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THE NEW FACE OF INVESTMENT ARBITRATION*

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A. 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]

* Adapted from *The New Face of Investment Arbitration: NAFTA Chapter 11*, 28 Yale J. Int'l L. 365–407 (Summer 2003).

[1] North American Free Trade Agreement, 32 I.L.M. 289 (1993). NAFTA was enacted in the United States 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 later) for claims brought by private investors. See Final Report,

The result was an awareness of the downside of arbitration, including the prospect that key economic and political matters would be decided in confidential 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 chapter 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.

B. The Contours of Investment Arbitration

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]

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 nineteenth and early twentieth centuries, 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 and King Léopold I of

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.

[3] Treaty of Amity, Commerce and Navigation, London, 19 November 1794, U.S.-U.K., 8 Stat. 116. 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). See generally J.L. Brierly *The Law of Nations* 285–8 (1963).

[4] Treaty-based arbitration might take place under the auspices of the World Bank's International Center for Settlement of Investment Disputes (discussed later) or one of the many Bilateral Investment Treaties. See generally Rudolf Dolzer and 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 L. Rev. 75 (2002).

Belgium, whose predispositions and sympathies did not always inspire confidence among developing countries.

Not surprisingly, host states reacted to what they perceived as foreign control of their economies. Invoking principles articulated by the nineteenth-century Argentine jurist Carlos Calvo, Latin American countries came to require similar treatment for foreign and domestic investors.[5] This effectively eliminated as options both diplomatic protection[6] 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[7]) to require host state courts rather than international arbitrators to determine the measure of compensation for expropriated property.[8]

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 International Chamber of Commerce (ICC), The International Center for Settlement of Investment Disputes (ICSID) and the London Court of International Arbitration (LCIA), as well as in the formulation of new procedural rules such as those of the United Nations Commission on International Trade Law (UNCITRAL).[9]

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.

Double standards

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

[5] See *Le Droit international théorique et pratique*. See generally Kurt Lipstein, *The Place of the Calvo Clause in International Law* Brit. Y.B. Int'l L. 130, 145 (1945), which concludes that "before international tribunals the Calvo Clause is ineffective."

[6] See later discussion.

[7] Thomas Waelde, "*Requiem for New International Order*" in G. Hafner *et al.* (eds.), *Liber Amicorum for I. Seidl-Hohenveldern* 771 (1998).

[8] Article 2(2)(c) of the Charter of Rights and Duties of States 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).

[9] See W. Laurence Craig, William W. Park and Jan Paulsson, *International Chamber of Commerce Arbitration* 661–78 (3rd edn, 2000). On the working of UNCITRAL, see Howard Holtzmann and Joseph E. Neuhaus, *A Guide to the Uncitral Model Law on International Commercial Arbitration* 4–6 (1989).

a tone quite different from when negotiating NAFTA.[10] 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 "hometown 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.[11] Absent assertions of diplomatic protection,[12] litigation in the expropriating country remains the default mechanism for adjudicating investment disputes.[13] 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,[14] and will inevitably either thwart cross-border economic cooperation or add to its cost.[15]

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.

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.[16] After claims for unfair treatment were filed *against* the United States government, arbitration looked different than when American companies

[10] See later discussion of the Trade Act of 2002. See also Edward Allen, *Washington Alters Line on US Investor Protection*, Financial Times, 2 October 2002, 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.

[11] 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 *Elettronica Sicula SPA (ELSI) (United States v. Italy)*, (1989) ICJ Rep. 15.

[12] 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 Brierly (n. 3) 285–8; Ian Brownlie, *Principles of Public International Law* 419–84 (6th edn, 2003).

[13] 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.

[14] The perception of litigation bias may be as significant as its reality. A study of U.S. 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, 1133–4 (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.

[15] 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(4) J. Int'l Arb. 99 (1995).

[16] NAFTA Chapter 11 protects "investors of another Party" (Art. 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."

were the investors.[17] This was a new experience, since NAFTA represented the first time two of the so-called G-7 industrialized countries[18] entered into mandatory arbitration arrangements with each other.[19]

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.[20]

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.[21]

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.[22]

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.

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[17] See Charles Brower and Lee Steven, *Who Then Should Judge?: Developing the International Rule of Law under NAFTA Chapter 11*, 2 Chicago 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. Transnat'l L. 37 (2003).

[18] 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.

[19] 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.

[20] See later discussion.

[21] See later discussion.

[22] For evidence of foreign fear of litigation bias in American courts, see later discussion of the *Loewen* case and findings reported in Clermont and Eisenberg (n. 14). 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 and Martin T. Wells, *Juries, Judges and Punitive Damages: An Empirical Study*, 87 Cornell L. Rev. 743 (2003).

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.

C. NAFTA Chapter 11

Safeguarding cross-border investment[23]

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.[24] 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,[25] and requiring "fair and equitable" treatment as well as compensation for nationalized property.[26] An entity incorporated and with substantial business activities[27] in a NAFTA country qualifies as an investor without regard to any "origin of capital" limitations.[28] 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.[29] Expropriation must be

[23] See generally Henri C. Alvarez, *Arbitration under the North American Free Trade Agreement*, 16 Arb. Int'l 393 (2000).

[24] 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).

[25] Each member country must treat NAFTA investors and their investments no less favorably than its own investors (Art. 1102, concerning National Treatment) and investors of other countries (Art. 1103, concerning Most-Favored-Nation Treatment).

[26] 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.

[27] See NAFTA, Art. 1113(2).

[28] See definitions in ibid. Arts. 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 U.S. citizen of the right to arbitrate claims concerning tobacco export tax rebates.

[29] While the terms "prompt, adequate, and effective" do not appear in the text of Chapter 11, some observers consider that 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, cmts 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 U.S. Secretary of State Cordell Hull on 22 August 1938. See *Banco Nacional de Cuba v. Chase Manhattan Bank*, 658 F. 2d 875, 888 (2nd 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"

justified by a public purpose and applied on a non-discriminatory basis.[30] 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,[31] 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.[32]

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[33] may choose either (i) arbitration supervised by ICSID (part of the World Bank group)[34] or (ii) a proceeding conducted under arbitration rules adopted by UNCITRAL.[35] Disputes raising common questions of fact or law may be consolidated into a single arbitration.[36]

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 later, this will have significant consequences when one side wishes to mount a challenge to the arbitration.

The role of the arbitral situs

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.[37] To understand the impact of local law, a brief contrast might be helpful. Under "pure" ICSID arbitration, the Washington Convention forecloses challenge to awards on normal

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* (n. 8).

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

[31] NAFTA, Art. 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. 641 (1993). 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.

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

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

[34] Established under the 1965 Washington 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, *Arbitration before the International Centre for Investment Disputes*, 3 Bus. Law Int'l 367 (Sept. 2002).

[35] NAFTA, Art. 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, Art. 1130, referring to a "Party [a NAFTA member] that is a party to the New York Convention."

[36] NAFTA, Art. 1126.

[37] See generally David Williams, *Challenging Investment Treaty Arbitration Awards: Issues concerning the Forum*, presented at ICCA Congress XVI, London, 15 May 2002.

statutory grounds[38] in favor of ICSID's special system of quality control under its own internal challenge procedure.[39]

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 are 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[40] or the Panama Convention,[41] both of which require deference to valid arbitration agreements and awards but say nothing about proper or improper annulment standards.[42] In contrast to ICSID, 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 ICSID Additional Facility is that NAFTA awards are now subject to the judicial review mechanisms that exist at the place of arbitration.[43] NAFTA Article 1136(3)(b) explicitly contemplates such review. Award enforcement for arbitration under ICSID 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.

[38] 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 U.S. 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 U.S. 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).

[39] See Convention on the Settlement of Investment Disputes between States and Nationals of Other States, Art. 52, ICSID Basic Documents 25 (1985). See generally W. Michael Reisman, *Systems of Control in International Adjudication and Arbitration* 46–50 (1992).

[40] 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).

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

[42] 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 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).

[43] In the United States award "finality" has been interpreted to mean final as allowed under relevant arbitration laws. See e.g. *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 (2nd 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.

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.

Minimum standards of treatment

Article 1105(1) of NAFTA 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 "international law" has been the object of controversy,[44] 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.[45]

In *Metalclad*[46] 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 *SD. Myers*[47] 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 give 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 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.[48] 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).

[44] See later discussion of Free Trade Commission *Notes of Interpretation*.

[45] Ian Brownlie, *System of the Law of Nations: State Responsibility* 161 (1983); ICSID Case ARB/87/3.

[46] See earlier discussion of *Metalclad Corp. v. Government of the United Mexican States*, Award of 25 August 2000.

[47] *S.D. Myers, Inc. v. Government of Canada*, Partial Award of 13 November 2000, reprinted in 40 I.L.M. 1408 (2001). A U.S. investor hoped to capture a large portion of the Canadian market for destruction of polychlorinated biphenyls (PCBs) by sending materials to Ohio facilities, a competitive advantage over Canadian facilities further away. Canadian environmental authorities responded to Canadian lobbying with an emergency ban preventing export of PCB waste.

[48] 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. A 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, in which the tribunal found that the export ban in question was not a requirement on "the conduct or operation of the investment."

Expropriation

Article 1110 of NAFTA extends protection against uncompensated expropriation to measures "tantamount to nationalization or expropriation," thus encompassing takings that have often been referred to as "creeping" expropriation.[49] 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 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."[50] 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,[51] or when the host state itself acquires nothing of value but "at least has been the instrument of distribution."[52]

Several Chapter 11 arbitrations have addressed the question of what constitutes expropriation, including *Azinian*,[53] *Metalclad*,[54] *Pope & Talbot*[55] and *S.D. Myers*.[56] Thus far none have departed from traditional notions of customary international law.

D. Arbitration and the New Host States

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.[57] Each case involves complaints about an American state rather than the federal government. In *Methanex*

[49] See later discussion.

[50] Restatement (Third) of Foreign Relations Law of the United States, § 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.

[51] Istvan Posgany, *Bilateral Investment Treaties: Some Recent Examples*, 1987 Foreign Inv. L.J. 964 (1987).

[52] Allahyar Mouri, *The International Law of Expropriation as Reflected in the Work of the Iran-U.S. Claims Tribunal* 66 (1994); *Poehlmann v. Spinnerei AG*, 3 U.S. Ct. Rest. App. 701, 702–04, 710 (1952).

[53] *Robert Azinian v. United Mexican States*, Award, on Merits, 1 November 1999, 14 ICSID Rev. Foreign Investment L.J. 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.

[54] *Metalclad Corp. v. Government of the United Mexican States*, Award on Merits of 25 August 2000.

[55] *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." Ibid. 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).

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

[57] 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.

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 Montréal 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.

The protest is pregnant with irony when one remembers how often the United States has imposed arbitration on other countries,[58] and how American negotiators advocated arbitration to promote the security of foreign investment over Mexico's longstanding opposition.[59]

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,[60] but also gives the term "measure" an understandably broad scope, to include "any law, regulation, procedure, requirement or practice."[61] Such a reading of the concept of measure is entirely consistent with the American position in connection with bilateral investment treaties.[62]

By implicating the judiciary, NAFTA arbitrations obviously touch an especially sensitive nerve. However, such actions follow a long line of "denial of justice" claims traditionally brought against developing countries[63] and recently made by an American investor against Mexico under NAFTA.[64]

Methanex[65]

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."[66] A Canadian corporation producing feedstock for this

[58] See W. Laurence Craig, William W. Park and Jan Paulsson, *International Chamber of Commerce Arbitration* ch. 36 (3rd edn, 2000).

[59] 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, 685.

[60] NAFTA, Art. 1110.

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

[62] See K. J. Vandevelde, *United States Investment Treaties: Policy and Practice* Appendix C, 166 (1992), 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.

[63] See Brierly (n. 3) 286–7, 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.

[64] See *Calmark Commercial Development, Inc. v. United States of Mexico*, Notice of Intent to Commence Arbitration filed 11 January 2002.

[65] *Methanex Corp. v. U.S.A.*, Amended Claim filed 12 February 2001 by Jones, Day, Reavis and Pogue, Washington, D.C. Available through <http://www.naftaclaims.com>.

[66] 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 Article 1101 of NAFTA, since the government measure did not

additive responded by filing an arbitration claim arguing discrimination, denial of minimum standard of treatment, and improper expropriation of its investment.[67]

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.[68]

Loewen

In *Loewen v. U.S.A.*,[69] a Mississippi jury verdict led to claims of failure to grant "fair and equitable treatment" and expropriation without adequate compensation. The 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 percent 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.

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 with

apply to the investors' product itself. The ban was effective 31 December 2001. See Exec. Order No. D-5–99 promulgated by Governor Gray Davis.

[67] Violations were alleged with respect to NAFTA, Arts. 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. U.S.A.*, 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, Art. 15(1) permits conduct of the proceedings "in such manner as [the tribunal] considers appropriate." *Amicus* briefs from NAFTA member countries are permitted under Article 1128 of NAFTA, which authorizes submissions on questions related to interpretation of NAFTA.

[68] 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, 478–9, notes 18–25 (2001).

[69] *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 <http://www.nafftaclaims.com>; Interim Award on Jurisdiction, 5 January 2001.

contractual relations.[70] 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."[71] 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.[72]

Aggrieved by the court decision, the Montréal 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."[73]

One can understand that such a proceeding might surprise many Americans. Imagine, however, the reverse situation, in which the rights of similarly situated Boston investors are rebuffed by a foreign court. It is not hard to imagine New England voices crying foul play.[74]

Reactions and complaints

As the first Chapter 11 cases were filed against the United States and Canada, 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. 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 investors and foreign governments has led to national laws being revoked, justice systems questioned and environmental regulations challenged.

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 U.S. Constitution ("We the people . . .") with captions that read: "Secret Courts for Corporations" and "Taxpayer Dollars for Foreign Polluters." 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.

[70] *Mondev International Ltd. v. U.S.A.*, ICSID Case No. ARB (AF)/99/2; Award of 11 October 2002, 42 I.L.M. 85 (2003).

[71] *Lafayette Place Associates v. Boston Redevelopment Authority*, 427 Mass. 508, 520 (1998).

[72] Ibid. 531–3. See MGL, c. 258, §§ 1, 10(c).

[73] *Mondev International Ltd. v. U.S.A.*, Notice of Arbitration, 1 September 1999, at 74. ICSID Case No. ARB(AF)/99/2.

[74] 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."

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

Environmentalists have been particularly vocal in saying that NAFTA makes it possible to undermine legitimate governmental regulations. Chapter 11 arbitration is portrayed as a forum insulated from rightful domestic political and legal safeguards. 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."

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. 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."

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 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, and to support government screening of arbitration requests to reduce the prospect that they are ever considered by arbitrators.

While not all legislators accepted the wisdom of such measures, some went even further. Senator Kerry of Massachusetts proposed amendments to the Andean Trade Preferences Act which would have given the investor state 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.

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.

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

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 well as measures "tantamount to" or "equivalent to" expropriation.[75] Indirect nationalization through improper administrative measures has long served as a back door to deprive the investor of its assets.[76] 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).[77] A federally chartered agency of the United States government, OPIC insures American investors against expropriation and currency inconvertibility in connection with their foreign investments.[78] Notwithstanding OPIC's broad definition of expropriation,[79] the experience of investors seeking reimbursement has not always been consistent.[80] In many

[75] See generally Burns H. Weston, *Constructive Takings under International Law: A Modest Foray into the Problem of "Creeping Expropriation,"* 16 Virg. J. Int'l L. 103 (1975). See also later discussion of Overseas Private Investment Corporation (OPIC). See generally Markham Ball, *Assessing Damages in Claims by Investors against States*, 16 ICSID Rev. Foreign Investment L.J. 408 (2001).

[76] See e.g. *Barcelona Traction, Light and Power Co., Ltd (Belgium v. Spain) (2nd Phase)*, 1970 ICJ 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).

[77] See generally Vance Koven, *Expropriation and the "Jurisprudence" of OPIC*, 22 Harv. Int'l L.J. 269 (1981); Wolfgang Peter, *Arbitration and Renegotiation of International Investment Agreements* 348–57 (2nd edn, 1995).

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

[79] OPIC's current *Program Handbook* (available at <http://www.opic.gov>), defines expropriation coverage as protection against "nationalization, confiscation or 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." Ibid. 11. See also <http://www.opic.gov/finance/products/expropriation.htm; Jonathan Haddon, *PLI Presentation*, February 1999, 784 PLI/Comm 271.

[80] 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 I.L.M. 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.

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.[81] 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.[82]

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.[83] 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,"[84] 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.[85]

Limiting the scope of investment arbitration

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. 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,[86] and investment is limited by a definition *numerus clausus* indicating what "investment means" rather than what "investment includes."[87] 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.[88] The creation of intellectual property rights will generally not give rise to rights to claim compensation for

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

[82] Waelde and Kolo (n. 81) conclude: "it 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." Ibid. 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 commitments or [when regulation has been used] to extract benefits unrelated to the legitimate purpose of the regulation…" Ibid.

[83] See e.g. *American Mfg. & Trading (AMT) v. Zaire*, 36 I.L.M. 1531 (1997).

[84] 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.

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

[86] NAFTA, Art. 1112.

[87] Art. 1139.

[88] Art. 1139.

expropriation,[89] 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.[90]

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

Expropriation through fiscal measures

Distinguishing abusive taxation 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.[91] 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.[92] From one perspective taxation constitutes a form of asset seizure (echoed in the American catchphrase "the power to tax is the power to destroy"[93]) 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 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.[94] At the time

[89] Art. 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.

[90] NAFTA, Art. 1110(8).

[91] 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 Eng. Rep. 1120 (KB 1775). For later articulations of this principle, see *HM Queen v. Gilbertson*, 597 F. 2d 1161 (9th Cir. 1979); *U.S.A. v. Boots*, 80 F. 3d 580 (1st Cir. 1996).

[92] 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, 100 (1927).

[93] The original U.S. 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.

[94] NAFTA, Art. 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

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."[95]

This awkwardly drafted "negative deadlock" provision gives the competent authorities six months to decide the question, failing which the investor may proceed to arbitration.[96] In attempting to distinguish normal from excessive taxation, fiscal authorities inevitably can be expected to rely on culturally influenced notions of tax.[97]

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."[98] Thus if the United States is accused of expropriating a Canadian investor's property, investment arbitration would be barred only if both the U.S. Department of the Treasury and the Canadian Department of Finance concluded that no expropriation had taken place.[99] Presumably the Canadian authorities would hesitate to acquiesce in the plundering of their 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 Article 1110 of NAFTA. 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.

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

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.

[95] 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.

[96] 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.

[97] 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. U.S.A.*, 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").

[98] The text of Article 2103(6) of NAFTA 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 states. 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.

[99] See NAFTA, Art. 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).

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.[100] To date, however, income tax treaty arbitration remains more aspiration than reality.[101] 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 ICC[102] and the Organization for Economic Cooperation and Development (OECD) have issued policy papers suggesting arbitration to resolve inconsistency in tax treaty application.[103] The International Fiscal Association (IFA) has sponsored a study on the topic.[104] Discussion of the topic has been organized by both the Tax Council Policy Institute[105] and the American Society of International Law.[106]

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.

Financial services

NAFTA provisions on financial services generally trump inconsistent stipulations in Chapter 11.[107] Under Chapter 14, the host state can invoke prudential concerns related to

[100] See e.g. William W. Park, *Income Tax Treaty Arbitration*, 31 Tax Mgmt Int'l J. 219 (May 2002); Gustaf Lindencrona and Nils Mattson, *Arbitration in Taxation* (1981); Jean-Marie Henckaerts, *EC Arbitration Convention for Transfer Pricing Disputes*, 10 J Int'l Arb. 111 (Sept. 1993).

[101] One practitioner has remarked a bit whimsically that ever since 1981, tax arbitration has been "an idea whose time is about to come." David R. Tillinghast, *Choice of Issues to be Submitted to Arbitration under Income Tax Conventions*, in H. Alpert and K. van Raad, *Essays on International Taxation* 349 (Boston, Kluwer, 1993).

[102] ICC Commission on Taxation, Arbitration in International Tax Matters, Doc. No. 180/438 (3 May 2000) available at <http://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 Sept. 2001).

[103] In 1995 the Organization for Economic Cooperation and Development (OECD) issued a confidential study on the topic. 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 Jan. 1995), DAFFE/CFA (95) 12.

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

[105] Proceedings of Conference held 8 February 2002, 10(4) George Mason L. Rev. (2002).

[106] 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 and W.W. Park).

[107] NAFTA, Art. 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

protection of depositors, financial markets and maintenance of safe and sound financial institutions.[108] On request of a member state, arbitrators must refer the matter to the NAFTA Financial Services Committee ("Committee") for a decision on whether the prudential concerns are valid defenses to an investor's claim, which decision is binding on the tribunal.[109]

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.[110] 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.

E. Old Problems, New Perspectives

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 host state's sombrero, the United States has come to a new appreciation of the predicaments experienced by capital importers.[111]

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

Article 1401, the "minimum standard of treatment" provisions (Art. 1105) do not apply to investment in financial services.

[108] 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 measures of general application in pursuit of monetary and credit or exchange rate policies.

[109] See NAFTA, Art. 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.

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

[111] See M. Sornarajah, *The Settlement of Foreign Investment Disputes* (2000); Wolfgang Peter, *Arbitration and Renegotiation of International Investment Agreements* (2nd edn, 1995).

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.[112]

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 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.[113] 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 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 Ricardo'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."[114] Such opposition was partly responsible for the collapse of the OECD-sponsored Multilateral Agreement on Investment.[115]

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[112] In a Chapter 11 arbitration brought by American investors against Mexico, the arbitral tribunal noted that: "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 unlawful end." *Azinian v. United Mexican States*, ICSID Case No. ARB(AF)/97/2, Award on Merits of 1 November 1999, para. 99.

[113] 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).

[114] See discussion of Charter of Economic Rights and Duties of States, in Park, *Legal Issues in the Third World's Economic Development* (n. 7).

[115] 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).

Members of the U.S. Congress commend trading partners who accept international arbitration as a potential tool to address foreign trade violations.[116] Yet when the United States is on the receiving end of a request for arbitration, protests are heard about "American laws being overridden" by NAFTA tribunals.[117] American legislators warn against "sacrificing state and local laws at the altar of ill-defined international investor rights"[118] and suggest that under NAFTA "the rights of an investor come before the rights to enact a chemical ban to prevent cancer."[119]

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.[120] Indeed, the complaints by the American investor in *Metalclad* arose from actions by a Mexican municipality, and in *Calmark* from actions before a Mexican state court.[121] Within the United States itself, notions of federal responsibility for local misdeeds have a long history.[122]

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 declared that "no principle of the law of nations [is] more firmly established than that which entitles the property of

[116] 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.

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

[118] 145 Cong. Rec. H-7368, Statement by Rep. Tierney (Massachusetts).

[119] Ibid., 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?" Ibid. H-7370.

[120] See Ian Brownlie (n. 12) 433, note 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, 110), the Mallen Claim (1927, RIAA IV, 173), and the Pellat Claim (1929, RIAA V, 534).

[121] See earlier discussion.

[122] 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 and John Jay, *The Federalist Papers* No. 18, at 476 (C. Rossiter (ed.), 1961), quoted in Gary Born, *International Civil Litigation in United States Courts* 11 (3rd edn, 1996).

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."[123]

Cynics might say that one should not be surprised at double standards. Selective application of procedural standards, however, can have profoundly disconcerting consequences for 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 even-handedness 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.[124] 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.

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.[125]

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 Article 1105 of NAFTA 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.[126] Moreover, the *Notes of Interpretation* limit the meaning of international law to "customary" minimum standards,[127]

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[123] Letter to Mr de Onis, Spanish Minister (1818), reprinted in John Basset Moore, 4 *Digest of International Law*, Section 535 (1906). See generally *Loewen Group & Raymond L. Loewen v. U.S.A.*, Joint Reply of Claimant, 8 June 2001, paras. 305–8, available at <http://www.naftaclaims.com>, noting numerous pronouncements by the United States in the context of claims against Brazil, Mexico, Colombia, Iran and Zaire emphasizing the affirmative obligation of the host state to ensure "full protection and security" to the property of American nationals.

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

[125] Article 1131(2) of NAFTA 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]."

[126] See NAFTA Free Trade Commission, *Notes of Interpretation of Certain Chapter 11 Provisions*, 31 July 2001, Part B, reprinted in 13 World Trade & Arb. Mat'ls 139 (Dec. 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.

[127] 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."

thus preventing recourse to other sources of international law that might either impose or relax restrictions on host state treatment of foreign investors.[128]

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." 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.[129]

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.[130] 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.

F. Conclusion

Until recently, the world of investment arbitration recognized 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 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 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.

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[128] 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.

[129] See *Pope & Talbot* (n. 55) Final Award, 31 May 2001, ordering Canada to pay $461,556 plus interest in damages.

[130] Presumably attempts to address potential conflicts would require recourse to the Vienna Convention on the Law of Treaties, 23 May 1969, Article 31, U.N. Doc. A/Conf. 39/27, entered into force 27 January 1980, 63 Am. J. Int'l L. 875 (1969), 81 I.L.M. 679 (1969).

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, serving simply as a justification for the exercise of unfettered government power.[131]

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.[132]

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.[133] 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 responses to NAFTA arbitration.[134] 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.[135] 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.[136]

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[131] One scholar has referred to sovereignty as "the unique character of governments." See W. Michael Reisman, *International Arbitration and Sovereignty*, 18 Arb. Int'l 231, 237 (2002), adapted, from 12th Annual Workshop of Institute for Transnational Arbitration, 21 June 2001, Dallas, Texas. Professor Reisman writes: "as 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."

[132] See generally, Jagdish Bhagwati and T.N. Srinivasan, *Trade and Poverty in the Poor Countries*, 92 Am. Economic Rev. 183 (2002).

[133] See Michael Goldhaber, *Czech Mate*, 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 earlier.

[134] For one recent comment on the role of arbitration in cross-border investment, see Brower (2003) (n. 17) 93–4.

[135] See earlier discussion of *Pope & Talbot* (n. 55) Final Award, para. 47, note 37. The process for amendment of NAFTA requires approval in accordance with "applicable legal procedures of each Party." See NAFTA, Art. 2202.

[136] See earlier discussion of H.R. 3005 and H.R. 3009.