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# INVESTMENT ARBITRATION UNDER NAFTA CHAPTER 11: A THREAT TO SOVEREIGNTY OF MEMBER STATES?

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ABSTRACT: Critics of NAFTA Chapter 11's investor state dispute settlement mechanism are primarily concerned with its invocation by corporate entities and its potential to effectively overturn or significantly weaken NAFTA states' ability to legislate or regulate in the public interest. This article will address this central concern and demonstrate, by evaluating Chapter 11 arbitration results, that these criticisms have been over-stated. While developing nations like Mexico are undoubtedly conflicted in their willingness to accept ISDS agreements, participation by all three NAFTA countries in this mechanism can lessen the political risk for foreign investment and attract much-needed outside capital in order to spur economic activity.

## INTRODUCTION

Cross-border investment liberalization is a central goal of the twenty-year-old North American Free Trade Agreement (NAFTA).<sup>1</sup> In pursuit of this goal, NAFTA includes a number of provisions designed to protect foreign investors from discrimination by host states and to facilitate the settlement of international investment disputes. These investment provisions include some of NAFTA's most contentious features, the investor protection standards and investor-state dispute settlement (ISDS) mechanism found in Chapter 11 of the agreement.<sup>2</sup> The proposed inclusion of similar provisions in new, multilateral trade agreements including the Trans-Pacific Partnership (TPP), the Canada-EU Trade Agreement (CETA), and the Trans-Atlantic Trade and Investment Partnership (T-TIP), makes an analysis of the impact of these provisions timely. By assessing the performance of NAFTA investor-state arbitration tribunals to date, this article will demonstrate that though weaknesses deserving of reform exist, Chapter 11's

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<sup>1</sup> North American Free Trade Agreement, Can-Mex-U.S., art. 1105, Dec 17, 1992, 32 I.L.M. 289 [hereinafter NAFTA].

<sup>2</sup> *Id.*

ISDS mechanism is a necessary tool of investor protection and has not eroded the power of sovereign states to regulate in the public interest.

NAFTA's Chapter 11 aims to create a fair and predictable framework to allow for expanded flows of cross-border investment, which in turn can generate greater economic growth across North America.<sup>3</sup> Improving the efficiency of capital allocation is meant to enable each signatory nation to benefit from the corresponding growth in cross-border investment associated with freer trade in goods and services.<sup>4</sup> "Since NAFTA came into force in 1994, foreign direct investment in North America has risen from \$110 billion per year in 1992 to \$650 billion per year in 2010, a 490% increase."<sup>5</sup>

In basic terms, Chapter 11 outlines investor protection principles based on international reciprocity and equitable treatment, and sets up an arbitration process to address the breach of these obligations by a signatory country.<sup>6</sup> This dispute settlement mechanism provides foreign investors with the authority to proceed directly against a NAFTA government<sup>7</sup>, a standing that represents a meaningful departure from past practice when such disputes were traditionally handled between national governments.<sup>8</sup> By empowering an investor to directly challenge a NAFTA government, the investor's grievances are theoretically less politicized, and adjudicated more impartially than they would be through state-to-state negotiation.<sup>9</sup>

Critics of Chapter 11 are primarily concerned with the use of this power by corporate entities and its potential to effectively overturn or significantly weaken NAFTA states' ability to legislate or regulate in the public interest, according to their respective constitutional powers and responsibilities. In other words, though the narrow interests of investors may be adversely affected by member states' public policies, these private interests should not be able to trump public regulation for environmental protection, consumer safety, and other legitimate sovereign state actions.<sup>10</sup> This potential investor influence goes well beyond that

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<sup>3</sup> Julie Soloway with comments by Chris Tollefson *NAFTA's Chapter 11: Investor Protection, Integration, and the Public Interest*, 9 INST. FOR RESEARCH ON PUB. POL'Y 4 (2003) [hereinafter Soloway & Tollefson].

<sup>4</sup> See NAFTA, *supra* note 1, art. 1 (listing the objectives of NAFTA including "eliminate barriers to trade in, and facilitate the cross-border movement of, goods and services between the territories of the Parties" and to "increase substantially investment opportunities in the territories of the Parties.")

<sup>5</sup> Diana Villiers Negroponte, *North American Leaders Meet in Toluca, Mexico: What Can We Hope For?* BROOKINGS (Feb. 18, 2014 12:00 PM) <http://www.brookings.edu/blogs/up-front/posts/2014/02/18-north-american-leaders-toluca-negroponte>.

<sup>6</sup> NAFTA, *supra* note 1, arts. 1105 and 1115.

<sup>7</sup> Soloway & Tollefson, *supra* note 3 at 4.

<sup>8</sup> *Id.* at 3.

<sup>9</sup> See Soloway & Tollefson, *supra* note 3, at 4 (asserting that "empowering a private investor to directly challenge a host government depoliticizes in principle the dispute settlement process by removing it from the realm of state-to-state diplomatic relations" *Id.*). See also Daniel M. Price, *NAFTA Chapter 11 – Investor-State Dispute Settlement: Frankenstein or Safety Valve?* 26 CAN.-U.S. L.J. 107 at 113 (2000) (stating that the intent of NAFTA was to depoliticize investor-state disputes by taking them out of the "political realm and put them more into the realm of international arbitration." *Id.*).

<sup>10</sup> *Id.* at 5.

contained in the World Trade Organization's (WTO) regime, which does not accord any substantive rights to private parties, whether corporations, NGOs, or other non-state actors. This article will address this central concern and demonstrate, by evaluating Chapter 11 arbitration results, that these criticisms have been over-stated. Rather, Chapter 11 does not employ an entirely new ISDS mechanism, its decisions have not resulted in critics' feared outcomes of investors overturning public regulations, and it contains a number of exemptions and safeguards that can prevent its abuse in the future.

#### I. THE U.S. HISTORY WITH ISDS, AND SOME NOTABLE FEATURES OF CHAPTER 11

The U.S. is not new to ISDS. In fact, the United States has a long history of involvement in international investment arbitration, dating as far back as the Jay Treaty of 1794, which allowed British investors access to international arbitration in awarding compensation for losses they sustained in the United States during the Revolutionary War.<sup>11</sup> More recently, since 1982, the United States has entered into fifty bilateral investment treaties that are currently in force and include ISDS provisions.<sup>12</sup> During this time, although the United States has been sued 17 times under Chapter 11 and other such investment agreements, it has never lost a case. Therefore, the United States has yet to encounter a situation in which a domestic regulation came under threat by the ruling of an investment arbitration panel.<sup>13</sup>

Commentators may argue that the U.S. is imposing a double-standard on developing nations as its leverage repels challenges to domestic regulations while well-resourced, U.S. multinational firms are able to extract gains from less powerful developing nations.<sup>14</sup> If this is indeed the case, the author of this article was not able to identify a body of supportive evidence demonstrating such a trend. Within NAFTA, Mexico decided it was in its national interest to accept ISDS provisions. While developing nations like Mexico are undoubtedly conflicted in their willingness to accept ISDS agreements, participation can

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<sup>11</sup> Treaty of Amity, Commerce, and Navigation, Nov. 19, 1794, U.S.-Gr. Brit., arts. V, VII, 8 Stat. 116, 119-20, 122. *See also* Jennifer A. Heindl, *Toward a History of NAFTA's Chapter 11*, 24 BERKELEY J. INT'L L. 676.

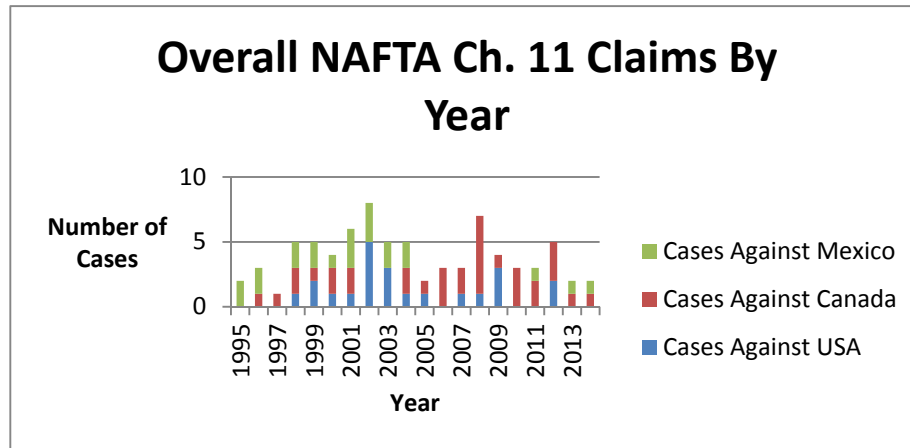
<sup>12</sup> *See* "United States Bilateral Investment Treaties," U.S. DEP. OF STATE, <http://www.state.gov/e/eb/afd/bit/117402.htm> (showing all bilateral investment treaties the United States is a party to). *See also* "Bilateral Investment Treaties and Related Agreements" U.S. DEP. OF STATE, <http://www.state.gov/e/eb/afd/bit/index.htm> (explaining that United States' bilateral investment treaties provide investments with six basic benefits, including providing "investors from both Parties [with] the right to submit an investment dispute with the treaty partner's government to international arbitration. There is no requirement to use that country's domestic courts." *Id.*).

<sup>13</sup> *The Facts on Investor-State Dispute Settlement*, Tradewinds: The Official Blog of the U.S. Trade Rep. (Mar. 27, 2014) <https://ustr.gov/about-us/policy-offices/press-office/blog/2014/March/Facts-Investor-State%20Dispute-Settlement-Safeguarding-Public-Interest-Protecting-Investors>.

<sup>14</sup> *See NAFTA Chapter 11 Cases: Bankrupting Democracy*, PUBLIC CITIZEN (2001), <http://www.citizen.org/documents/ACF186.PDF>.

lessen the political risk for foreign investment, attracting much-needed outside capital in order to spur economic activity.<sup>15</sup> Interestingly, the body of evidence present in NAFTA's Chapter 11 cases does not point to a rich-poor country divide. Most claims have been made between the United States and Canada rather than between the U.S. and Mexico, or between Canada and Mexico. In fact, Canada has faced the greatest number of Chapter 11 claims.<sup>16</sup>

To date, there have only been 68 Chapter 11 cases in NAFTA's 20 years of existence, amounting to just over four per year on average; the vast majority of these cases have either favored the national government or have not reached a settlement or resolution.



**Figure 1:** Claims measured in each year first filed, without double-counting consolidated proceedings or including the sole terminated case, Centurion Health.<sup>17</sup>

As shown above, there is no discernible upward trend in the volume of claims made over time, nor does the record demonstrate a greater quantity or

<sup>15</sup> *Executive Summary 7<sup>th</sup> Annual Forum of Developing Country Investment Negotiators*, INTERNATIONAL INSTITUTE FOR SUSTAINABLE DEVELOPMENT (Jakarta, Indonesia Nov. 4-6, 2013) [http://www.iisd.org/pdf/2013/7th\\_annual\\_forum\\_report.pdf](http://www.iisd.org/pdf/2013/7th_annual_forum_report.pdf).

<sup>16</sup> See generally SCOTT SINCLAIR, CAN. CENTRE FOR POLICY ALTERNATIVES, NAFTA CHAPTER 11 INVESTOR-STATE DISPUTES TO JANUARY 1, 2015 (2015) [hereinafter SINCLAIR]. See also Sunny Freeman, *NAFTA's Chapter 11 Makes Canada Most-Sued Country Under Free Trade Tribunals*, HUFFINGTON POST (Jan. 14, 2015) (Summarizing the previously cited survey, and quoting the author of the study, "Thanks to NAFTA chapter 11, Canada has now been sued more times through investor-state dispute settlement than any other developed country in the world.").

<sup>17</sup> See generally SINCLAIR, *id.* See also PUBLIC CITIZEN, TABLE OF FOREIGN INVESTOR-STATE CASES AND CLAIMS UNDER NAFTA AND OTHER U.S. "TRADE" DEALS (2015).

scope of decisions reached. Simply put, nothing approaching the worst-case scenarios articulated by ISDS critics of proliferating corporate suits, or harmful anti-sovereignty, anti-democratic or anti-public interest decisions, have occurred.

In examining the outcomes of each of these cases in order to assess the overall impact of Chapter 11, it is important to keep several points in mind. First, a distinction should be made between the arguments of claimants and the actual findings of arbitration tribunals. Though some investors under Chapter 11 have made bold, broad claims, the actual findings of the tribunals have been much narrower in scope. In total, while approximately \$55 billion in damages have been sought by Chapter 11 claims, only \$430.4 million in damages sought have been awarded and paid to foreign investors.<sup>18</sup> Of all eighty-six claims that have been filed under the NAFTA to date, 21 cases (24.4%) were dismissed or won by governments, 14 cases (16.2%) were won by investors or resulted in settlements in favor of investors, and the remaining cases (59.3%) are pending or have yet to be concluded.<sup>19</sup>

For example, although much has been made recently of US-based Eli Lilly's \$500 million claim<sup>20</sup> against the Canadian government over the invalidation of Lilly's drug patents, no arbitration decision has been issued. In essence, Lilly claims that the invalidation is tantamount to expropriation, among other violated protections under Chapter 11.<sup>21</sup> Though a dramatic claim, Lilly's suit remains just that, a claim. This case will be summarized in greater detail later in the article. In alleged expropriation cases such as that one, investors have lost far more often than they have won against NAFTA member governments, despite making ambitious claims.

The second notable feature of Chapter 11 cases is that tribunal decisions do not establish precedent under international law. It may be naïve to think that tribunals never consider previous decisions, but the decisions made by one Chapter 11 tribunal nonetheless cannot explicitly be used to guide or influence future decisions.<sup>22</sup> This feature limits the extent to which arbitration tribunals can begin veering in one direction or another in terms of decisions biased towards investors or nation states. The same principles of investor protection must apply in the same ways in each and every case that faces a NAFTA Chapter 11 arbitration tribunal.

Third, there continues to be ample evidence that a large majority of investor-state disputes are successfully adjudicated through the use of historic domestic venues. That is, in most cases, investment disputes are settled within a domestic court system without the need to resort to a Chapter 11 filing. At this point in time, it appears that Chapter 11 cases rightly represent an exception to the norm. If, over time, it becomes apparent that investors immediately move to file suit

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<sup>18</sup> PUBLIC CITIZEN, *supra* note 14.

<sup>19</sup> *Id.*

<sup>20</sup> Eli Lilly v. Canada, UNCT/14/2 (2013) [hereinafter Eli Lilly].

<sup>21</sup> *Id.*

<sup>22</sup> See, e.g., NAFTA, *supra* note 1, art. 1136 (providing that “an award made by a Tribunal shall have no binding force except between the disputing parties and in respect of the particular case.” *Id.*).

under Chapter 11, this situation should be examined further to determine whether this feature of the NAFTA is being misused or abused.

Last, even in cases where investors successfully challenged the laws or regulations of a nation-state, Chapter 11 arbitral tribunals cannot force member countries to reverse or dismantle the laws or regulations in question. Nor can decisions include an injunction against government action or recommend amending the law or regulation at issue. Tribunals can only impose a financial penalty for monetary damages, applicable interest, litigation costs, and the restitution of property. A tribunal may not order a party to pay punitive damages.<sup>23</sup> These limits of tribunal influence and legal authority comport with the essential principle of sovereignty under international law. More detailed information on the parameters of an award can be found in Article 1135 of Chapter 11.

The main investment obligations for treaty parties contained in Chapter 11 upon which an investor claim may be based are as follows:

(1) National Treatment (Article 1102): A signatory government's obligation to treat other investments or investors from another NAFTA signatory no less favorably than domestic investments or investors in similar circumstances.<sup>24</sup>

(2) Most-Favored Nation (MFN) treatment (Article 1103): A signatory government's obligation to treat investments or investors from another NAFTA signatory no less favorably than any other country.<sup>25</sup>

(3) Minimum standard of treatment (Article 1105): A signatory government's obligation to treat investments or investors from another NAFTA signatory in accordance with international law, including fair and equitable treatment.<sup>26</sup>

(4) Expropriation and compensation (Article 1110): The obligation to not expropriate, or take measures tantamount to expropriation, the investments of a NAFTA signatory investor without adequate compensation.<sup>27</sup>

(5) Performance requirements (Article 1106): The obligation to not impose certain performance requirements, such as domestic content percentages, in connection with an investment.<sup>28</sup>

## II. A SELECTION OF NOTABLE CHAPTER 11 CASES TO DATE

The *Metalclad*<sup>29</sup> case, initiated in 1999, demonstrates the value of ISDS in NAFTA and its potential value in future agreements. It is also the only case in which an investor proved the expropriation of its investment. In *Metalclad*, a California-based hazardous waste disposal corporation's facility in the Mexican

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<sup>23</sup> NAFTA, *supra* note 1, art. 1135.

<sup>24</sup> *Id.* art. 1102.

<sup>25</sup> *Id.* art. 1103.

<sup>26</sup> *Id.* art. 1105.

<sup>27</sup> *Id.* art. 1110.

<sup>28</sup> *Id.* art. 1106.

<sup>29</sup> *Metalclad Corp. v. United Mexican States*, ICSID Case No. ARB (AF)/97/1, ¶ 107 (2001).

State of San Luis Potosi was effectively shuttered by municipal and state government actions.<sup>30</sup> By refusing to grant operational permits to the company based on environmental justifications, Mexico was held to have treated Metalclad inequitably, amounting to indirect expropriation.<sup>31</sup>

In its finding, the tribunal noted that as a foreign investor, Metalclad had appropriately relied on the information provided to it by the Mexican federal government, which stated that the municipal construction permits in question were not required. As such, as a NAFTA signatory, Mexico failed to live up to its treaty obligations, namely the provision of a transparent and predictable framework for the planning and investment of an investor from a NAFTA party. In the absence of this framework, and due to the clear and intentional prohibition of use of the landfill facility, the actions by the local authorities in question were ruled tantamount to indirect expropriation. The panel found that a Mexican state governor had used a series of bad faith environmental measures in order to block the opening of a foreign investor's site, despite otherwise being compliant with all applicable legal standards. Of the \$90 million in damages Metalclad had filed suit for, the arbitration panel awarded \$16.7 million.

In Mexico's appeal of the decision to the Supreme Court of British Columbia (the jurisdiction where the NAFTA hearing was held), the court partially reversed the arbitral award in order to tailor the definition of expropriation more narrowly to cases where state interference was proven to be intentional and for the state's benefit.<sup>32</sup> This partial reversal, while not rejecting the core finding, exemplifies an institutional check on the potentially far-reaching implications of NAFTA tribunal decisions. The British Columbia court decision also reduced the amount of the award by \$1.1 million to \$15.6 million based on a redetermination of the applicable interest rate period.<sup>33</sup>

As earlier described, Eli Lilly's suit against the Government of Canada alleges that Canada's invalidation of its *Strattera* and *Zyprexa* pharmaceutical patents represents a failure to provide a minimum standard or national treatment, and that Canada's actions have expropriated Lilly's investments. Canadian domestic courts have upheld the invalidation on the basis of the "promise doctrine," which states that in order for an invention to be patentable, not only must it be deemed useful for a given purpose, it must also deliver any utility promised in the patent specification.<sup>34</sup> While the Canadian government has defended this doctrine in claiming that Lilly's patents no longer meet this promised utility, Lilly argues that this standard is not an internationally accepted practice and violates Canada's investment obligations under NAFTA Chapter 11. In its most recent Special 301 Report, the U.S. Trade Representative noted serious concerns with Canada's intellectual property policy in the pharmaceutical

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<sup>30</sup> *Id.* at ¶ 29.

<sup>31</sup> *Id.* at ¶ 103.

<sup>32</sup> *United Mexican States v. Metalclad Corp.*, 2001 B.C.S.C. 664 (B.C.S.C.) (May 2, 2001) (Can.).

<sup>33</sup> *Id.*

<sup>34</sup> *See, e.g.*, Eli Lilly, *supra* note 20; Export Report of Timothy R. Holbrook (Jan. 26, 2015) (discussing the dispute between Eli Lilly and the Government of Canada over the "utility" of Eli Lilly's patents).



sector, singling out the promise doctrine as leading to uncertainty for patent holders and disincentives for foreign investors.<sup>35</sup> If a Chapter 11 tribunal eventually considers this case, a central question in its proceedings will be the extent, if at all, to which Lilly's treatment can be compared to that of Canadian companies.

In *Methanex*,<sup>36</sup> a Canadian company with a U.S. subsidiary brought a Chapter 11 complaint against the U.S. after an Executive Order was issued to remove a gasoline additive known as MBTE. This order was issued in response to research by the University of California that demonstrated the harmful effects of MBTE leaking from storage tanks in water systems. Methanex, which produces methanol, the main component of MBTE, filed a claim arguing that this scientific evidence was flawed and that the measure violated Articles 1102 (non-discrimination) and 1105 (minimum standard of treatment) of Chapter 11, respectively.<sup>37</sup> However, the tribunal in that case found that there was not a "legally significant connection" between the ban on MBTE and the investor. Though Methanex was surely affected by the regulation, the scope of regulation was viewed as too broad to be the subject of such a challenge as it did not appear to target Methanex specifically. In its claim, Methanex attempted to demonstrate that the regulation effectively discriminated against its interests relative to a comparable domestic investor.<sup>38</sup> In the eyes of the tribunal, Methanex had failed to do so and, as a consequence, an environmental regulation withstood the challenge of a well-resourced foreign investor.

In *Loewen*,<sup>39</sup> a Canadian funeral home corporation brought a Chapter 11 suit against the U.S. government for \$725 million, alleging that a Mississippi court ruling against it violated U.S. obligations to provide national treatment (1102), fair and equitable treatment (1105), and not allow for any actions tantamount to expropriation (1110). Though the NAFTA tribunal allowed a foreign investor to challenge a domestic court ruling, the tribunal narrowly dismissed the investor claim on procedural grounds as the Loewen Corporation had reorganized under U.S. bankruptcy laws and, as such, no longer qualified as a foreign investor.

In 2010, the Canadian Government settled with AbitibiBowater Inc. for \$122 million after the U.S. firm sued for expropriation and compensation under the NAFTA's Chapter 11.<sup>40</sup> AbitibiBowater alleged that the Government of Newfoundland and Labrador had unlawfully confiscated its timber, water, and equipment property after the closure of an AbitibiBowater plant. Newfoundland

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<sup>35</sup> OFFICE OF THE U.S. TRADE REPRESENTATIVE, 2014 SPECIAL 301 REPORT (2014).

<sup>36</sup> *Methanex Corp. v. United States*, NAFTA/UNCITRAL (Aug. 3, 2005), <http://www.state.gov/documents/organization/51052.pdf>

<sup>37</sup> *Methanex Corp. v. United States*, Draft Amended Claim, at 3-4 (Feb 12, 2001), <http://www.state.gov/documents/organization/3940.doc>.

<sup>38</sup> Soloway & Tollefson, *supra* note 3.

<sup>39</sup> *The Loewen Group, Inc. and Raymond L. Loewen v. United States*, ICSID Case No. ARB(AF)/98/3 (June 26, 2003), <http://www.italaw.com/cases/632>.

<sup>40</sup> *AbitibiBowater Inc. v. Canada*, Notice of Intent to Submit a Claim to Arbitration (23 April 2009); Canada – Department of Foreign Affairs and International Trade, Foreign Affairs and International Trade Canada Issues Statement on AbitibiBowater Settlement, DFAIT Press Release 2010 No. 268 (Aug. 24, 2010), <http://www.italaw.com/cases/39>.

and Labrador claimed that these rights were contractually contingent on company's continued operation. While there was no tribunal decision in this case, there was also no public policy at stake in this particular matter.

The consolidated proceedings of three Canadian softwood lumber parties, Canfor<sup>41</sup>, Terminal Forest<sup>42</sup>, and Tembec<sup>43</sup>, in 2005 covered \$540 million in damages sought, caused allegedly by U.S. anti-dumping and countervailing duties applied on allegedly subsidized Canadian softwood lumber exports to the United States. The case was discontinued when the United States and Canada entered into a comprehensive political agreement dealing with lumber subsidies, which resolved the overall softwood lumber trade dispute. The *2006 Softwood Lumber Agreement* (SLA) between the United States and Canada stipulated that the United States would lift duties provided that lumber prices stayed above a specified range, and below this range, the United States would be authorized to impose a mixed export tax and quota regime on imported Canadian lumber. The SLA also established a special dispute settlement mechanism for softwood-related claims before the London Court of International Arbitration.

In the currently pending CANACAR<sup>44</sup> case, a consortium of Mexican trucking companies is suing the United States for blocking Mexican-owned carriers from transporting cargo beyond U.S. border states. In 1982, the United States passed legislation establishing a moratorium on permits for foreign truckers operating in the United States and later lifted the moratorium for Canadian truckers. After unmet U.S. assurances in the NAFTA negotiation to phase-out the prohibition against the Mexican truckers, in 2001 a five-member panel unanimously concluded, in a Chapter 20 party-to-party dispute resolution mechanism, that the United States was in violation of the national treatment and MFN obligations under Chapter 11. In filing a new claim under Chapter 11, CANACAR alleges that the United States has not implemented the tribunal's 2001 decision and that U.S. regulations violate the non-discrimination, MFN, and "fair and equitable treatment" investor protections under the NAFTA, which has resulted in \$30 billion in damages, the largest claim made to date. The United States has continued to state that safety concerns remain paramount in denying operating permits to Mexican trucking firms. However, CANACAR argues that its companies have already made significant investments to raise the fleet standards to those comparable with American fleets, and that this measure is designed to protect American truckers from less expensive foreign labor. As of the publication of this article, this case had not been resolved.

Seeking to protect a de facto monopoly, the Detroit International Bridge Company, a U.S.-based corporation which owns and operates the only bridge that connects Detroit, Michigan to Windsor, Ontario, sued the Canadian government for \$3.5 billion in 2010 in protest of the government's plans to build

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<sup>41</sup> Canfor v. United States, Decision on Preliminary Question (June 6, 2006) and Joint Order on the Costs of Arbitration and for the Termination of Certain Arbitral Proceedings (July 19, 2007), <http://www.italaw.com/cases/200>.

<sup>42</sup> *Id.*

<sup>43</sup> *Id.*

<sup>44</sup> CANACAR v. United States, <http://www.italaw.com/cases/3443>.

a second bridge across the Detroit River.<sup>45</sup> The bridge company's claim is that several decisions made by the Canadian Government with respect to the bridge's operation violate Article 1102 (national treatment), Article 1103 (most-favored nation treatment) and Article 1105 (minimum standard of treatment). This case has yet to be resolved. However, even if it were to be settled in favor of the claimant, the potential for impact on any significant public regulation remains unclear.

In 2004, Cargill Incorporated, a U.S. corporation, filed a notice of arbitration against Mexico on behalf of itself and its wholly-owned subsidiary, Cargill de Mexico S.A. de C.V., a Mexican company<sup>46</sup>. Cargill claimed that its investments in high fructose corn syrup had been adversely impacted by Mexico's 2002 adoption of a tax on high fructose corn syrup. Cargill alleged that the tax was aimed at protecting Mexico's domestic sugar producers and excluding high fructose corn syrup from the soft drink sweetener market, thus violating the national treatment obligation under Article 1102, the most-favored-nation obligation (Article 1103), the minimum standard of treatment obligation (Article 1105), the prohibition on performance requirements in (Article 1106) and the expropriation obligation (Article 1110). Cargill sought damages in excess of \$100 million and was awarded \$77 million, later \$96 million with interest, after a Canada-based arbitration panel ruled in Cargill's favor in 2009.

In that case, Mexico did not make the argument that its ability for sovereign, legitimate public regulation was compromised in appealing the decision or in appealing similar decisions by WTO panels against this discriminatory, protectionist tax.<sup>47</sup> Essentially, Mexico defended its actions by citing the alleged failure of the United States to live up to its market access commitments for Mexican sugar under the NAFTA. This claim implicitly acknowledged discriminatory retaliation against a U.S. investor without even the pretense of justifying the tax as a public health regulation. In recent years, the United States has made several claims against Mexico for alleged sugar dumping, and Mexico has alleged U.S. corn syrup dumping into its domestic market. In that case, a U.S. investor bore the brunt of a broader bilateral trade dispute. Mexico never possessed the legal authority, such as that which could be bestowed by the WTO Agreement, to retaliate and the arbitration panel made its decision accordingly.

The central theme across each of these cases is that arbitral tribunals made narrow decisions based on factual evidence. There are additional institutional checks in place to prevent abuses of power and provide meaningful recourse to dissatisfied parties. In fact, the author of this article could not identify a landmark case in which a major public regulation was effectively overturned due to a Chapter 11 tribunal's ruling in favor of a claimant investor.

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<sup>45</sup> *Detroit International Bridge Company v. Canada*, PCA Case No. 2012-25, <http://www.italaw.com/cases/354>.

<sup>46</sup> *Cargill Inc. v. United Mexican States*, ICSID Case No. ARB(AF)/05/2, <http://www.italaw.com/cases/documents/1214>.

<sup>47</sup> Panel Report, *Mexico – Tax Measures on Soft Drinks and Other Beverages*, WT/DS308/R (Oct. 7, 2005); Appellate Body Report, *Mexico – Tax Measures on Soft Drinks and Other Beverages*, WT/DS308/AB/R (6 March 2006).

Looking at all Chapter 11 cases together, there is also no apparent evidence that regulatory entities in NAFTA countries are prevented or deterred from adopting new or updated regulations that pursue legitimate public interests because of the risk of exposure to investment arbitration. Based on the cases decided to date, it is difficult to argue that regulatory effectiveness or quality has been appreciably diminished. Furthermore, as earlier described, even in cases where tribunals rule against a given NAFTA member, these tribunals can only force said member to pay fair, monetary compensation to the aggrieved investor rather than actually punish or otherwise compel a member state to reverse the policy in question.

### III. SUBSTANTIVE SAFEGUARDS IN PLACE AND NEEDED REFORMS

In the original negotiations that established the NAFTA, a number of notable regulatory areas were both broadly and specifically exempted from the Chapter 11 claims of foreign investors including national security, healthcare and social welfare, among many others. NAFTA Article 1101, the very first article of Chapter 11, immediately limits its scope in several key provisions.<sup>48</sup> For example:

4. Nothing in this Chapter shall be construed to prevent a Party from providing a service or performing a function such as law enforcement, correctional services, income security or insurance, social security or insurance, social welfare, public education, public training, health, and child care, in a manner that is not inconsistent with this Chapter.<sup>49</sup>

Additionally, a full and lengthy list of exclusions and specially treated areas under Ch. 11 can be found in Annexes I through IV of the NAFTA.<sup>50</sup> The creation of these exemptions demonstrates the negotiator's original awareness of the risks for sovereignty and public regulation of an unchecked investor-state dispute resolution mechanism. Mexico reserved 89 sectors in its economy, the U.S. reserved 50, and Canada reserved 48, respectively. Other sectors that included significant reservations from national treatment and most-favored nation include transportation, energy, and legal services. In these areas and others, each country maintains a robust list of investment thresholds and screening mechanisms to shield sensitive subjects.

In other substantive areas, like environmental protection, which were not originally offered as robust an exemption, it is fair to question whether the

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<sup>48</sup> For instance, NAFTA art. 1101 provides that a Party has the right to perform exclusively certain enumerated economic activities set out in Annex III; that Chapter 11 does not apply to measures adopted or maintained by a party to the extent that they are covered by NAFTA Chapter 14 on financial services; and that nothing in Chapter 11 shall be construed to prevent a party from providing a service or performing a function such as law enforcement, correctional services, income security or insurance, social security or insurance, social welfare, public education, public training, health, and child care.

<sup>49</sup> See NAFTA, *supra* note 1, art. 1101(4).

<sup>50</sup> *Id.* at Annexes 1120.1, 1137.2, 1137.4 and 1138.2.

NAFTA strikes the right balance of regulatory autonomy and investor protection. The scope and scale of future exemptions should be adjusted to reflect the preferences and priorities of negotiating partners, while also ameliorating the concerns that multinational firms will have the power to trump national constitutions and sovereign authority.

As ISDS is considered for inclusion in future trade agreements, negotiating parties should evaluate past allegations and evidence of disparate treatment of foreign investors. This evaluation should inform the creation of legal institutions that can accurately and consistently address these grievances. In tailoring these investor protections and dispute settlements, trade negotiators and political leaders should work to better define eligible “investment,” and clarify “fair and equitable treatment,” “indirect expropriation,” and “national treatment” among other key concepts in the NAFTA’s Chapter 11. Future negotiators should focus on deriving the appropriate lessons learned from the NAFTA experience in order to strengthen ISDS, and with it, international trade and investment.

From the NAFTA Chapter 11 decisions, we observe a number of potential areas that might be strengthened or amended through both procedural and substantive reforms. Doing so could improve the NAFTA’s investment provisions while also serving as practical guidance for future trade agreements.

On the procedural front, the NAFTA arbitration tribunals can become more transparent and accountable through greater, timelier public reporting and the fuller acceptance and consideration of amicus briefs filed by NGOs and other public interest groups. Creating more accessibility for all stakeholders could create another institutional safeguard to ensure the tribunals remain accountable and afford sovereign entities their prerogative for legitimate regulation in the public interest. The United States Trade Representative’s “Model Bilateral Investment Treaty,” released in 2012, makes good progress in laying out these improvements within investor-state treaties.<sup>51</sup>

More can be done to see that non-meritorious cases are expeditiously dismissed and that the costs of cases do not unfairly disadvantage a lesser-resourced party to a dispute. Similarly, because tribunals’ decisions do not constitute precedent, more can and should be done to alleviate confusion or undue compliance burdens when multiple decisions about the same investor protections are inconsistent in the future.

Substantively, treaty parties must continue to evaluate the treatment of certain sensitive industries and economic sectors, ensuring that investor protections are appropriately balanced against legitimate public interest regulation. Notably, the aforementioned 2012 “Model BIT” strengthens standards for labor rights and environmental protection.

#### IV. WHAT IS NEXT FOR ISDS IN NAFTA, FUTURE AGREEMENTS?

Customary international law and the domestic law of each of the NAFTA parties should theoretically allow for each country to take regulatory action that

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<sup>51</sup> See U.S. Model Bilateral Investment Treaty, [www.state.gov/documents/organization/188371.pdf](http://www.state.gov/documents/organization/188371.pdf).

is in good faith. However, ongoing discriminatory regulation against foreign investors is an unfortunate reality. Well-tailored ISDS provisions are an important form of protection and recourse for foreign investors that have been unfairly treated. Clearly, addressing the claims of private actors becomes more challenging when this treatment is less overtly unfair and is shrouded in more noble intentions.

The author's conclusion is that while Chapter 11 cases thus far under NAFTA arbitration proceedings do not create a cause for concern, going forward, we must ensure that the legitimate interests of states applying public policy is honored. The real test is fundamentally whether public policies are applied to foreign and domestic enterprises in an equitable fashion. An appropriate analogy is the "Dormant Commerce Clause Doctrine" of the U.S. Constitution, which has been understood to mean that states may not adopt regulations or taxes that place an undue burden on interstate commerce. As a general rule, U.S. states may not advantage their own businesses while excluding other businesses from other states.

While Chapter 11 cases decided by the NAFTA arbitration so far do not create cause for concern, they do signal some weaknesses in the current provisions. State obligations and arbitration tribunals need more coherent and well-defined boundaries so that they strike an appropriate balance between investor protections that facilitate cross-border capital flows and the uninhibited role that sovereign regulators can and should play in protecting the environment, public health and the autonomy of their own legal systems. However, before dismissing Chapter 11 or future such provisions outright in free trade agreements, we should recognize their value in liberalizing investment and continue to evaluate the facts of these tribunals' performance using a sober, cost-benefit analysis. This analysis should inform practical reforms that address ISDS weaknesses while enhancing the ability of NAFTA tribunals and equivalent bodies to protect investors and create economic growth and development into the future.