tribunal found that Canada had breached NAFTA article 1105. Award on damages issued 21 April 2002. The Tribunal ordered Canada to pay USD$461,566. Award on costs issued 26 November 2002. The Tribunal ordered Canada to pay USD$120,200 plus interests.	Articles 1102, 1105, 1106, 1110.	Implementation of the U.S.-Canada Softwood Lumber Agreement violates NAFTA.
5. S.D. Myers	21 July 1998	$20,000,000	Interim award on the merits issued 13 November 2000. The Tribunal found that there was a breach of NAFTA articles 1102 and 1105. Interim award on damages issued 21 October 2002. The Tribunal ordered Canada to pay CND$6,050,000. Final Award on costs issued on 30 December 30. The Tribunal ordered Canada to pay CND$350,000 (costs) and CND$500,000 (legal fees). Canada is seeking to set aside the award.	Articles 1102, 1105, 1106, 1110.	Ban on the export of polychlorinated biphenyl (PCB) waste.
6. Signa, S.A.*	Not available	Not available	Not available.	Not available	Not available

7. Sun Belt Inc.	27 November 1998	$10,500,000,000	Submission to Arbitration file 12 October 1999. According to the available information this arbitration was abandoned.	Articles 1102, 1105, 1110, 1118	Suspension of a license on the export of water by British Columbia.
8. Trammel Crow Company	7 December 2001	$32,000,000	The Parties settled this matter.	Article 1105	Canada Post Corporation denied access to an open and transparent bidding process.
9. United Parcel Services	19 January 2000	$160,000,000	On 22 November 2002, the Tribunal issued an Award on Jurisdiction dismissing claims under NAFTA articles 1105, 1502 and 1503. The Tribunal also rejected Canada's jurisdictional challenge to the article 1102 claim and joined two other jurisdictional challenges to the merits.	Articles 1102, 1105, 1502 and 1503.	Anti-competitive practices by Canada Post in a non-monopolized market.

Cases against México

1. Adams *et al*	11 November 2000	$75,000,000	Submission to Arbitration filed on 16 February 2002.	Article 1102, 1105 and 1110.	Expropriation and discriminatory measures taken by the Government and the Supreme Court with respect to a property in Ensenada.
2. Calmark Comercial Development Inc.	11 January 2002	$400,000,000	Not available.	Articles 1105, 1109 and 1110.	Denial of justice by the courts in connection with a Joint Venture Agreement for a development in Cabo San Lucas.
3. Corn Products	Not available	Not available	Not available	Not available	Not available

4. Fireman's Fund	30 November 2000*[*]	$50,000,000	Submission to Arbitration filed 30 October 2001. Submission from Mexico on jurisdiction filed 21 October 2002.	Articles 1102, 1105, 1110 and 1405.	Government action allegedly favoring acquisition of peso denominated debentures owned by Mexican nationals over dollar denominated debentures owned by Fireman's Fund.
5. Frank	12 February 2002	$1,500,000	Submission to Arbitration filed 5 August 2002.	Articles 1102, 1105 and 1110.	Expropriation of beachfront property in Baja, California in August 1999.
6. GAMI Investments Inc.	1 October 2001	$55,016,808	Submission to Arbitration filed 9 April 2002.	Articles 1102, 1105 and 1110.	Discriminatory and arbitrary regulation of the sugar industry. Expropriation on 3 September 2001 of sugar mills.
7. Halchette Corporation	Not available	Not available	Not available.	Not available.	Not available.
8. International Thunderbird Gaming Corporation	2002	Not available	Not available.	Articles 1102, 1103, 1105 and 1110.	Gambling licensing. Closure of the investor's gaming facilities.
9. Karpa (Feldman)	April 1999	$50,000,000	Interim award issued 6 December 2000 (jurisdiction). Award on the merits issued 16 December 2002, finding Mexico in breach of NAFTA article 1102 and ordering payment of Mx$9,464,672.50 plus interest (Mx$7,496,428.47).	Articles 1102,1105 and 1110	Taxation measures.

[*] Amended Notice of Intent.

10. Metalclad Corporation	October 1996	$90,000,000	Award on the merits issued 2 September 2000 finding Mexico in breach of NAFTA articles 1105 and 1110 and ordering payment of US$16,000,000. Award partially confirmed by court in Vancouver (2 May 2001). Supplemental reason for decision (31 October 2000).	Articles 1105 and 1110.	State action denying a permit to open and operate a hazardous waste facility in La Pedrera, San Luis Potosi.
11. Promotora Internacional Santa Fe	Not available	Not available	Not available	Not available	Denial of construction permits for a development in Santa Fe, Mexico City.
12. Robert Azinian (Desona)	24 November 1996	$17,000,000	Final award in favor of the Mexican government (1 November 1999).	Articles 1105 and 1110	Termination by a municipal authority of a concession to operate a landfill and waste management system in Naucalpan.
13. Waste Management (I) (Acaverde)	February 1998	$60,000,000	Award on jurisdiction issued on 2 June 2000. The Tribunal found that the investor had not filed a proper waiver under NAFTA article 1121.	Articles 1105, 1110	Payment under a concession for public waste management services in Acapulco.
14. Waste Management (II) (Acaverde)	27 September 2000	$60,000,000	Award in favor of jurisdiction issued on 26 June 2002.	Articles 1105, 1110	Payment under a concession for public waste management services in Acapulco.

Cases against the U.S.

1. ADF Group Inc.	February 2000	$90,000,000	Submission to Arbitration filed 19 July 2000. Award issued on 9 January 2003. The Tribunal found in favor of the U.S. on the merits.	Articles 1102, 1103, 1105 and 1106.	The Federal Surface Transportation Assistance Act of 1982 and the Department of Transportation's implementing regulations requiring that federally-funded state highway projects use only domestically produced steel.
2. Canfor Corp.	5 November 2001	$250,000,000	Submission to Arbitration filed 9 July 2002.	Article 1102, 1103, 1105 and 1110.	U.S. antidumping, countervailing duty and material injury determinations with respect to imports of softwood lumber
3. Doman Industries Ltd.	1 May 2002	$513,000,000	Not available.	Articles 1102, 1103, 1104, 1105, 1110.	U.S. antidumping and quota allocation determinations (softwood lumber).
4. Kenex Ltd.	14 January 2002	$20,000,000	Submission to Arbitration filed 2 August 2002.	Articles 1102, 1103, 1105 and 1104.	The Drug Enforcement Administration's interpretation of the Controlled Substances Act as prohibiting the sale of products that cause THC tetrahydrocamaninal (THC) to enter the human body.
5. Methanex Corporation	2 July 1999	$970,000,000	Partial award on admissibility and jurisdiction issued 7 August 2002. Reformulated claim filed 5 November 2002.	Articles 1102, 1105 and 1110.	California ban on the use or sale in California of the gasoline additive MTBE.

6. Mondev International Limited	6 May 1999	$50,000,000	Submission to Arbitration filed 1 September 1999. Award on the merits finding for the U.S. issued 11 October 2002.	Articles 1105 and 1110	Decision by the Supreme Judicial Court of Massachusetts and Massachusetts state law.
7. R. Loewen and Loewen Corporation	29 July 1998	$725,000,000	Interim award on jurisdiction issued 5 January 2001.	Articles 1102, 1105 and 1110	A Canadian corporation seeks damages for alleged injuries arising out of litigation in which the company was involved in Mississippi state courts.
8. Tembec Corp.	4 May 2002	Not available	Not available.	Not available	Not available