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CHAPTER 11 – PRIVATE PARTY VS. GOVERNMENTS, INVESTOR-STATE DISPUTE SETTLEMENT: FRANKENSTEIN OR SAFETY VALVE?

David R. Haigh, Q.C[*].

Since the North American Free Trade Agreement (NAFTA),[1] took effect in January, 1994, many of the deep concerns, which initially surrounded its introduction, appear to have gradually abated. In fact, the commemorative ceremonies marking the fifth anniversary of the NAFTA last year were generally highlighted by an impressive litany of trade statistics. Since the implementation of the NAFTA, Canada's trade with the United States has risen eighty percent, while trade with Mexico has doubled. In 1998, total three-way trade among Canada, Mexico, and the United States reached approximately $752 billion, with Canada-U.S. and Canada-Mexico trade accounting for $484 billion. Since 1993, foreign direct investment in Canada has risen by fifty-four percent to $218 billion, of which about sixty-eight percent comes from the NAFTA parties.[2] Measured by the increase of trade and investment among the three North American economies, the NAFTA appears to have been an unparalleled success.

While the trading benefits of the NAFTA appear to be broadly accepted, there continue to be some dissenters who do not share the general enthusiasm for NAFTA's accomplishments.[3] Whether these critics are the same old objectors who have simply persisted in their original viewpoint or whether they speak to fresh concerns which have arisen since the implementation of the NAFTA, their voices have, no doubt, gained considerable impetus in the post "Battle in Seattle" environment. In particular, the investment provisions

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[1] *North American Free Trade Agreement Between the Government of Canada, the Government of Mexico and the Government of the United States,* 17 Dec. 1992, Can. T.S. 1994 No.2, 32 I.L.M. 289 (entered into force 1 Jan. 1994) [hereinafter NAFTA].

[2] Dep't of Foreign Aff. and Int'l Trade, *The NAFTA at Five Years: A Partnership at Work*, (visited July 20, 2000), <http://www.dfait-maeci.gc.ca/nafta-alena/five-e.asp>.

[3] Obviously, not everyone agrees that increased "marketization" and globalization have been universally successful. *Cf.* Jay Mazur, *Labour's New Internationalism* (Jan./Feb., 2000) FOREIGN AFF., at 79; Wendy Dobson, *Fallout from the Global Financial Crisis: Should Capitalism Be Curbed?*," 54 INT'L J. OF THE CAN. INST. OF INT'L AFF., at 375.

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and the investor-state dispute resolution regime of Chapter 11, have begun to attract considerable negative attention.

On a broad basis, the apprehension is that each NAFTA country has sold its sovereignty down the river by agreeing to subject itself to lawsuits by investors who may seek not only damages, but may also attack these governments at the heart of their policy making capacity. This would occur because it is measures adopted or maintained by these governmental Parties which are necessarily impugned in proceedings commenced by investors under Chapter 11.[4] A "measure" is defined in Article 201 as including "... any law, regulation, procedure, requirement or practice." Thus, the regulatory and legislative enactments of governmental Parties are subject to attack by private investors where it is alleged that the underlying covenants applicable to investors of another party, as set forth in Section A of Chapter 11, have been breached.

To appreciate the potential breadth of the "measures" to which investors may object, I propose to consider the example of some of the alleged causes of action in the case of *Ethyl Corporation* v. *Government of Canada* (*Ethyl* v. *Canada*),[5] and the manner in which they were dealt with in the course of a Hearing of preliminary objections by Canada, especially on the question of whether any actionable measures existed at the required times in terms of the arbitration procedures of the NAFTA.

In its original "Notice of Intent To Submit a Claim to Arbitration," dated September 10, 1996 (Notice of Intent), Ethyl complained, *inter alia*, of a previously announced intention by a Canadian Minister of the Environment that the Government of Canada would remove MMT from use in Canada. Ethyl further complained that the Government of Canada had attempted to prohibit MMT by exercising its regulatory power over international and interprovincial trade by introducing to Parliament Bill C-94, being *an Act to regulate interprovincial trade in and the importation for commercial purposes of certain manganese-based substances*. Bill C-94 did not complete its passage through the House of Commons when Parliament was prorogued at the end of January, 1996. In Canadian parliamentary practice, this has traditionally meant that any pending but uncompleted legislative steps are considered to have been suspended.

Subsequently, with the second session of the same Parliament resuming in April of 1996, Canada reintroduced what Ethyl characterized as "this

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[4] *See* NAFTA, *supra* note 1, at art. 1101, (providing specifically that Chapter 11 applies to measures adopted or maintained by a Party relating to investors of another Party and investments of another Party in the territory of the Party and, with respect to Articles 1106 and 1114, all investments in the territory of the Party).

[5] Ethyl Corporation v. The Government of Canada, 38 I.L.M. 708, (1998).

measure" to Parliament, referring the bill directly to third reading. By this time, the Bill was renumbered as Bill C-29.[6] Until third reading, the Bill cannot be considered to have been passed by the House of Commons. Moreover, it is then subject to consideration by the Senate where it must likewise receive three readings and subsequently the formality of Royal Assent before it becomes law. In this case, Bill C-29 went through not only the formal readings in the House of Commons and the Senate, but at the second reading stage in the Commons and the Senate it was also referred to two Parliamentary Committees – the House of Commons Standing Committee on Environment and Sustainable Development and the Senate Standing Committee on Energy, Environment and Natural Resources. Ethyl, it was said, participated in the legislative process by various means, including lobbying and appearing as a witness before the Senate Committee.[7]

In these circumstances, therefore, Ethyl was complaining in its Notice of Intent of a putative measure which had not yet received third reading by the House of Commons, had not yet been submitted at all to the Senate, and certainly had not yet become law in any formal sense. Canada later pleaded:

> When Ethyl delivered its Notice of Intent, debate on Bill C-29 had not occurred and the Bill had not passed. In fact, debate on the Bill began in the House of Commons on September 25, 1996 and continued until December 2, 1996 when it was passed by the House of Commons and sent to the Senate for consideration.[8]

Ethyl's Notice of Intent also complained of certain public statements made by another Minister of the Environment indicating his concern with the potential negative effect on the health of Canadians caused by possible interference of MMT on automobile computer systems monitoring tailpipe emissions.

The potential significance of these events arises from the requirements of Article 1119 of the NAFTA, which states, in part:

> The disputing investor shall deliver to the Disputing Party written notice to submit a claim to arbitration at least 90 days before the claim is submitted....

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[6] Bill C-29, An Act to Regulate Interprovincial Trade in and the Importation for Commercial Purposes of Certain Manganese-Based Substances, 2d Sess., 35th Parl., 1996 (Third reading, April 22, 1996).

[7] Statement of Defence of the Government of Canada (27 Nov. 1997), at para. 9; Award on Jurisdiction (June 24, 1998), at para. 78.

[8] Statement of Defence of the Government of Canada, supra note 7, at para. 12.

Ethyl had purported to comply with this provision by alleging, among other things,

> The recurring unsubstantiated statements made by officials of the Government of Canada, including the Ministers of the Environment, against the safety and environmental soundness of MMT, constitutes such a measure [as defined in Article 201].[9]

Ethyl had further stated in its Notice of Intent at para. 20,

> These governmental measures have resulted in harm to Ethyl Corporation's property....

After the commencement of arbitral proceedings by Ethyl against Canada and following the organization of the Tribunal,[10] a preliminary meeting and the exchange of pleadings, Canada took a preliminary objection to the jurisdiction of the Tribunal on a number of grounds, including the objection that Canada had not adopted or maintained a measure within the meaning of Articles 201 and 1101 of the NAFTA at the time Ethyl submitted its claim to arbitration.

Canada particularized its objections in this regard in a number of ways. First, it stated that to the extent the claim made by Ethyl was based on statements made in support of proposed legislation, those ministerial statements were neither "measures" nor "measures relating to" "investors" or "an investment" and were not, therefore, subject to proceedings under Chapter 11. In addition, Canada stated that to the extent the claim was based on the passage of a Bill through the House of Commons and the Senate of Canada, passage of a Bill that had not yet come into force was neither a measure nor was it a measure relating to an investment or an investor and was, therefore, not properly the subject of Chapter 11 proceedings. Finally, Canada took the view that the legislation complained of in Ethyl's Statement of Claim had not been enacted nor had it come into force at the time the claim was submitted and there could not be any measure relating to an investment or an investor in effect upon which Ethyl could found any alleged breach of any obligations under Chapter 11.[11]

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[9] Notice of Intent to Submit a Claim to Arbitration (10 Sept. 1996), at para. 19.

[10] The arbitral Tribunal in the *Ethyl* case, was composed of well-recognized and very experienced arbitrators. Ethyl's nominee was Mr. Charles N. Brower. The Government of Canada nominated Mr. Marc Lalonde. The Tribunal was chaired by Professor Dr. Karl-Heinz Bockstiegel.

[11] Statement of Defence of the Government of Canada, *supra* note 7 at para. 11-15, 22(b).

In reply to Canada's arguments that there were no measures adopted or maintained by it relating to Ethyl's investment either at the date of the Notice of Intent (September 10, 1996), or at the date of the Notice of Arbitration (April 14, 1997), Ethyl took the position that the *MMT Act,* which came into force on June 24, 1997, was by that date undoubtedly a "measure" within the meaning of Article 201.

In the *Ethyl* case, it is interesting to observe that Mexico exercised its right to participate in the arbitration pursuant to Article 1128, which provides that "...a Party may make submissions to a Tribunal on a question of interpretation of NAFTA." Mexico pointed out, as did Canada in its submissions, that:

> [T]o properly be the subject of an investor-State arbitration, the measure at issue must have been in effect at the time the arbitral process was initiated. Given the express contemplation of proposed measures in other parts of the NAFTA, this language cannot be interpreted to reach proposed measures. In Mexico's submission, therefore, the use of the words "adopt" and "maintain" means that the measure complained of must already be in existence at the time that the proceeding is initiated i.e. at the time the notice of claim is filed pursuant to Article 1119.
>
> This is particularly so in the case of Chapter Eleven, since a measure that has not yet produced legal effects cannot cause damages for which compensation or restitution may be due.[12]

Mexico added that tribunals under Chapter 11 should adhere to the requirements of Section B for the initiation of arbitration proceedings. In this case, Mexico said, among other things, "... the claim should have been ripe at the time that it was filed, and that the claimant not be permitted to change its claim from a non-arbitral non-measure to an arbitrable measure during the process."[13]

Ethyl replied to Mexico's points. It reiterated that a measure was adopted when the *MMT Act* received Royal Assent and claimed, therefore,

> [T]he only question presently before the Tribunal is whether Ethyl violated a requirement to wait six months after the 'events giving rise to the claim' and, if so, what is the proper remedy for this alleged

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[12] Award on Jurisdiction, *supra* note 7, at para. 48(ii).

[13] *Id.*at 48(iii).

> procedural breach. Thus, 'the Tribunal may never need to decide what a measure is ' and, indeed, 'should avoid' doing so.[14]

The stage was set, therefore, for this Tribunal to address some very interesting points and potentially to provide some helpful guidance to others who might need to determine how far into the legislative and policy making process a private investor could reach in making its claim. Clearly in Chapter 20 of NAFTA there is provision for the resolution of disputes between the Parties regarding the interpretation or application of NAFTA, "...wherever a Party considers that *an actual or proposed measure* of another Party is or would be inconsistent with the obligations of this Agreement..." [emphasis added].[15] That sort of state-to-state procedure could, theoretically, have been instigated if the United States had chosen to construe the Bills before Parliament or the ministerial statements as "proposed" measures with which it wished to take issue. Could an investor, however, somehow manage to claim the same privilege to dispute a proposed measure? As Canada had argued, until the *MMT Act* took effect, there was no legislative prohibition, which could have allegedly harmed Ethyl's investment. To extend the right of the investor to advance its claim so as to encompass proposed enactments would be, Canada and Mexico said, an unwarranted extension of the right of private action to which the NAFTA Parties had consented.

The Tribunal's consideration of the question of whether there were measures in play which could warrant the bringing of proceedings by an investor under Chapter 11, is instructive in several respects, and some would argue that it illustrates very well the problematic procedure to which the NAFTA Parties have subscribed. The waiver of sovereign immunity in the form of their consent to actions brought under Chapter 11, by Canada, the United States, and Mexico, some would argue, may have opened the floodgates to an overall loss of sovereignty.

With respect to the preliminary objections, for the most part, the Tribunal dismissed Canada's jurisdictional objections, including in particular, its position that no arbitration proceedings under Chapter 11 could be pursued unless a measure had been adopted or maintained by Canada by the date of the Notice of Arbitration.

At the beginning of its analysis of Canada's objections, the Tribunal noted Canada's *Statement on Implementation of the North American Free Trade Agreement*,[16] at page 80, which stated:

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[14] *Id.* at para. 49.

[15] NAFTA, *supra* note 1, at article 2004: Recourse to Dispute Settlement Procedures.

[16] North American Free Trade Agreement, Canadian Statement on Implementation, C.Gaz. 1994.I.68 [hereinafter the *Canadian Statement on Implementation*].

> The term 'measure' is a non-exhaustive definition of the ways in which governments impose discipline in their respective jurisdictions.

After referring to Article 201 of NAFTA, the Tribunal stated "Clearly something other than a 'law,' even something in the nature of a 'practice' which may not even amount to a legal stricture, may qualify."[17]

While acknowledging Canada's argument "...that an unenacted legislative proposal, which is unlikely to have resulted even in a 'practice,' cannot constitute a measure," the Tribunal nonetheless appears to fix upon the obvious situation that had emerged.

> In the end, however, the *MMT Act* did come into force 24 June 1997, after having received Royal Assent on 25 April, 1997, just eleven days following the Claimant's delivery of its Notice of Arbitration. The *MMT Act* is, Canada concedes, a measure within the meaning of Article 1101(1). Canada's objection, then, is that Ethyl 'jumped the gun,' and, having done so, should be requested to commence an entirely new arbitration, which, it is conceded, it can (subject to any scope limitations).[18]

After reciting that the *MMT Act*, based on Ethyl's allegations, was the realization of a legislative program of the Canadian Government, sustained over a period of time, the Tribunal again noted, "In any event, the *MMT Act* is, as of 24 June 1997, a reality, and therefore the Tribunal is now presented with a claim based on a "measure" which has been "adopted or maintained" within the meaning of Article 1101."[19]

This conclusion, without more, in this writer's view, does not meet the point of Canada's (and Mexico's) objection that Ethyl's complaint was not properly arbitral on April 14, 1997 when the Notice of Arbitration was issued. Under Article 1137, a claim is submitted to arbitration when, in the case of UNCITRAL proceedings, the Notice of Arbitration is received by the disputing party. Either there was a viable claim on that date or there was not. The repeated reference by the Tribunal to the fact that, subsequently to the date of the Notice of Arbitration, the *MMT Act* was indeed a 'measure" as contemplated by Article 1101 really does not resolve the issue raised by Canada.

The question of what stage a measure must reach in order to permit pursuit of a claim under Chapter 11 was further considered by the Tribunal in

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[17] Award on Jurisdiction, *supra* note 7, at para. 66.

[18] *Id.* at paras. 67-68.

[19] *Id.* at para. 69.

the context of what it characterized as "...several procedural requirements to which Canada points."[20] While the Tribunal reviewed the arguments concerning whether Articles 1118, 1119, and 1120, dealing with consultation,[21] Notice of Intent, and Notice of Arbitration, respectively, could be complied with in a timely way in the absence of a measure which had already been adopted or maintained, it nonetheless concluded there was no need to address these arguments,

> [S]ince the fact is that in any event six months and more have passed following Royal Assent to Bill C-29 and the coming into force of the *MMT Act*. It is not doubted that today Claimant could resubmit the very claim advanced here (subject to any scope limitations). No disposition is evident on the part of Canada to repeal the *MMT Act* or amend it. Indeed, it could hardly be expected. Clearly a dismissal of the claim at this juncture would disserve, rather than serve, the object and purpose of NAFTA.
>
> In the specific circumstances of this case the Tribunal decides that neither Article 1119 nor 1120 should be interpreted to deprive this Tribunal of jurisdiction.[22]

This conclusion, as with the earlier one on the ambit of the term "measure," simply does not meet Canada's arguments. Either there was a claim, in the sense that an impugnable measure had been adopted or maintained by Canada at the dates of the Notice of Intention or the Notice of Arbitration, respectively, or there was not. The decision by this Tribunal avoids the burden of this issue by resorting instead to the applicable rules of treaty interpretation found in the *Vienna Convention on the Law of Treaties* (Vienna Convention),[23] in particular Articles 31 and 32.

In a footnote to its conclusion, the Tribunal justifies its result by tracking the language of Article 31 of the Vienna Convention, which states:

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[20] *Id.* at paras. 74-88.

[21] During argument on jurisdiction, Ethyl complained that Canada had failed to comply with Article 1118, which requires that, "The disputing parties should first attempt to settle a claim through consultation or negotiation." While one meeting did occur after delivery of Ethyl's Notice of Intent, on November 12, 1996, Canada disputed that it was a "consultation." This position led the Tribunal to speculate in a footnote to the Award, that the Canadian officials feared that admitting a "consultation" might compromise the position that Bill C-94, then pending third reading in the House of Commons, was not a "measure." *Id.* at paras. 76-78.

[22] *Id.* at para. 85.

[23] Vienna Convention on the Law of Treaties, 23 May 1969, 115 U.N.T.S. 331, 8 I.L.M. 679, (entered into force on Jan. 27, 1980).

Article 31. General Rules of Interpretation

1. A treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the Treaty in their context and in the light of its object and purpose.

What the Tribunal stated in its footnote to its conclusion was:

> Specifically, the Tribunal concludes that this results from interpreting those Articles in good faith in accordance with the ordinary meaning to be given to the terms thereof in their context and in the light of the object and purpose of NAFTA as prescribed by Article 31 of the Vienna Convention, and that, considering particularly the circumstances of NAFTA's conclusion, any different interpretation would lead to a result which is manifestly absurd or unreasonable within the meaning of Article 32 of the Vienna Convention.

This last reference is to the following wording from the Vienna Convention:
Article 32. Supplementary Means of Interpretation

> Recourse may be had to supplementary means of interpretation, including the preparatory work of the treaty and the circumstances of its conclusion, in order to confirm the meaning resulting from the application of Article 31, or to determine the meaning when the interpretation according to Article 31:
>
> (a) Leaves the meaning ambiguous or obscure; or
>
> (b) Leads to a result, which is manifestly absurd or unreasonable.

The Tribunal completed its Award in this respect with two sets of observations and a cost disposition. Firstly, it acknowledged that Ethyl may have "jumped the gun" for tactical reasons relating to the legislative process. In this regard, the Tribunal noted the proximity of the Notice of Intent, on September 10, 1996 to the commencement of debate on Bill C-29 on third reading which commenced September 25, 1996, recognizing that the "claimant may have decided to file its Notice of Intent on September 10,1996 for the purpose of affecting that debate."[24] It further observed that one of the witnesses for Ethyl stated that on February 5, 1997 (after Bill C-29 had passed the House of Commons), representatives from Ethyl appeared before

[24] Award on Jurisdiction, *supra* note 7, at para. 87.

the Senate Standing Committee and offered to resolve the dispute by not proceeding with its pending NAFTA claim if the Government of Canada would not pass Bill C-29. Subsequently, the Notice of Arbitration was delivered "right on the heels of Senate passage of Bill C-29, i.e. five days later."[25]

Finally, the Tribunal held:

> Had Ethyl first awaited Royal Assent to Bill C-29, and then bided its time another six months, the Tribunal would not have been required to deal with this issue. The Tribunal deems it appropriate to decide, therefore, that claimant should bear the costs of the proceedings on jurisdiction insofar as these issues are involved.

What is to be made of this case in the context of the general debate on whether Chapter 11 is in any way problematic for the Parties that created it? We should recall, of course, Article 1136(1) which provides:

> Article 1136: Finality and Enforcement on an Award
>
> 1. An award made by a Tribunal shall have no binding force except between the disputing parties and in respect of the particular case.

Therefore, it is arguable that this particular decision is of limited significance, confined basically to its peculiar circumstances and without general application. The problem with that approach is that, notwithstanding Article 1136(1), in the next Chapter 11 case where an investor is seeking to extend its claim as to what may properly be a measure, there is no doubt that this Award will be referred to as authoritative and a model to be followed. For example, in a very recent case comment on this Award, Alan C. Swan of the University of Miami School of Law wrote:

> If the Tribunal's decision had rested solely on a pragmatic sense that Ethyl's defaults were simply not serious enough to warrant dismissal of its claim, there would be little reason to take note of the decision. But there is a good deal more to the decision that that. It is highly principled, rooted in an interpretive methodology that, in the writer's view, is a model for the application of Articles 31 and 32 of the Vienna Convention on the Law of Treaties (the Vienna Convention), and a powerful riposte to the "formalism" that is increasingly creeping into the interpretation of treaties, constitutions, statues, and even private contracts. It reflects an interpretive methodology that

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[25] *Id.*

recommends itself for future NAFTA arbitrations, whether under Chapter 11 or under Chapters 19 and 20.[26]

Professor Swan's position will, no doubt, be shared in due course by other investors and claimants who wish, for tactical reasons to "jump the gun" and affect the debate which, in a usually free and democratic process may be a source of some concern.

The *Ethyl* case, therefore, illustrates generally why some of the concern that is currently expressed in each of the NAFTA countries may be warranted. Obviously, if governmental statements of policy and statements of ministerial intention to introduce legislation are, in themselves, actionable, Chapter 11 potentially creates an opportunity for foreign corporations from one of the Parties investing in the territory of one of the other Parties to attempt to influence the legislative process and potentially even to impede the passage of legislation or the exercise of regulatory power which would otherwise be legitimate behavior for autonomous governments to pursue. Should that effect be considered to be in accordance with the ordinary meaning of the terms of NAFTA in their context and in the light of its object and purpose?

In the *Oxford English Dictionary, Second Edition*, "Frankenstein" is defined as "... the name of the title-character of Mrs. Shelley's romance *Frankenstein* (1818), who constructed a human monster and endowed it with life. Commonly misused allusively as a typical name for a monster who is a terror to his originator and ends by destroying him."

The *Random House Dictionary of the English Language* more succinctly defines Frankenstein as, "... a person who creates a monster or destructive agency that he cannot control or that brings about his own ruin."

The debate in the *Ethyl* case concerning the meaning and ambit of the term "measure" may suggest there is some substance to the argument that the NAFTA parties have inadvertently created a destructive agency which they now cannot control and which might, in some ways, arguably bring about their ruin. While that proposition may be somewhat inflated, it nevertheless highlights the principal areas for concern, namely, that public policies can now be potentially affected by arbitral panels which are completely outside the usual public policy-making process. Generally speaking, the NAFTA parties have given to investors coming into their territorial jurisdiction from one of the other Parties, a right of redress against them which has not been granted even to their own citizens since governmental measures in each of the NAFTA countries would not, ordinarily, be subject to action by corporate citizens within those countries.

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[26] *Ethyl, supra* note 5.

Nor, it should be further noted, is the possible breadth of the interpretation of the term "measure" in Article 1101 the only area for concern. For example, some have become alarmed at the frequency with which claimants have been relying on the very broad wording of Article 1110. As one of the underlying assurances to investors, it has been given some very innovative interpretations in various claims made against the NAFTA Parties. The following examples are illustrative of the characterization of various measures as expropriation:

> S.D. Meyers Inc., the Ohio-based corporation engaged in processing, transportation and disposal of waste contaminated with PCBs, alleged that: "The effect of the PCB Export Bans [implemented by the Government of Canada] has been to [totally] frustrate the Canadian operations of the Investor. This has resulted in the deprivation of the benefits of the Investor's investment in Canada, constituting a measure tantamount to expropriation."[27]

> The Loewen Group, Inc., the Vancouver-based funeral services company alleged that a Mississippi jury award of $500 million (including $74 million in damages for emotional distress and $400 million in punitive damages), the application of a 125% appeal bond requirement, and a coerced settlement "had the effect of severely infringing and interfering with Loewen's property rights, and thus were tantamount to expropriation."[28]

> Robert Azinian et al, as shareholders of a Mexican corporation with a concession contract for waste disposal, argued that the repudiation of the contract constituted an expropriation "if the state exercises its executive or legislative authority to destroy the contractual rights as an asset."[29]

The portion of Article 1110 on which some of this attention is focused provides as follows:

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[27] S.D. Meyers Inc. v. Government of Canada, "Notice of Intent to Submit a Claim to Arbitration" (21 July 1998), at para. 14.

[28] Lowen Group, Inc. v. United States, Notice of Claim, Oct. 31, 1998, at para. 167; *see also* Harmonization Project, Briefing Paper, Loewen Group, Inc. v. United States (visited July 28, 2000) <http://www.harmonizationalert.org/NAFTA/loewen.htm>.

[29] Robert Azinian, Kenneth Davitian, & Ellen Baca v. The United Mexican States, "Award" (1 Nov. 1999), Case No. ARB(AF)/97/2 (International Centre for Settlement of Investment Disputes), at paras. 87-89.

Article 1110: Expropriation and Compensation

> No Party may directly or indirectly nationalize or expropriate an investment of an investor of another Party in its territory or take a measure tantamount to nationalization or expropriation of such an investment ("expropriation") except:
>
> (a) for a public purpose;
>
> (b) on a non-discriminatory basis;
>
> (c) in accordance with due process of law and Article 1105(1); and
>
> (d) on payment of compensation in accordance with Paragraphs 2 through 6.

Significantly Article 1110(2) provides:

> Compensation shall be equivalent to the fair market value of the expropriated investment immediately before the expropriation took place ("date of expropriation"), and shall not reflect any change in value occurring because the intended expropriation had become known earlier. Valuation criteria shall include going concern value, asset value including declared tax value of tangible property, and other criteria, as appropriate, to determine fair market value.

Having in mind the earlier discussion on the interpretation of the term "measure" in the *Ethyl* case, where a governmental Party has committed itself to adhere to a standard such as not taking a measure tantamount to nationalization or expropriation, it may discover in due course that its presumed sovereign discretion to legislate and regulate has indeed been materially curtailed. As explained earlier, the definition of measure in Article 201, "... includes any law, regulation, procedure, requirement or practice." Consequently, a governmental Party may find itself accountable for a practice or requirement that is merely tantamount to expropriation. It is debatable whether such action would qualify as the exercise of the power of *eminent domain*, a taking for which most domestic governmental authorities would ordinarily expect to compensate the expropriated party.

The language of Article 1110(1) suggests that the drafters of NAFTA were intent on casting a wider net than merely the traditional form of expropriation which compulsory taking by an authority ordinarily implies.

It is appropriate, therefore, to ask what are the underlying philosophical considerations that appear to have created the Chapter 11 regime? In other words, is there some valid philosophical or practical objective that would justify the extraordinary rights that appear to have been granted to investors under Chapter 11 of NAFTA? Or have the parties to NAFTA inadvertently, simply undermined their viability as nation states? Is Chapter 11 indeed a Frankenstein?

What can we discern about the philosophical foundations of Chapter 11 from its language and upon which we can place the burden of its potentially far reaching application?

It is my opinion that the fundamental objective of Chapter 11 of NAFTA is to create a bargain between host states and investors. The terms of this bargain are that those who respond to the invitation from the host country to invest their expertise and other resources in that state may be assured tnat the basic standards of fairness spelled out in Section A of Chapter 11 will be fully observed by the host government. When the private party has committed its wherewithal in the territory of the host government, it is subject to all the law making authority of that government. Such investors do not have the same relationship with that government that ordinary citizens have. Consequently, they do not have the usual political recourse nor any legitimate role in the public policy process. They are, therefore, uniquely vulnerable to the legislative or regulatory whims of their host.

In the development of most bilateral investment treaties, the response to this vulnerability has usually been to set out the basic standards of fairness which should be observed, leaving the task of ensuring full adherence either to inter-governmental dispute resolution procedures or, alternatively, to some form of investor-state dispute mechanism. Thus, for example, in the Canada-U.S. Free Trade Agreement (FTA) the parties committed themselves to dispute settlement procedures dealing with anti-dumping and countervailing duty matters. In addition, the parties agreed to resolve any other disputes between them through well-defined, somewhat elaborate arbitral procedures. [Neither of these dispute procedures, however, provided for recourse by investors who are frequently the ones mostly directly affected by governmental measures.] When the FTA entered into force on January 1, 1989, the emphasis was on fostering liberalized trade, more than creating basic rules for investment. If there were issues, from time to time, between foreign investors and the respective host governments, FTA did not purport to deal with them. Outside investors had no higher rights than other corporate

citizens in their dealings with governmental authority and, often, they had fewer rights to the extent that they were subject to foreign investment controls.

In their book, *Bilateral Investment Treaties*, Rudolf Dolzer and Margrete Stevens have outlined the development of bilateral investment treaties (BITs) in the 20th Century.[30] Dolzer and Stevens have pointed out how various BITs have acknowledged the importance of promoting private investment. For example, they cite Article 258 of the Lomé Convention, which acknowledges that the promotion of private investment would need to include binding obligations to:

> (b) accord fair and equitable treatment to such investors;
>
> (c) take measures and actions which help to create and maintain a predictable and secure investment climate as well as enter into negotiations on agreements which will improve such climate[.]

Proceeding from such broad policy footings, hundreds of bilateral investment treaties around the world have created the means for investors to hold their host governments accountable for their official actions.

> Virtually all modern treaties provide for the arbitral settlement of investment disputes, generally by reference to institutional or other pre-existing arbitration rules. The overwhelming majority of BITs contain a reference to ICSID. However there is also a significant number of treaties that refer to arbitration under the UNCITRAL Rules or to ICC Arbitration. In fact, most modern treaties allow for the possibility of a choice between different arbitral regimes.[31]

When the NAFTA introduced Chapter 11 to the North American consciousness, it may have surprised those who had become accustomed to the old inter-governmental dispute mechanisms of the FTA. But, clearly Chapter 11 added a whole new element to the trade liberalization scheme of the FTA. NAFTA's Chapter 11 is, in essence, a tri-lateral investment treaty grafted onto an arrangement which is otherwise largely directed at establishing liberalization and fairness in the trade of goods and services. As with "virtually all modern treaties" of this nature, as noted by Stevens and Dolzer, there is provision for the settlement of investor-state investment disputes under either the ICSID Convention, the Additional Facility Rules of

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[30] RULDOF DOLZER & MARGRETE STEVENS, BILATERAL INVESTMENT TREATIES, International Centre for Settlement of Investment Disputes (1995).

[31] *Id.* at 129.

ICSID, or the UNCITRAL Arbitration Rules.[32] In this respect, at least, NAFTA Chapter 11 is hardly novel. Rather, as an investment treaty, it has simply followed the already well-established model for investor-state dispute resolution.

Why then would this arrangement, nevertheless, seem to arouse such concern? Chapter 11 is the first time that Canada and the United States, both members of the Organization for Economic Cooperation and Development (OECD), have agreed to investor-state arbitration between themselves. In this regard, it is important to note some of the characteristics of the economic relationship, which has developed, first between Canada and the United States, and subsequently with Mexico. In the period following World War II, the pattern of trading and investment between Canada and the United States began to change dramatically. Up until then, trade was divided between its so-called "mother country," Great Britain and the United States. Following the War, however, the United States had become the largest single customer for Canadian exports and the greatest single source of its foreign investment. For the last half of the 20th Century, therefore, Canada and the United States shared the distinction of being one another's largest customers. Throughout that era, there were continuing inter-governmental communications on this significant trading relationship. Some of the talking led to specific agreements, such as the Auto Pact arrangements.[33] Mostly, however, each government legislated and regulated on trade and investment issues from a domestic perspective. In the context of this, let us say traditional, trading relationship, private investment disputes, generally speaking, required investors in the two countries to resort to one another's courts and to rely on private international law for the recognition and enforcement of foreign judgments in one another's courts. Recourse by foreign investors against host governments was basically non-existent.

With the introduction of the NAFTA negotiations, however, several of the features which had characterized trading and investment between Canada and the United States until then, underwent significant review.

It is no secret that at first Canada was somewhat hesitant to join the trade discussions, which had been initiated between the United States and Mexico. It was obvious, however, that the Administration of President Bush was intent on vigorously pursuing the favorable climate for its talks with Mexico, and Canada accordingly joined in. There was, in any event, some very large and important policy considerations leading the United States to encourage

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[32] NAFTA, *supra* note 1, at art. 1120: Submission of a Claim to Arbitration.

[33] *See* Paul Wonnacott, *Autos and the Free Trade Agreement: Toward a More Secure Trading Relationship*, *in* TRADE-OFFS ON FREE TRADE: THE CANADA-U.S. FREE TRADE AGREEMENT 271 (Marc Gold & David Leyton-Brown eds. 1988) (discussing the Auto Pact).

the economic prosperity of its Spanish-speaking neighbor. To the extent that Mexico has since the inception of NAFTA relatively quickly become the second largest trading partner of the United States, after Canada, replacing Japan in that respect, the aspirations of those who moved to integrate Mexico into a North American market have been more than fulfilled.

If Mexico was prospectively to enjoy the full benefits of increased trade and investment which NAFTA's framework was set up to encourage, however, then Mexico, among other things, would have to be perceived as a fair and reliable host country. Historically, the Calvo doctrine, based on a decision of the Argentinian jurist Carlos Calvo in 1896, had been embraced in Mexico as elsewhere in Latin America. Pursuant to this doctrine, rules governing foreign investment were to be based on the concept of national treatment and that the rules of domestic law should not be modified by international law principles.[34] It also meant that claims by foreign investors could be brought only before Mexico's domestic courts. In addition, it was well known that Mexico was subject, from time to time, to nationalistic storms that were not always good news for foreign investors.[35]

Providing a framework which would potentially create the world's largest common market was further complicated, in this instance, by the challenge of balancing the claims of the world's largest national economy with the different, but in each case much smaller economies of its two neighbors, one well-developed and the other state-dominated and still developing.

Placed against these background circumstances, the question arises whether the NAFTA Parties should have agreed, in the investment provisions of Chapter 11, to such an invasion of their national autonomy? Could they have settled for something more modest and less invasive?

When examined in the context of hundreds of other investment treaties, and having regard to the underlying covenant which defines the investor-state relationship, the real question, in my opinion, ought to be how could the NAFTA negotiators have undertaken to do anything less than what they achieved with Chapter 11. It is true, of course, that it entails some limited waiver of sovereign immunity which is not very comfortable for those whose political sense of survival leads them to look to strong state-led actions. However, it is important to remember some of the objectives of NAFTA which are set out in Article 102.

Article 102: Objectives

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[34] DOLZER, *supra* note 30, at 8.

[35] Nationalistic storms were not limited to Mexico as certain laws in both Canada and the United States would attest.

> The objectives of this Agreement, as elaborated more specifically through its principles and rules, including national treatment, most-favored-nation treatment and transparency, are to:
>
> (a) eliminate barriers to trade in, and facilitate the cross-border movement of, goods and services between the territories of the Parties;
>
> (b) promote conditions of fair competition in the free trade area;
>
> (c) increase substantially investment opportunities in the territories of the Parties;
>
> (d) establish a framework for further trilateral, regional and multilateral cooperation to expand and enhance the benefits of this Agreement.

The framework of Chapter 11 is admirably created to achieve these objectives.

It is also important to recall at least three of the resolutions set forth by the Parties in the Preamble to NAFTA, namely, to:

> ENSURE a predictable commercial framework for business planning and investment;
>
> CREATE new employment opportunities and improve working conditions and living standards in their respective territories;
>
> PRESERVE their flexibility to safeguard the public welfare.

Pursuing these goals will require a balancing of public and private interests. To have laid out the laudable objectives of national treatment, most-favored-nation treatment, and transparency together with the undertaking in Article 1110 on expropriation and nationalization, as prescribed in Section A of Chapter 11, without creating an effective enforcement procedure would, in the end have amounted only to a lot of pious, but relatively meaningless, words.

Therefore, Chapter 11's Section B is anything but a Frankenstein creation. It is, in fact, a bold creative step by which the goals of economic fairness are most likely to be achieved. If governments are obliged to adjust course because of a few successful claims brought pursuant to Chapter 11

that will signal not the demise of the nation state, so much as it will confirm economic democracy in North America.

Making the governmental parties directly accountable to those whose economic interests may be unlawfully harmed, contrary to Chapter 11, is our best assurance that NAFTA's highest goals will be achieved.

One further footnote that I would add is the outcome of the *Ethyl* case, for those not familiar with it, was that, after the award on jurisdiction was rendered by the Tribunal, it was settled. Canada paid Ethyl approximately thirteen million dollars (U.S.) in compensation, and withdrew its legislation.

What is not often recognized, however, is that prior to that act of settlement, a very interesting event had also occurred in Canada quite apart from the Chapter 11 proceedings.

In Canada, we have an agreement on internal trade, which reflects a lot of the same trade undertakings which are contained in Chapter 11 itself, only the agreement is among the provinces and the government of Canada.

Under the agreement on internal trade, if there is a dispute among the provinces or the government of Canada as to whether one or the governments has breached its undertakings in that agreement, arbitral proceedings may be brought.

This happened in this case. The Province of Alberta, my home province, brought a complaint against the government of Canada with respect to the legislation of the *MMT Act*. It was joined or supported in this respect by the Province of Quebec and the Province of Saskatchewan.

That case was heard, and the decision on the proceedings, the Agreement on Internal Trade (AIT), was rendered about a month before the award under the NAFTA jurisdictional hearing. And that decision was adverse to Canada. The tribunal in that case made a clear finding that Canada had exceeded its legislative authority, had breached its undertakings in the Agreement on Internal Trade.

And so I would like to remind people that it was not just the award on jurisdiction, which ultimately led to the settlement that occurred. I want to just say that, in my view, bad decisions, or disappointing decisions, should not be deemed to undermine the process. The process is a good one, and I strongly advocate it.

As a footnote, I would offer two proposals. It is my hope that as the experience with the Chapter 11 dispute resolution procedures grows there will be developed an open, transparent reporting system so that all who are interested may follow the cases as they occur, from time to time. In due course, the Parties may eventually wish to modify Article 1136(1) so that a body of jurisprudence may grow from the decision making, a jurisprudence which could be considered at least of persuasive, if not precedential, value.

We know that a common law, developed case by case, occasionally moderated by legislated enactments, is always good insurance against tyranny and state excess. Thus the balance of public and private interests can continue to be served.

Secondly, I would advocate a much more open, transparent disclosure of the proceedings in these cases, limited only by proper concerns for confidentiality of proprietary business information.