

5-1-2005

An Evaluation of Current Legitimacy-Based Objections to NAFTA's Chapter 11 Investment Dispute Resolution Process

Naveen Gurudevan

Follow this and additional works at: <https://digital.sandiego.edu/ilj>



Part of the [Dispute Resolution and Arbitration Commons](#), [International Law Commons](#), [International Trade Law Commons](#), and the [Transnational Law Commons](#)

Recommended Citation

Naveen Gurudevan, *An Evaluation of Current Legitimacy-Based Objections to NAFTA's Chapter 11 Investment Dispute Resolution Process*, 6 *San Diego Int'l L.J.* 399 (2005)
Available at: <https://digital.sandiego.edu/ilj/vol6/iss2/9>

This Comment is brought to you for free and open access by the Law School Journals at Digital USD. It has been accepted for inclusion in *San Diego International Law Journal* by an authorized editor of Digital USD. For more information, please contact digital@sandiego.edu.

An Evaluation of Current Legitimacy-based Objections to NAFTA's Chapter 11 Investment Dispute Resolution Process*

TABLE OF CONTENTS

| | | |
|------|--|-----|
| I. | INTRODUCTION | 400 |
| | A. <i>Overview of Chapter 11 Provisions</i> | 401 |
| | B. <i>Background of Debate on Chapter 11</i> | 401 |
| | C. <i>Analytic Framework</i> | 403 |
| II. | THE ARTICLE 1110 REGIME OF "TANTAMOUNT TO NATIONALIZATION OR EXPROPRIATION"—TEXTUAL INDETERMINACY? | 403 |
| | A. <i>Background of Article 1110</i> | 404 |
| | B. <i>The Concept of Creeping Expropriation in International Law</i> | 404 |
| | C. <i>Regulation: Breach of a Commercial Contract or Expropriation?</i> | 408 |
| | D. <i>Jurisprudence from Chapter 11-based Tribunal Decisions</i> | 411 |
| | 1. <i>Robert Azinian v. Mexico</i> | 412 |
| | 2. <i>Pope and Talbot Inc. v. Canada</i> | 412 |
| | 3. <i>Myers v. Canada</i> | 414 |
| | 4. <i>Metalclad Corp. v. Mexico</i> | 416 |
| | 5. <i>Feldman v. Mexico</i> | 418 |
| III. | LEGITIMACY-BASED OBJECTIONS TO NAFTA'S INVESTMENT DISPUTE SETTLEMENT MECHANISM | 419 |
| | A. <i>Private Party Actions against Host States</i> | 420 |
| | B. <i>Arbitral Tribunals versus National Courts—Threat to National Sovereignty?</i> | 422 |
| | C. <i>Transparency and the related Question of Democratization</i> | 425 |
| IV. | NEW DIRECTION FOR NAFTA'S CHAPTER 11: RENEGOTIATION OR FRESH INTERPRETIVE METHODOLOGY? | 427 |

* J.D. candidate 2005, University of San Diego School of Law.

| | | |
|----|--|-----|
| A. | <i>Is there a Need to Re-Negotiate the Investment Provisions of NAFTA?</i> | 427 |
| | i. <i>Re-crafting Article 1110</i> | 427 |
| | ii. <i>Uniform Standard for Judicial Review of Chapter 11 Awards</i> | 428 |
| | iii. <i>General Considerations</i> | 429 |
| B. | <i>Suggestions for Interpretive Methodology</i> | 430 |
| | i. <i>Interpretation of Article 1100</i> | 431 |
| V. | CONCLUDING REMARKS | 432 |

I. INTRODUCTION

The year 1994 saw the conclusion of a very important trilateral trade and investment treaty in North America: the North American Free Trade Agreement.¹ Since then, this agreement has had a tremendous impact on the trading relations among the three signatory states—the United States, Canada, and Mexico.² Of particular significance is Chapter 11, the Investment Chapter. One of the main objectives of Chapter 11 is to provide an effective means for the resolution of disputes between a foreign investor and the host government.³ To this end, it provides a mechanism whereby private parties can initiate arbitration proceedings against the host state before an international tribunal⁴ such as, for example, the International Convention for the Settlement of Investment Disputes, commonly referred to as ICSID.⁵

1. North America Free Trade Agreement, 32 I.L.M. 605 (1994) [hereinafter NAFTA].

2. Hereinafter, the United States, Canada, and Mexico are referred to as "Parties."

3. NAFTA, *supra* note 1. According to the Preamble of NAFTA, the Parties undertook to "[ensure] a predictable commercial framework for business planning and investment . . . in a manner consistent with environmental protection and conservation . . . and promot[ion of] sustainable development." Article 102 (1)(e) states that the objective of the Agreement is to "create effective procedures for the implementation and application of this Agreement, for its joint resolution and for the resolution of disputes. . ." North American Free Trade Agreements, Dec. 8, 1992, prmb., art. 102(1)(e), *reprinted in* NORTH AMERICAN FREE TRADE AGREEMENTS, TREATY MATERIALS, at 2–3 (James R. Holbein & Donald J. Musch eds., 1992).

4. NAFTA, *supra* note 1, at art. 1116 (which permits investors to initiate international arbitration against a host state for violations of the substantive investment provisions in NAFTA). For an overview of the investor dispute settlement mechanism in the NAFTA Investment Chapter, see Gary N. Horlick & Amanda DeBusk, *Dispute Resolution under NAFTA: Building on the U.S.-Canada FTA, GATT and ICSID*, 10 J. INT'L ARB. 51 (1993).

5. Convention on the Settlement of Investment Disputes between States and Nationals of other States, March 18, 1965, 17 U.S.T. 1270, 575 U.N.T.S. 159, 4 I.L.M. 532 (1965) [hereinafter The ICSID Convention]. This is only one among three permissible fora for arbitration of investment disputes permitted under the NAFTA regime and is by way of illustration only.

A. Overview of Chapter 11 Provisions

The substantive obligations of each NAFTA Party with respect to investment arrangements are set out in Part A of Chapter 11.⁶ Part B of Chapter 11 contains rules regarding the enforcement mechanism, such as the forum for dispute settlement and the choice of procedural rules governing the arbitral proceedings.⁷ Article 1120⁸ provides a choice between three sets of arbitral rules to govern investment disputes that arise under Part A: the ICSID Convention and its rules;⁹ the ICSID (Additional Facility)¹⁰ and its rules¹¹ (in the event the parties choose institutional arbitration; or, in case the parties choose *ad hoc* arbitration, the United Nations Commission on International Trade Law (UNCITRAL) Arbitration Rules.¹²

B. Background of Debate on Chapter 11

Chapter 11 of NAFTA represents a significant shift in Mexico's approach to foreign investment, which had until then followed a policy of economic protectionism.¹³ It is also the first time that two developed

6. Section A contains provisions dealing with the scope of application of Chapter 11 and substantive obligations of the Parties in the investment context, such as national treatment, most-favored-nation treatment, minimum standard of treatment, and compensation in the context of expropriation. NAFTA, *supra* note 1, at arts. 1101–14.

7. For a detailed description of the dispute resolution mechanism envisaged in Chapter 11 B, see Gary N. Horlick & Alicia L. Marti, *NAFTA Chapter 11 B: A Private Right of Action to Enforce Market Access through Investments*, 14 J. INT'L ARB. 43, 45–48 (1997). For a practical overview of the relevant provisions of Chapter 11 B and the three possible regimes of arbitral procedure permitted under NAFTA, see Cheri D. Eklund, *A Primer on the Arbitration of NAFTA Chapter 11 Investor-State Disputes*, 11 J. INT'L ARB. 135, 140–53 (1994).

8. NAFTA, *supra* note 1, at art. 1120.

9. The ICSID Convention, *supra* note 5, at art. 44.

10. ICSID Additional Facility for the Administration of Conciliation, Arbitration, and Fact-Finding Proceedings, Doc. ICSID/11 (June 1979) [hereinafter *The Additional Facility*].

11. Rules Governing the Additional Facility for the Administration of Proceedings by the Secretariat of the International Centre for Settlement of Investment Disputes, Schedule C-Arbitration Rules, Doc. ICSID/11 (June 1979) [hereinafter *Additional Facility Rules*].

12. Arbitration Rules of the United Nations Commission on International Trade Law, approved by the United Nations General Assembly on December 15, 1976, U.N. GAOR, 31st Sess., Supp. No. 17, at 32, U.N. Doc. A/31/17 (1976) [hereinafter *Arbitration Rules*].

13. Gloria L. Sandrino, *The NAFTA Investment Chapter and Foreign Direct Investment in Mexico: A Third World Perspective*, 27 VA. J. TRANSNAT'L L. 259, 262

nations, namely Canada and the United States, have included such provisions in an agreement among themselves.¹⁴ Prior to NAFTA, investor-state disputes usually consisted of investors from developed countries making claims against host states that were developing nations. The NAFTA experience, however, appears to have ushered a new and perhaps unanticipated scenario with developed countries often in the role of host nation.¹⁵

No other provisions of NAFTA have been more hotly debated in recent times than Chapter 11 and, in particular, Article 1110, which addresses indirect expropriation.¹⁶ This is due in large part to the numerous investor claims filed against NAFTA host governments. Beginning in 1999, there has been a steady flow of NAFTA investor-state disputes involving investments in the United States, while the trend of U.S. investors seeking compensation from the other two Parties for their investments in those host countries also continues.¹⁷

There has been much suspicion and concern on the part of public interest groups that the dispute resolution process, in particular the resolution of claims of creeping expropriation, tends to short-change the host state and is a weapon in the hands of corporate investors.¹⁸ NAFTA claimants voice the opposite concern—that the host states illegitimately resort to their municipal courts to overturn pro-claimant arbitral awards, despite the apparent conflict of interest.¹⁹

(1994). Prior to NAFTA, Mexico's approach to foreign investment was epitomized by the Calvo doctrine, which was in direct opposition to prevailing international law protecting the rights of foreign investors. *Id.* at 308.

14. Daniel M. Price, *An Overview of the NAFTA Investment Chapter: Substantive Rules and Investor-State Dispute Settlement* 27 INT'L LAW. 727, 731 (1993).

15. Guillermo Aguilar Alvarez & William W. Park, *The New Face of Investment Arbitration: NAFTA Chapter 11*, 28 YALE J. INT'L L. 365, 370 (2003).

16. NAFTA's investor-state provisions have generated much literature on their structure and legitimacy. See, e.g., Charles H. Brower II, *Structure, Legitimacy and NAFTA's Investment Chapter*, 36 VAND. J. TRANSNAT'L L. 37 (2003); Ari Afilalo, *Constitutionalization through the Back Door: A European Perspective on NAFTA's Investment Chapter*, 34 N.Y.U. J. INT'L L. & POL. 1, 3 (2001).

17. Todd Weiler, *Foreign Investment in the United States: The Dawning of a New Era in NAFTA Investor-State Dispute Settlement*, 34 INT'L LAW 405, 405-06 (2000).

18. For an appraisal of the various investor claims from an environmental standpoint, see e.g. Stephen L. Kass & Jean M. McCarroll, *NAFTA's Chapter 11: Environmental Claims*, 228 N.Y. L.J. 3, (col. 1) (2002).

19. One example of an arbitration award that was sought to be (and was) set aside by a municipal court upon the complaint of a host government is the *Metalclad* decision, discussed *infra*. It evoked a visceral response among some scholars as overstepping the bounds of municipal authority by "de facto extend[ing] the scope of its review by importing some of the standards of review of decisions of domestic administrative tribunals when dealing with . . . [t]he Arbitral Tribunal's finding of expropriation as a result of the ecological decree." Hector Olasolo, *Have the Public Interests been Forgotten in NAFTA Chapter 11 Foreign Investor/Host State Arbitration? Some Conclusions from the Judgment of the Supreme Court of British Columbia on the Case of*

C. Analytic Framework

Charles Brower describes the widely debated legitimacy question as one partly stemming from textual indeterminacy.²⁰ The analytic framework of this Comment however treats the question of textual indeterminacy as distinct from the normative question of the legitimacy of the tribunal and of the dispute resolution process as a whole, rather than as a part of it.²¹ Consequently, Part II explores the extent to which the indeterminacy of the text in Article 1110 has been resolved through arbitral decisions. It argues that as a practical matter, and contrary to public perception, the approach of tribunals in resolving investor-state disputes has been fairly even-handed and consistent. Article 1110 has been chosen here as the analytic vehicle for exploring textual indeterminacy because such provision has been the target of much criticism.

Normative concerns of legitimacy and transparency remain despite the substantial resolution of the textual indeterminacy question. They require critical evaluation at a level that transcends merely the fear of a “bad” outcome, which is, depending on one’s vantage point, one that is perceived as unreasonably favoring investors’ interests over the host state’s public interest concerns, or vice versa. These concerns are addressed in Part III.

Part IV provides suggestions for future arbitral tribunals interpreting the provision on indirect expropriation, bearing in mind its context within NAFTA, as well as obligations under customary international law.

II. THE ARTICLE 1110 REGIME OF “TANTAMOUNT TO NATIONALIZATION OR EXPROPRIATION”—TEXTUAL INDETERMINACY?

Admittedly, the observations relating to one provision in the Investment Chapter may not necessarily shed light on the more general question of textual indeterminacy. Nonetheless, as suggested earlier, Article 1110 is

Mexico v. Metalclad, 8 L. & BUS. REV. AM. 189, 202 (2002).

20. Brower, *supra* note 16, at 59–60.

21. This approach is distinct from Professor Brower’s approach, wherein he treats textual indeterminacy as part of the larger problem of perceived legitimacy or illegitimacy of, among other things, the tribunal, the scope of the claims made by investors, and actions of host states in approaching municipal courts to set aside arbitral awards. He states: “The root of the [illegitimacy] problem lies not in the purportedly avaricious hearts of investors but in textual indeterminacy created by the NAFTA Parties.” Brower, *supra* note 16, at 62.

a good exemplar for examining the charge of textual indeterminacy and the extent to which it has been resolved since NAFTA came into effect. It is indicative of the approach of arbitral tribunals to interpretation of NAFTA Investment Chapter provisions.

A. Background of Article 1110

Article 1110 provides that a NAFTA Party shall not expropriate either directly or indirectly an investment, nor shall it take a measure “tantamount to nationalization or expropriation,” unless it is done for a public purpose and on a non-discriminatory basis.²² The latter part of the Article appears to be designed to address the problem of creeping expropriation.²³ Negotiation of the Investment Chapter reveals that this provision was primarily aimed at preventing illegal takings of United States and Canadian businesses by the Mexican government.²⁴ This was due to previous instances of seizure by Mexico of foreign-owned companies.²⁵ Ironically, this provision has been invoked in numerous actions against the Canadian and United States governments.²⁶

From the numerous NAFTA investor-state arbitrations that have unfolded, it emerges that claimants, usually multinational corporations, have attempted to push the interpretive boundaries of the phrase “tantamount to expropriation” to questionable limits, to the point where any governmental action that threatens foreign investment unhesitatingly becomes the subject of investor-state arbitration.²⁷ Whether or not they have been successful in doing so, thereby justifying the fears of many critics, will be revealed in the analysis of some decisions of the tribunals.

B. The Concept of Creeping Expropriation in International Law

The concept of expropriation in and of itself is not new in international

22. NAFTA, *supra* note 1, at art. 1110.

23. Sandrino, *supra* note 13, at 308. She suggests that although NAFTA was supposed to represent a reversal of the Calvo Doctrine in Mexico, which placed national sovereignty above the rights of foreign investors, the Parties appear not to have anticipated its use against host states other than Mexico, i.e., the United States and Canada. *Id.*

24. Price, *supra* note 14, at 728.

25. For a discussion of the historical background of the international framework of foreign direct investment, and in particular Mexico’s role as the Third World protagonist through its Calvo Doctrine, see generally, Sandrino, *supra* note 13. See also Matthew Nolan and Darin Lippoldt, *Obscure NAFTA Clause Empowers Private Parties: Investor Protection Clause Lets Companies Haul Signatories into Arbitration for Violation of Pact*, NAT’L L.J., Apr. 6, 1998, at 32.

26. Alvarez & Park, *supra* note 15, at 368.

27. Nolan, *supra* note 25, at 34.

law.²⁸ A successful claim of expropriation in international law generally rests on the finding that a taking or deprivation of some legally recognized right has been affected by the State party to the claim.²⁹ The principle that a forcible takeover of the premises of a forging investment facility or the confiscation of personal property by government officials would constitute an expropriatory taking can be elicited from the awards of ICSID tribunals and the Hague Tribunal.³⁰

While there is ample jurisprudence on direct expropriation, it is not entirely clear as to what actions of the host government can be said to be “tantamount to expropriation” or indirect expropriation.³¹ This becomes problematic when one tries to interpret this phrase as it appears in Article 1110.³² Thus, while Article 1130³³ makes it clear that the substantive law

28. RUDOLF DOLZER & MARGRETE STEVENS, *BILATERAL INVESTMENT TREATIES* 98 (1995).

29. Rudolf Dolzer, *Indirect Expropriation of Alien Property*, 1 ICSID REV. FOREIGN INVESTMENT L. J. 41, 41 (1986), stating that the object of protection against expropriation is essentially a property right. Such a right may be tangible or intangible, such as contractual rights. Dolzer suggests that the law of expropriation in part defines its scope through the definition of such property rights.

30. For a full discussion of expropriatory takings decisions by the Hague Tribunal and ICSID tribunals, see John A. Westberg, *Applicable Law, Expropriatory Takings and Compensation in Cases of Expropriation: ICSID and Iran—U.S. Claims Tribunal Case-Law Compared*, 8 ICSID REV.-FOREIGN INVESTMENT L.J. 1, 10–15 (1993). After a comprehensive review of awards by both the Hague Tribunal and the various ICSID tribunals, he observes some principles emerge. For instance, he states that “the forcible takeover of the premises of a foreign investment facility or the confiscation of personal property, by military personnel or other government officials acting in an official capacity for the government, constitutes takings which may be found to be expropriatory if the other elements of expropriatory conduct are found to be present.” *Id.* at 13.

31. Vicki Been & Joel C. Beauvais, *The Global Fifth Amendment? NAFTA’s Investment Protections and the Misguided Quest for an International “Regulatory Takings” Doctrine*, 78 N.Y.U. L. REV. 30, 51 (2003).

32. Article 1110 states:

1. No Party shall 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 the general principles of treatment provided in Article 1105; and
 - (d) upon payment of compensation in accordance with paragraphs 2 to 6.

NAFTA, *supra* note 1.

33. Article 1131 states: “A Tribunal established under this Subchapter shall decide the issues in dispute in accordance with this Agreement and applicable rules of international law.” *Id.*

to be applied by the tribunal is the Agreement itself and the applicable *international law*, the latter is far from precise.³⁴

Comeax and Kinsella explain creeping expropriation as one “accomplished through a series of hostile actions that cumulatively deprive the investor of the value of the investment.”³⁵ The term “creeping” is not a neutral term,³⁶ and “indirect expropriation” is preferable for the purpose of this discussion. They state that such expropriatory actions of the state deprive the investor of effective ownership of the asset, even though the investor retains nominal ownership.³⁷ Another author has attempted to define in more general terms.³⁸

Numerous governmental actions have been held to be compensable acts of expropriation by the Iran-U.S. Claims Tribunal.³⁹ Indeed, the tribunal frequently considered the issue of indirect expropriation.⁴⁰ Some examples

34. Been and Beauvais caution that it is unclear whether the language in Article 1130 creates a new treaty specific standard, i.e., *lex specialis*, or is merely a reiteration of existing customary international law. Been & Beauvais, *supra* note 32, at 51–52. As later parts of this comment will discuss, some claimants have tried to make the argument that it is indeed a *lex specialis*—an argument that the tribunal in *S.D. Myers, Inc. v. Canada* rejected. *S.D. Myers, Inc. v. Canada*, Partial Award, ¶ 286.

35. PAUL E. COMEAUX & N. STEPHAN KINSELLA, *PROTECTING FOREIGN INVESTMENT UNDER INTERNATIONAL LAW: LEGAL ASPECTS OF POLITICAL RISK* 8 (1996).

36. See Dolzer, *supra* note 29, at 44.

37. DOLZER & STEVENS, *supra* note 28, at 99: “[T]o the investor, the line of demarcation between measures for which no compensation is due and actions qualifying as indirect expropriation may well make the difference between the burden to operate (or abandon) a non-profitable enterprise and the right to receive full compensation. . . .”

38. Sandrino describes creeping expropriation as “involving measures whereby the government increasingly imposes restrictions and controls such as excessive and repetitive tax regulatory measures on the foreign investment enterprises so as to make it difficult to continue in business at a profit. This leads to the sale or abandonment of the project to the government or local private investors, thus having a net confiscatory effect.” Sandrino, *supra* note 13, at 317.

39. CHARLES N. BROWER & JASON D. BRUESCHKE, *THE IRAN-UNITED STATES CLAIMS TRIBUNAL* 669 (1998) (noting that the tribunal has contributed a significant amount of precedent that have influenced the shaping of international legal principles).

40. Charles N. Brower, *Current Developments in the Law of Expropriation and Compensation: A Preliminary Survey of Awards of the Iran—U.S. Claims Tribunal*, 21 *INT’L LAW*. 639, 643 (1987). After reviewing several of the awards issued by the Tribunal, he states that it has been fairly consistent in its treatment of expropriation claims. His conclusion on the pattern of expropriation findings by the Tribunal is as follows:

A taking will be found to occur whenever actions attributable to the Government amount to an unreasonable interference with the owner’s use or control of the property. The reasonableness of the interference is generally determined pragmatically, focusing on the owner’s rights to management and income. A finding of attributability generally requires at least one deliberate governmental assertion of control over the corporation, such as the substitution of Government-appointed managers. Losses caused by revolutionary unrest not directly traceable to such a governmental action have not generally been held to constitute compensable expropriations.

Id. at 669.

include incremental increases in taxes, increasingly harsh regulations, import and export restrictions, price controls, zoning laws, prolonged “temporary seizures” of assets, and control on expatriation of profits.⁴¹

The Iran-U.S. claims tribunal in *Starrett Housing Corp. v. Republic of Iran* found that for an expropriation to occur, host state interference must be to the extent that the property rights are rendered so useless that they must be deemed to have been expropriated:

Measures taken by a state can interfere with property rights to such an extent that these rights are rendered so useless that they must be deemed to have been expropriated, even though the state does not purport to have expropriated them and the legal titles to the property formally remains with the original owner.⁴²

Subsequent tribunals, in examining the question of whether a taking constitutes an indirect expropriation, have followed the test laid down in this case. The test places emphasis on the effect on the investor’s rights in making the determination.⁴³

Indirect expropriation was also used by the government of Communist China in the form of “hostage capitalism.”⁴⁴ The Chinese government adopted a two-stage approach. In the first phase, it would impose price controls, tax increases, and wage increases on foreign investors while imposing ceilings on funds flowing out of China; in the second phase, the Chinese government would then prohibit the investors from closing operations without their express approval, even though the investors were losing money.⁴⁵ Increasing liabilities would force the foreign parent to remit money to the Chinese subsidiary.⁴⁶

While these cases and scenarios illustrate governmental actions that have been held to amount to indirect expropriation, no rule of customary international law emerges.⁴⁷ Rudolf Dolzer, after comprehensively reviewing state practice and *opinio juris* of nations on indirect expropriation, concludes that the law of indirect expropriation is “sketchy and rough” and that it is an area where “large lacunae remain.”⁴⁸ Investment treaties,

41. COMEAUX & KINSELLA, *supra* note 35, at 8.

42. *Starrett Housing Corp. v. Republic of Iran*, Interlocutory Order, 4 Iran-U.S. Cl. Trib. Rep. 122, 154 (1983).

43. DOLZER & STEVENS, *supra* note 28, at 100.

44. Pat. K. Chew, *Political Risk and U.S. Investments in China: Chimera of Protection and Predictability?*, 34 VA. J. INT’L L. 615, 627 (1994).

45. *Id.*

46. *Id.*

47. IAN BROWNLIE, *PRINCIPLES OF INTERNATIONAL LAW* (1991).

48. Dolzer, *supra* note 29, at 59.

including NAFTA, do not lay down any precise definitions for indirect expropriation., although they refer to it as a compensable act. Nor do any general principles⁴⁹ exist across domestic legal systems regarding indirect expropriation. Each legal system has a different approach to indirect expropriation depending on its constitutional limitations and broad economic policy.⁵⁰ Thus, there appears to be little guidance in the form of rules for arbitral tribunals deciding claims of indirect expropriation. This only underscores the need for and importance of well-reasoned arbitral decisions in every investment dispute in which the issue arises.⁵¹

C. Regulation: Breach of a Commercial Contract or Expropriation?

The problem arising from a lack of clear authority on the law of indirect expropriation is further compounded by the fact that an act of indirect expropriation may be factually difficult to distinguish from one of lawful regulation, and indeed from ‘ordinary’ breach of contract by the sovereign.⁵² The distinction is crucial, however, because as the discussion below reveals, each type of governmental action leads to dramatically different legal consequences.⁵³

Every nation has the sovereign right to regulate certain activities of private individuals and entities in the public interest.⁵⁴ Such regulations are characteristic of governments of modern states and, in municipal legal systems, are by and large not viewed as compensable incursions of individuals’ property rights.⁵⁵ Many government regulations in some way or another negatively impact a particular economic interest and affect business opportunities for some; but unless it is *confiscatory* in nature, it will not give rise to liability of the government as an action constituting a compensable taking.⁵⁶ Instead, it is considered to be a lawful exercise of ‘police power’ or eminent domain of the state, without

49. BROWNLIE, *supra* note 47, at 19.

50. The diversity of doctrinal approach is well explained through illustration by Dolzer, *supra* note 29, at 59.

51. Arbitral awards generally bind only the parties to the dispute and have no precedential value for subsequent tribunals. The NAFTA regime is no exception. Art. 1131(1) explicitly states: “An award made by a Tribunal shall have no binding force except between the disputing parties and in respect of the particular case.” NAFTA, *supra* note 1. It is not uncommon at all, however, for investment tribunals to peek at the factual and legal reasoning in prior awards as persuasive authority.

52. Richard C. Levin & Susan Erickson Marin, *NAFTA Chapter 11: Investment and Investment Disputes*, 2 NAFTA L. & BUS. REV. 82, 97 (1996).

53. *Id.*

54. Dolzer, *supra* note 29, at 41.

55. *Id.*

56. RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 712 cmt. g (1986).

which the state cannot effectively carry out its function of distributive justice.⁵⁷

This is particularly important in the context of environmental regulations in many countries, including NAFTA Parties.⁵⁸ While the definitional expense may differ from country to country,⁵⁹ the underlying policy basis of these environmental regulations appear to be the same—that the need to protect and preserve the environment for the present and future generations outweighs the need to preserve the liberty of corporations to freely carry on business at a profit.

Further, a state is not “responsible”⁶⁰ in international law for the repudiation of a commercial contract—at least, where a state raises a genuine dispute as to its legal obligations under the contract.⁶¹ This may happen when an investor defaults in performance, thereby compelling the government to abandon the contract.⁶² The key to distinguishing between an expropriatory act and a commercial breach of contract therefore is the role of the government at the time of the allegedly unlawful action. If the government was acting as a sovereign rather than as a commercial participant, the act is far less likely to be characterized as expropriatory.⁶³ In the United States, the Restatement on Foreign Relations Law is unequivocal in its separate treatment of expropriation and breach of contract.⁶⁴ It states:

57. For a discussion of the state’s interest in regulating the environment and implications for expropriation claims, see Charles N. Brower, *The Implications of National and International Environmental Obligations for Foreign Investment Protection Standards, Including Valuation: A Report from the Front Lines*, in INTERNATIONAL INVESTMENTS AND PROTECTION OF THE ENVIRONMENT: THE ROLE OF DISPUTE SETTLEMENT MECHANISMS 19, 20–28 (International Bureau of the Permanent Court of Arbitration ed., 2000).

58. *Id.*

59. Julie Soloway, *NAFTA’s Chapter 11—The Challenge of Private Party Participation*, 16 J. INT’L ARB. 8 (1999). The author compares the Canadian and U.S. approach to defining property rights and the police power of the state and observes that while in the Canadian context one sees an expansive approach to the scope of the state’s police power, that is not so in the United States. *Id.* at 8–9. Also, property rights are not enshrined in the Canadian Constitution, unlike in the United States Constitution. This doctrinal divergence at the domestic level compounds the interpretive difficulty facing NAFTA tribunals, given the sparse international law on the point. See *supra* Part II B.

60. The phrase is used in the sense of state responsibility for economic injury in international law.

61. See generally Mann, *State Contracts and State Responsibility*, 54 AM. J. INT’L L. 572 (1960).

62. *Id.*

63. Levin & Marin, *supra* note 52, at 98.

64. RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED

A state is responsible for economic injury resulting from breach of contract to an alien under international law only where such breach is discriminatory or occasioned by non-commercial considerations, and also in situations where the alien is not given an adequate forum for seeking relief or not duly compensated.⁶⁵

In the confines of a theoretical paradigm, an attempt to distinguish each of the above may appear relatively straightforward. In practice however, characterizing an action in a given set of facts as one of regulation, breach of commercial contract, or indirect expropriation is far from easy. Yet, each type of action leads to a totally different consequence in law with respect to the duty of the host state to compensate for the resultant economic injury.

The result as far as the NAFTA experience is concerned has been a barrage of investor claims, based on innovative arguments that characterize a measure of the host state as being tantamount to expropriation.⁶⁶ Arguably, in many of the claims filed by investors before the ICSID tribunals, the phrase “tantamount to expropriation” has been extended beyond its intended limits and applied to varied situations of economic loss resulting from governmental regulation.⁶⁷ Each claim points to a mix of alleged interference with property rights and resulting substantial economic effects on the claimant’s property.⁶⁸ In *Loewen v. United States*, for example, a judicial award was challenged as an expropriatory act.⁶⁹ The claim by an investor before an arbitral tribunal that an award of a domestic judicial body was expropriatory was quite startling as a development in international law and perhaps stretched Chapter 11 beyond conventional notions of indirect expropriation.⁷⁰ No rational distinction was made between a lawful sovereign act of regulation and one of expropriation, especially in the context of environmental measures.⁷¹

Regardless of the eventual success or failure of the claim in the arbitration, such indiscriminate labeling of governmental action represents an alarming trend that requires, and indeed has generated, much public

STATES § 712 (1986).

65. *Id.*

66. See discussion in Part III.

67. This will be explored further in later sections.

68. *Id.*

69. *Loewen v. United States*, Statement of Claim, 62, 69–70. (Oct. 30, 1998). The award ultimately dismissed the Canadian corporation’s Chapter 11 challenge to the \$500 million jury verdict for what was essentially a breach of contract claim. *Loewen v. United States*, ICSID (W. Bank) Case No. ARB (AF)/98/3 (2003), award of June 26, 2003, available at <http://www.state.gov/documents/organization/22094.pdf>.

70. Arguably, it is the possibility to make such creative claims before an arbitration panel that makes NAFTA and other bilateral investment treaties attractive as a forum for investors. Mark Friedman and Gaeten Verhoosel, *Arbitrating over BIT Claims* 26 NAT’L L.J. 15 (2003)

71. Nolan and Lippoldt, *supra* note 25, at B8.

debate. Some argue the trend suggests that corporate entities place commercial interests over public health and welfare, including environmental concerns,⁷² and look upon Chapter 11 proceedings as a possible means to shift responsibility away from themselves and onto the host state.⁷³ The question of whether these criticisms are justified requires an examination of how the arbitral tribunals have addressed claims of indirect expropriation in the NAFTA context.

D. Jurisprudence from Chapter 11-based Tribunal Decisions

While a number of investor claims have been filed under Chapter 11 in the last few years, many have reached settlement before a final award was rendered.⁷⁴ The rules do not provide for a deadline for the tribunal to reach a decision, as a result, arbitration proceedings before the ICSID tend to be long-drawn.⁷⁵ While some of these awards have addressed the issue of interpreting “tantamount to expropriation,” there has not been much jurisprudential inquiry—which is somewhat understandable given the nature of arbitral tribunals and their inability to create binding precedent. The findings have turned largely on the facts of each case, as one might consider proper in the arena of commercial arbitration.⁷⁶ There are, however, a number of observations made by arbitration panels that are worth taking into account in order to understand the interpretive trend of the Chapter 11 awards.⁷⁷ The following discussion considers some of the cases that shed light on the “tantamount to expropriation” language in Article 1110.⁷⁸

72. See, e.g., Howard Mann, *Protecting Investor Rights and the Public Good: Assessing NAFTA's Chapter 11*, Paper prepared for 2002 Conference on NAFTA Chapter 11 at the Institute for International Economics in Washington, D.C. (Apr. 11, 2002), available at <http://www.iie.com/publications/papers/graham0502.pdf>.

73. Nolan and Lippoldt, *supra* note 25, at B8.

74. For a summary of NAFTA awards to date, as well as information on pending and settled cases, see *NAFTA Chapter 11 Investor-State Cases: Lessons for the Central America Free Trade Agreement*, Public Citizen (Feb. 2005), available at <http://www.wtwatch.org/library.cfm?refid=60391> (last visited Feb. 27, 2005).

75. Horlick & DeBusk, *supra* note 4, at 71.

76. There are of course serious questions as to whether a NAFTA investor-state dispute can be likened to a private international commercial arbitration, given that the dispute implicates other stakeholders and often triggers public policy concerns. For more discussion, see Olasolo, *supra* note 19, at 195–96.

77. NAFTA, *supra* note 1, at art. 1136 (provides that the tribunal's award has no binding force except between the parties to the dispute. At the same time, arbitral tribunals strive for consistency in results, despite the lack of any institutional obligation to that effect).

78. For a summary of recent developments in NAFTA investment disputes in

1. Robert Azinian v. Mexico⁷⁹

The claimants in this case alleged that the Mexican government, by canceling a concession contract awarded to the claimants for the construction of a hazardous waste landfill, caused economic injury to the claimant, which they alleged was in the nature of “loss of the value of the concession contract as an on-going enterprise.”⁸⁰ The claimants argued that the repudiation of the contract amounted to an expropriation of contractual rights, quoting Ian Brownlie’s treatise *Principles of Public International Law* that an expropriation occurs “if the state exercises its executive or legislative authority to destroy the contractual rights as an asset.”⁸¹

The tribunal was categorical in its finding that NAFTA does not allow investors to seek international arbitration for mere contractual breaches.⁸² It held that phrases like “destroy contractual rights as an asset,” which was quoted by claimants’ counsel, while serving as a description of extraordinary breaches amounting to expropriation, do not indicate the basis of distinction between expropriation and ordinary breach of contract.⁸³ The tribunal found that no act ‘tantamount to expropriation’ under Article 1110 had occurred.

This was the first occasion for a Chapter 11 based ICSID Tribunal to consider the difference between an act of indirect expropriation and one of commercial breach of contract, thus taking it from a normative level to a practical one applicable to the facts of a given case and offering valuable guidance to future tribunals confronted with a similar issue.

2. Pope and Talbot Inc. v. Canada⁸⁴

The claimant in this case alleged breaches of five separate obligations under Section A of Chapter 11 of NAFTA, including expropriation under Article 1110.⁸⁵ The impugned government action was the Canadian government’s Export Control Regime, which imposed various limitations, including the reduction of the claimant’s fee-free export quota, allegedly resulting in the claimant suffering “injury to its business

general, see Todd Weiler, *Foreign Investment Law and the United States: You Can’t Tell the Players without a Scorecard*, 37 INT’L LAW. 279 (2003).

79. Azinian v. Mexico, Case No. ARB (AF)97/2, 14 ICSID REV. FOREIGN INVESTMENT L. J. 538 (1999).

80. *Id.* ¶ 28.

81. *Id.* ¶ 88.

82. *Id.* ¶ 87.

83. *Id.* ¶ 90.

84. Interim Award rendered on June 26, 2000 [hereinafter Interim Award], available at <http://www.naftaclaims.com>.

85. *Id.* ¶ 11.

operations, its expansion and management and its overall profitability.”⁸⁶

On the question of expropriation, the claimant argued that Article 1110 creates a *lex specialis* in that it goes beyond the meaning of expropriation in customary international law, comprehending a measure beyond an outright taking or indirect expropriation. In other words they urged that the term “tantamount” includes even non-discriminatory measures of general application that have the effect of substantially interfering with the investments of investors of NAFTA Parties.⁸⁷

The tribunal found that the investor’s access to the United States market was indeed an investment within the meaning of Article 1139 and therefore covered by Article 1110.⁸⁸ It observed, however, that the deciding factor for whether the Export Control Regime amounted to an act tantamount to expropriation was the *degree of interference* by the regulation.⁸⁹

The exemption of a regulation from scrutiny for an expropriatory element by a plea that it was within the “police power” of the host state is thus not automatic and must stand the test of “degree.” In this case, the tribunal found that the interference was not substantial enough to be characterized as expropriation.⁹⁰ The sole “taking” that could be identified by the investor was interference with its ability to carry on its business of exporting softwood lumber to the United States, resulting in reduced profits but not complete elimination of profits.⁹¹ There was no evidence or suggestion of transfer of control or ownership to the Canadian government.⁹² The tribunal here appears to espouse the traditional confiscation test that has been used in the past for direct expropriation.⁹³

On the scope of “tantamount,” the tribunal observed that it does not expand the scope of indirect expropriation beyond the traditional customary international law understanding of expropriation—it means nothing more than ‘equivalent to something’ and cannot encompass more.⁹⁴ This observation of the ICSID tribunal is significant to the

86. Pope & Talbot v. Canada, Statement of Defense, ¶¶ 155–56 (NAFTA Ch. 11 Arb. Trib. Oct. 8, 1999), available at http://www.dfaitmaeci.gc.ca/tna-nac/documents/damage_award.pdf.

87. *Id.* ¶ 150.

88. Pope & Talbot v. Canada, Interim Award, *supra* note 84, ¶ 96.

89. *Id.*

90. *Id.*

91. *Id.* ¶ 101.

92. *Id.*

93. *Starrett*, 4 Iran-U.S. Cl. Trib. Rep. at 154.

94. *Azinian*, *supra* note 79, ¶ 104. The tribunal noted that the French translation of

extent that it brought clarity to the meaning of “tantamount” in Article 1110 that had thus far been absent. The tribunal’s position was that “tantamount to expropriation” cannot take in more in its scope than expropriation as understood in international law. This in effect means that the standard of governmental conduct “tantamount to expropriation” is no lower than the standard in customary international law. This statement is not operationally helpful, however, because as discussed earlier, there are no applicable norms in customary international law. At the same time, taking the “degree of interference” test to be the guiding principle, if future tribunals choose to adopt the *Pope & Talbot* line of reasoning, it rules out the success of claims brought by corporations based on loss of profits alone, without showing a sufficient degree of interference from the host government. In fact, this approach was followed in the *Myers* decision rendered in November 2000, discussed below.

3. *Myers v. Canada*⁹⁵

The *Myers* claim concerned an order of the Government of Canada banning the export of polychlorinated biphenyls (PCBs) from Canada.⁹⁶ The claimant’s primary business was to carry PCB waste from Canada to the United States for treatment of the waste to make it safe for disposal.⁹⁷ The claimant was a significant player in the Canadian market for PCB waste disposal.⁹⁸ There existed only one other significant Canadian competitor.⁹⁹ The export ban allegedly caused the claimant Myers to suffer various economic losses, ranging from loss of profits to unfavorable tax consequences.¹⁰⁰ This formed the basis for the claim under Article 1110—that the ban was tantamount to expropriation.¹⁰¹

The tribunal concluded that the order of the Canadian government was not a measure tantamount to expropriation for the purposes of liability under Article 1110.¹⁰² The primary basis for its decision was the temporary nature of the ban in this case—a total of eighteen months, as the factual

the NAFTA uses a phrase that means ‘equivalent.’ *Id.*

95. S.D. *Myers v. Canada*, Partial Award (Nov. 13, 2000), available at <http://www.appletonlaw.com/cases/Myers%20-%20Merits%20Award.pdf> (last visited Jan. 17, 2005).

96. *Id.* ¶ 126

97. S.D. *Myers v. Canada*, Statement of Claim, ¶¶ 13, 14 (Oct. 30, 1998), available at <http://www.appletonlaw.com/cases/mclaim.pdf> (last visited Jan. 17, 2005).

98. Partial Award, *supra* note 95, ¶ 112.

99. *Id.*

100. *Id.* ¶ 144.

101. *Id.* ¶ 142.

102. *Id.* ¶ 288.

record reveals.¹⁰³ In the tribunal's opinion, an expropriation usually involves a lasting removal of the ability of the owner to make use of his or her economic rights, which did not happen in Myers' situation.¹⁰⁴ They observed "tantamount" in Article 1110 means "equivalent." The tribunal stated that in deciding whether conduct tantamount to expropriation has occurred, they must look at the real interests, purpose, and effect of the government measure.¹⁰⁵ The tribunal was in agreement with the decision in *Pope and Talbot* that the phrase "tantamount to expropriation" refers to indirect expropriation and is not an expanded version of the concept.¹⁰⁶

The *Myers* decision is an excellent attempt by the tribunal to make a clear distinction between an act of expropriation and regulation. It laid down three points of distinction between the two in the course of its decision that are summarized in the Table below:

| EXPROPRIATION | REGULATION |
|--|---|
| 1. Involves the deprivation of ownership rights. ¹⁰⁷ | 1. Involves a 'lesser' interference. ¹⁰⁸ |
| 2. With some exceptions, it usually amounts to a lasting removal of the owner's ability to utilize her economic rights. ¹⁰⁹ | 2. Not necessarily a lasting deprivation. ¹¹⁰ |
| 3. Connotes some exercise of <i>de facto</i> or <i>de jure</i> power amounting to a 'taking' by a government authority with a view to transferring ownership—these are undoubtedly covered by Article 1110. ¹¹¹ | 3. Regulatory conduct by a public authority is unlikely to be subject of complaint under Article 1110, but the possibility is not ruled out. ¹¹² |

103. *Id.* ¶ 284.
 104. *Id.* ¶ 283.
 105. *Id.* ¶ 285.
 106. *Id.* ¶ 286.
 107. *Id.* ¶ 282.
 108. *Id.*
 109. *Id.* ¶ 283.
 110. *Id.*
 111. *Id.* ¶ 280.
 112. *Id.* ¶ 281.

These are important distinctions—ones that claimants often have chosen to ignore in filing Chapter 11 claims. While it is often not easy to apply the distinctions in a given factual situation, it is encouraging for the public to note that the tribunals charged with the question have not lost sight of it and make every attempt to maintain a balance between investors' rights and the sovereignty of the NAFTA Parties.

4. Metalclad Corp. v. Mexico¹¹³

Metalclad represents the first Chapter 11 case in which a final award was rendered with a positive finding of expropriation by the NAFTA Party respondent, Mexico.¹¹⁴ The case involved a concession contract that was awarded to the claimant by the Mexican government for the construction and operation of a hazardous waste landfill.¹¹⁵ Federal and state officials gave the claimant the necessary permit to construct the landfill.¹¹⁶ Upon completion of the project, however, allegations were made that the construction had been undertaken without the necessary municipal permit.¹¹⁷ The claimant was not informed of the meeting of municipal officials in which its application for the permit had been considered and denied and thus was not given an opportunity to make its case.¹¹⁸ Further, the Governor of that Mexican state issued an Ecological Decree, the effect of which was to permanently preclude the claimant from operating the landfill.¹¹⁹

The Tribunal held that the municipality had acted in excess of its authority, as its role was only to administer the construction permit issued by the federal and state government.¹²⁰ In a very short passage, the tribunal concluded that by acquiescing to the illegal conduct of the municipality that resulted in the deprivation of the right of the claimant to operate its landfill, Mexico's conduct was tantamount to expropriation. The Tribunal stated that it need not decide the motivation or intent of the adoption of the environmental measure in question.¹²¹ The Tribunal went on to state:

113. Final Award rendered on August 30, 2000, *available at* <http://www.naftaclaims.com> (last visited Jan. 17, 2005).

114. For a full discussion of the factual background of the *Metalclad* case, see Marisa Yee, *The Future of Environmental Regulation after Article 1110 of NAFTA: A Look at the Methanex and Metalclad Cases*, 9 HASTINGS W.-NW. J. ENVTL. L. & POL'Y 85, 98 (2002).

115. *Supra* note 113, at ¶ 28.

116. *Id.* ¶ 29.

117. *Id.* ¶ 51.

118. *Id.* ¶ 54.

119. *Id.* ¶ 59.

120. *Id.* ¶ 106.

121. *Id.* ¶ 103.

[E]xpropriation under NAFTA includes not only takings of property, such as outright seizure or formal or obligatory transfer of title in favor of the host State, but also covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use of reasonable to-be-expected economic benefit of property even if not necessarily to the obvious benefit of the host State.¹²²

It thus espoused an effects-based rather than intent-based analysis of the host state's action. The same effects-based analysis was applied by the Tribunal in its final award in the *Pope and Talbot* matter.¹²³ Not surprisingly, this case evoked public outcry by environmentalists and NAFTA commentators.¹²⁴ Such a broad test for indirect expropriation would sweep within its scope several governmental measures that are regulatory in nature. This approach conflicts with the conception of a police powers exception.¹²⁵ The *Metalclad* award thus supports the position of NAFTA critics that arbitration panels do not weigh important public policy concerns that are implicated by the matter before them.¹²⁶

Mexico appealed the *Metalclad* award to the British Columbia Supreme Court and sought an order to set it aside.¹²⁷ The finding of the tribunal that Mexico's actions prior to the issuance of the Ecological Decree constituted a violation of Article 1110 was set aside,¹²⁸ although the award itself was upheld on jurisdictional grounds.¹²⁹ The decision was welcomed in several quarters despite what some have characterized as a cautious stance by the British Columbia Supreme Court on the scope of judicial review.¹³⁰

122. *Id.* ¶ 103.

123. Final Merits Award, rendered on April 10, 2001 (redacted version available at www.naftaclaims.com).

124. Olasolo, *supra* note 19, at 190. For a critical discussion of the *Metalclad* award, see Yee, *supra* note 114, at 105–06.

125. Mann, *supra* note 72, at 578–79.

126. Yee, *supra* note 114, at 105.

127. Rules Governing the Additional Facility for the Administration of Proceedings by the Secretariat of the International Center for Settlement of Investment Disputes, ICSID Doc. 11 (June 1979), available at <http://www.worldbank.org/icsid/facility/partA-article.htm> (last visited Jan. 17, 2005). The ICSID Additional Facility Rules governing the arbitration provide that the applicable law for review of the award is the jurisdiction in which it is made. *Id.*

128. *Metalclad*, 89 B.C.L.R.3d 359, 381–82 (2001).

129. *Id.* at 386.

130. For a full discussion of the nature and implications of the decision of the British Columbia Supreme Court, see Chris Tollefson, *Metalclad v. United Mexican States Revisited: Judicial Oversight of NAFTA's Chapter 11 Investor-State Claim Process*, 11 MINN. J. GLOBAL TRADE 183, 191–226 (2002). For *Metalclad's* reaction to the outcome, see *US Firm Sees NAFTA Case Win as Hollow Victory*, GLOBE AND MAIL, May 5, 2001, at B3.

The approach of tribunals was, however, more conservative in later cases, such as *Feldman v. Mexico*.

5. *Feldman v. Mexico*¹³¹

In this case, the tribunal rejected the investor's claim that Mexico's decision not to provide rebate for significant amounts of export tax paid for the export of cigarettes from Mexico constituted '[creeping] expropriation' of its business.¹³²

The tribunal observed that while in some cases regulation can amount to indirect expropriation in violation of Article 1110, it was not the case in this instance.¹³³ It cautioned that not every business problem experienced by an investor can amount to an Article 1110 violation.¹³⁴ While it conceded that the investor had experienced some difficulty with the tax authorities, it stated that tax authorities in most countries do not act consistently or predictably and such a general tax measure did not amount to an expropriatory act.¹³⁵ In the words of the tribunal: "[N]ot all government regulatory activity that makes it difficult or impossible for an investor to carry out a particular business, change in the law or change in the application of existing laws that makes it uneconomical, to continue a particular business, is an expropriation under Article 1110."¹³⁶

The language used in this tribunal's award thus allows some room for host governments to carry out legitimate governmental regulation; in particular, the exercise of the general taxing power without the threat of a claim of indirect expropriation. While the outcome is to be expected given the clear regulatory nature of the impugned governmental action, it must be lauded because it indicates that *Metalclad* was an anomalous result. Indeed, the tribunal agreed with the opinion of the British Columbia Supreme Court that later reviewed the much-criticized *Metalclad* award.¹³⁷

At one level, the course adopted by the *Feldman* tribunal would appear appropriate; after all, arbitrators are appointed to resolve the narrow question raised by the investment dispute. On the other hand, is it desirable to have an *ad hoc* international tribunal decide matters without regard to public policy, or should such a tribunal be vested with the authority to decide the matter in the first place? This question is a

131. *Feldman v. Mexico*, ICSID, Case No. ARB(AF)99/1, award of Dec. 16, 2002, available at <http://www.state.gov/documents/organization/16639.pdf>.

132. *Id.* ¶ 110.

133. *Id.* ¶ 111.

134. *Id.*

135. *Id.* ¶ 112.

136. *Id.*

137. *Id.* ¶ 133.

normative one and presents a problem that is quite distinct from that of textual indeterminacy. Arguably, the problem stemming from the sparse text in NAFTA defining the scope of “tantamount to expropriation” has been resolved like most questions that are fact-dependent—by a thorough analysis of the facts involved in each matter brought before an arbitral tribunal. As an empirical matter, and as the cases reviewed in this Part appear to suggest, arbitral tribunals have achieved a surprising degree of consistency in their decision-making. This does not answer the legitimacy-based objections, however, and the latter are addressed in the next part.

III. LEGITIMACY-BASED OBJECTIONS TO NAFTA’S INVESTMENT DISPUTE SETTLEMENT MECHANISM

The legitimacy problem faced by the NAFTA regime is multi-faceted and by no means unique to NAFTA.¹³⁸ One aspect of the problem is the notion of a private party’s right of action against the host government, which though an integral part of the investment dispute resolution process, is perhaps not a desirable method by which these disputes should be resolved.¹³⁹

A second related concern is that the host state’s vulnerability to such arbitration is an infringement of its sovereignty.¹⁴⁰ This concern is somewhat countered by recent cases involving host states resorting to municipal courts as a *de facto* appellate authority and seeking to expand their scope of review.¹⁴¹ This latter trend presents the separate problem of domestic courts’ authority to exercise appellate review over international arbitrations in which foreign states are disputants.¹⁴²

138. Similar questions plague the World Trade Organization’s dispute settlement mechanism. For more on this issue, see generally, Joel P. Trachtman & Philip M. Moreman, *Costs and Benefits of Private Party Participation in WTO Dispute Settlement: Whose Right is it Anyway?*, 44 HARV. INT’L L. J 221, 227–28 (2003); see also Friedman & Verhoosel, *supra* note 70.

139. Trachtman and Moreman, *supra* note 138, at 249. The authors propose a cost-benefit approach suggesting that before “transferring rights back from states to individuals, we should investigate the benefits that might flow from each institutional structure, as well as the costs, including transaction costs.” *Id.*

140. See discussion III.B below.

141. Brower, *supra* note 16, at 73.

142. Indeed, investors would argue that this form of municipal judicial review is even more pernicious than the perceived lack of accountability of the arbitral tribunal. As Brower states:

Even assuming that the notion of private party participation is sound, and no viable objections can be made relating to incursion of state sovereignty, there still remains the problem of whether arbitration behind closed doors before a panel of arbitrators is the desirable approach to resolve such disputes, or whether the process needs to be democratized to some extent to allow for voices other than those of the corporate investor and the host state. All of these questions are explored below.

A. *Private Party Actions against Host States*

The debate of whether private parties ought to be able to commence arbitration proceedings against a host state is not new.¹⁴³ As mentioned earlier, NAFTA is not the only investment treaty that allows for arbitration between a private investor and the host nation.¹⁴⁴ Such provisions are commonplace in bilateral investment treaties and are frequently used by investors.¹⁴⁵ To state that NAFTA is novel in this regard is misleading; in the thirty years preceding NAFTA, bilateral investment treaties had begun to grant direct investor standing.¹⁴⁶ Indeed, the United States was a party to many of those treaties and at least theoretically was subject to arbitral claims by foreign investors in the United States.¹⁴⁷

Before attacking the notion of private party standing in international investment arbitration, it is important to keep in mind its historical

Requiring national courts of NAFTA parties themselves to balance those states' politically charged legislative, judicial, and regulatory interests against alien investors' substantive and procedural rights under NAFTA is an open invitation to controversy, potentially even manipulation.

Charles N. Brower, *NAFTA's Investment Chapter: Dynamic Laboratory, Failed Experiments and Lessons for the FTAA*, 97 AM. SOC'Y INT'L L. PROC. 251, 254 (2003).

143. For a brief discussion of the pros and cons of private party direct access in international dispute mechanisms, see Jessica S. Wiltse, Comment, *An Investor-State Dispute Mechanism in the Free Trade Area of the Americas: Lessons from NAFTA Chapter 11*, 51 BUFF. L. REV., 1145, 1168-72 (2003).

144. For an informative discussion on bilateral investment treaties and arbitration provisions, see Aron Broches, *Bilateral Investment Protection Treaties and Arbitration of Investment Disputes*, in THE ART OF ARBITRATION 63 (J. Schultz & J. van den Berg, eds., 1982).

145. Moshe Hirsh points to the trend of expanding activities of modern states in international economics and the resulting proliferation of bilateral treaties to deal with investment disputes with foreign investors that provide for arbitration as the preferred mode of dispute settlement. MOSHE HIRSH, THE ARBITRATION MECHANISM OF THE INTERNATIONAL CENTER FOR THE SETTLEMENT OF INVESTMENT DISPUTES 10 (1993).

146. Coe, *infra* note 150170, at 1414. More than ever, in recent times, bilateral investment treaties have been on the rise. For a brief background on bilateral investment treaties, see Friedman and Verhoosel, *supra* note 70.

147. *Id.* As a factual matter, however, the host nations against whom foreign investors made claims were developing countries and not the United States.

genesis as a reaction to the inadequacy of existing dispute resolution structures in the context of international investment disputes.¹⁴⁸ Prior to the advent of bilateral investment treaties, investors from developed nations often faced problems of expropriation without compensation by host states pursuing a protectionist economic policy.¹⁴⁹ Resort to the national courts of the very same government that was infringing the investor's property interests often proved ineffective and deprived the foreign investor of a neutral forum. Nor was it feasible to resort to the investor's home state in light of doctrines that foreign sovereign immunity and separation of powers protected the host state from being prosecuted in the domestic court of another state.¹⁵⁰ The doctrine of diplomatic protection, which is the traditional manner in which private rights of nationals are vindicated by home states at the state to state level, proved too inefficient and provided far too much discretion to the state of nationality in pursuing the claims of their nationals.¹⁵¹

The point is that private party standing in investment disputes is the result of evolution from the lack of existing feasible alternatives. Private party participation is a process that forms the core of the NAFTA Investment Chapter.¹⁵² Despite its problems, it is likely to remain on the books until there is consensus on a better, more neutral alternative to arbitration whereby private investors' rights against expropriation (of the direct or indirect kind) may be vindicated.¹⁵³

148. For historical background, *see* Wiltse, *supra* note 143, at 1147, 1148.

149. In fact, the United States was the chief proponent of arbitration as a means to resolve investment dispute, in view of protectionist doctrines like the Calvo Doctrine in Mexico. For more discussion, *see* Alvarez and Park, *supra* note 15, at 367-69. *See also* Sandrino, *supra* note 13.

150. Jack Coe, *Taking Stock of NAFTA Chapter 11 in its Tenth Year: An Interim Sketch of Selected Themes, Issues and Methods*, 36 VAND. J. TRANSNAT'L L. 1381, 1416 (2003).

151. *Id.*

152. This is especially so because NAFTA specifically forecloses resort to private lawsuits. Article 2021 states: "No Party may provide for a right of action under its domestic law against any other Party on the ground that a measure of another Party is inconsistent with this Agreement."

153. HIRSH, *supra* note 145, at 9. One reason for arbitration with foreign investors as the preferred mechanism is explained by Hirsh as follows:

Arbitration is held in private, and it is obviously preferable for the resolution of conflicts which the parties would rather not publicize. This is particularly relevant to disagreements relating to commercial secrets (patents, the financial situation of a firm, etc.), sensitive political subjects (especially when a state is involved in a dispute).

Id.

*B. Arbitral Tribunals versus National Courts—Threat to
National Sovereignty?*

The arbitration of investment disputes often requires the panel to rule on the validity of the host state's actions.¹⁵⁴ The actions in many cases are those of state and local governments.¹⁵⁵ This not-uncommon scenario raises concerns about state sovereignty.¹⁵⁶ Some scholars argue that states should be free from interference and from the fear of an adverse arbitration outcome in order to effectively deploy its police powers to protect the health and safety of its citizens.¹⁵⁷

One response to this position is that when the Parties negotiated NAFTA, they were well aware of this and yet ceded their sovereignty to a limited extent.¹⁵⁸ On the other hand, did the Parties really envisage the barrage of investor claims that Article 1110 has invited? Probably not; however, if sovereignty were a true concern for the NAFTA Parties, there would have been some initiative to amend NAFTA's provisions. While there have been rumblings in the past,¹⁵⁹ no clear initiative has emerged, suggesting that perhaps the perceived threat to sovereignty is illusory or so marginal that as a practical matter states choose to condone such incursions in light of other more compelling policy considerations, including the safeguarding of investors' rights and assuring a neutral forum for their vindication. In any event, NAFTA tribunals have expressed restraint and deference to national courts of the host nation in their awards, refusing to acknowledge any appellate authority over them.¹⁶⁰

Leaving aside the consent argument described above, however, there may be some validity to the concern that important questions of domestic public policy and state liability to foreign investors should not be left to *ad hoc* arbitral panels that unlike domestic courts are unaccountable.¹⁶¹ The objection takes either of two forms: 1) that

154. Donald S. MacDonald, *Chapter 11 of NAFTA: What are the Implications for Sovereignty?*, 24 CAN.-U.S. L. J. 281, 287 (1998).

155. For a brief but informative discussion of some recent NAFTA awards' impact on state and local sovereignty, see William T. Warren, *NAFTA and State Sovereignty: A Pandora's Box of Property Rights*, SPECTRUM: J. OF STATE GOV'T. 21 (Spring 2002).

156. *Id.*

157. See, e.g., Samrat Ganguly, *The Investor-State Dispute Mechanism (IDSM) and a Sovereign's Power to Protect Public Health*, 38 COLUM. J. TRANSNAT'L & COMP. L. REV. 113, 125 (1999).

158. Celine Levesque, *Investor-State Arbitration Under NAFTA Chapter 11: What Lies Beneath Jurisdictional Challenge*, 17 ICSID REV. FOREIGN INVESTMENT L.J. 320 (2002).

159. MacDonald, *supra* note 154, at 282.

160. Coe, *supra* note 150, at 1401.

161. The concern about the increasingly limited role of courts is not confined to NAFTA alone—it is a manifestation of a more general fear in the United States. Martin L. Haines, *Who Needs the Courts? Many People are Worried that Courts are being*

adjudication of investment disputes should not be left to supra-national entities of any kind, or 2) that it should not be delegated to *ad hoc* arbitration. In its first form, the objection is very broad, and despite its normative plausibility, will likely be untenable as a practical matter, given the historical failure of leaving the resolution of investment disputes to domestic courts.¹⁶² In its second form, however, the objection could be substantially addressed by creating a permanent judicial tribunal at the regional level among NAFTA Parties to resolve investment disputes.¹⁶³ While no easy task, it is certainly conceivable.¹⁶⁴

In the absence of any other mechanism to address the sovereignty concern, one approach has been judicial review of the arbitral award by domestic courts. The precedent of the *Metalclad* case and judicial review of the award by the Canadian court was the first of its kind in the NAFTA context.¹⁶⁵ While resort to national courts is seen by some as the more sound approach,¹⁶⁶ this scenario is alarming because it undermines the integrity of the arbitral process of settling investor-state disputes that the NAFTA Parties have agreed upon. Furthermore, the use of national courts is problematic for two other reasons. First, if an

Displaced as Our Primary Dispute Resolvers, 164 NAT'L L. J. 311 (2001), stating: "Many Americans are worried that courts are being displaced as our primary dispute resolvers by arbitration, mediation and other less-formal procedures—ones less likely to be concerned with accountability and fairness."

162. See discussion in the previous section.

163. Wiltse suggests that the creation of a standing body in place of ad hoc tribunals that decide NAFTA investment disputes "to interpret and apply NAFTA law, and hear appeals from various dispute settlement mechanisms, including Chapter 11, would provide consistency and stability to the NAFTA dispute process." Wiltse, *supra* note 143, at 1190.

164. Coe suggests various forms that a standing appellate body could take, including a Chamber of the International Court of Justice established for the specific purpose of reviewing investment awards. He also states that arguments in support of such a body might suggest replacement of non-permanent arbitral panels altogether. At the same time, he points out that it would eliminate the parties' power to select arbitrators for the dispute in question, which is seen as an element of legitimacy in the current regime. Coe, *supra* note 150, at 1451, 1452. Nonetheless, it is a plausible idea to create a permanent judicial body. Indeed, that might be the mechanism in place in the future.

165. Yee, *supra* note 114, at 105. In its appeal to the Canadian court, Mexico argued for a more searching judicial review in the NAFTA investment dispute context than is usually the case in private commercial arbitration, as the investor seeks to enforce a treaty obligation rather than the terms of a commercial agreement. For more discussion on this argument, see Tollefson, *supra* note 130, at 203.

166. Afilalo suggests that the solution to problems of transparency and legitimacy seen in the context of NAFTA tribunals is best resolved by having the Parties' national courts decide Chapter 11 disputes. Afilalo, *supra* note 16, at 52.

investor must resort to the national court of the state against which it asserts a claim of indirect expropriation, it would be deprived, at least theoretically, of a neutral forum—a problem that gave rise to the arbitration alternative in the first place.¹⁶⁷ Second, even if the investor could bring the dispute before a national court of a Party other than the one against whom the claim is asserted, it would present the even more troubling problem of one sovereign nation adjudicating the rights of another—a notion that flies in the face of international law.¹⁶⁸

Chapter 11 does not contain a provision that directly addresses the question of whether there can be judicial review of an arbitral award by a domestic court, and if so, to what extent. Article 1136¹⁶⁹ hints at the possibility of judicial review by a national court, but does not specify whether judicial review by the national court of any NAFTA Party is permissible, or is limited to the national court of the NAFTA Party to the investment dispute, or for that matter the national court of the place where the arbitration is held. Article 1136 does however reference the arbitral rules that the parties to a dispute have chosen to govern their arbitration.¹⁷⁰ The ICSID Convention provides facilities for arbitration of foreign investment disputes only between member states and nationals of other member states.¹⁷¹ Given that neither Mexico nor Canada are parties to the ICSID Convention, the grounds of review contained in it¹⁷²

167. Indeed, the possibility of a neutral forum is what spurred investor-state arbitration in the first place. HIRSH, *supra* note 145, at 10–12.

168. The *Metalclad* case at least facially does not raise these particular concerns because it was Mexico that sought to set aside the award in a Canadian court. They are however clear corollaries and could well characterize judicial review of some future NAFTA award.

169. NAFTA, *supra* note 1, at art. 1136 (2) refers to the “applicable review procedure for an interim award.” Art. 1136 (3) states:

A disputing party may not seek enforcement of a final award until: (a) in the case of a final award made under the ICSID Convention (i) 120 days have elapsed from the date the award was rendered and no disputing party has requested revision or annulment of the award, or (ii) revision or annulment proceedings have been completed; and (b) in the case of a final award under the ICSID Additional Facility Rules (i) three months have elapsed from the date the award was rendered and no disputing party has commenced a proceeding to revise, set aside or annul the award, or (ii) a court has dismissed or allowed an application to revise, set aside or annul the award and there is no further appeal.

170. The problem is apparent from the face of art. 1136. NAFTA, *supra* note 1, at art. 1136; *see also* Olosalo, *supra* note 19, at 200, 201.

171. The ICSID Convention, *supra* note 5, at art. 1.

172. The ICSID Convention, *supra* note 5, at art. 52. It provides for an internal review procedure through an ad hoc committee. *Id.* Rule 50(3) states the grounds for such review: the tribunal was not properly constituted; the tribunal has manifestly exceeded its powers; serious departure from a fundamental rule of procedure; failure to state the reasons for an award; and corruption on the part of a tribunal member. Even if these grounds were somehow relevant to a NAFTA arbitral proceeding, they are very

remain irrelevant. That leaves the UNCITRAL Rules¹⁷³ and the ICSID (Additional Facility) Rules¹⁷⁴—neither of which contain provisions that address the proper scope of judicial review by national courts; nor do they lay down specific annulment standards.¹⁷⁵

This lack of clarity in the arbitral rules suggests that while judicial review of NAFTA awards in investment disputes was envisaged by the NAFTA Parties, the scope, extent, and even the question of which national court may conduct judicial review remains uncertain and largely hinges on tactics employed by investors in seeking judicial review, as well as the national courts' approach to reviewing such awards, whether deferential or more searching in nature. This is bound to lead to inconsistent results stemming from the diverse judicial approaches of each NAFTA Party. It also presents the possibility of derailing the arbitral process, which is premised on efficiency and faith in the finality of awards. At the very least, one may conclude from this discussion that unfettered judicial review of NAFTA awards is not an appropriate antidote to the perceived institutional legitimacy problem that plagues NAFTA tribunals.

C. Transparency and the related Question of Democratization

The need for transparency of arbitration proceedings has often been expressed in the NAFTA Chapter 11 context while addressing legitimacy concerns.¹⁷⁶ The provisions of Chapter 11 do not by themselves provide the public the right to receive copies of pleadings, evidence, or other written arguments.¹⁷⁷ Nor do they confer a right on the public to

narrow grounds for review and do not contemplate review of factual or legal findings of the tribunal.

173. Arbitration Rules, *supra* note 12.

174. Additional Facility Rules, *supra* note 11.

175. Alvarez and Park, *supra* note 15, at 374, 375 (explains that whether arbitration is conducted under UNCITRAL or the Additional Facility Rules, the arbitration will proceed under either the New York Convention or the Panama Convention—and since neither provides grounds for annulment, NAFTA awards are consequently subject to the rules of judicial review prevailing at the place of arbitration. If this analysis is accurate, it is baffling and indeed troubling that the Investment Chapter would (intentionally or otherwise) leave the important question of the scope of judicial review of an arbitral award subject to such uncertainty).

176. See e.g., Soloway, *supra* note 59, at 10 (stating: “[The] lack of transparency seems to run counter to ‘the values and views’ integral to the post-war trading system and indeed democratic principles, where transparency of legal process is a fundamental norm”).

177. This follows as a matter of negative implication from the provisions that

participate in the proceedings.¹⁷⁸ This appears problematic, because the parties to the investment dispute are often litigating matters that are of core public concern, while non-party stakeholders are precluded from participation.¹⁷⁹ As a practical matter, most of the tribunals' awards have been made publicly available. This is, however, more a result of consent to publication by the parties to disputes and therefore leaves the normative problem unchanged.

In modern legal systems, transparency is seen as a central fairness value and often taken for granted, or at the very least, is largely undisputed.¹⁸⁰ Commercial arbitration on the other hand has been conventionally a closed-door proceeding, with confidentiality being the paramount value and often a precondition for parties agreeing to submit to arbitration.¹⁸¹ The problem has been to identify the place of investment disputes in this context—is there a spectrum of transparency, and if so, which model of dispute resolution does it more closely approximate? The stake of the private investor in a confidential resolution of the dispute is often considerable,¹⁸² however, the involvement of the public's interest, particularly environmental interests, is inescapable and deserves vindication through a process that allows for voices of stakeholders, other than the parties to the dispute, to be heard.¹⁸³

In response to demands for transparency and the need to democratize the arbitration process from several quarters,¹⁸⁴ two of the arbitral panels accepted *amicus curiae* briefs.¹⁸⁵ A few months ago, the Free Trade

explicitly grant the other non-disputing NAFTA Parties a right of access to such documents. See NAFTA, *supra* note 1, at arts. 1127–29.

178. *Id.*

179. Chris Tollefson, *Games without Frontiers: Investor Claims and Citizen Submissions under the NAFTA Regime*, 27 YALE J. INT'L L. 141, 151–52 (2002).

180. Michael D. Goldhaber, *Arbitration Scorecard: Private Practices*, 25 AM. LAW. S. 16 (2003).

181. *Id.*

182. Indeed, the aspect of confidentiality is the chief attraction of arbitration. HIRSH, *supra* note 145. Coe points out that the extent of transparency that is to be expected in NAFTA proceedings should be relative to its counterparts in international commercial arbitration, and that in fact, to the latter, “[NAFTA] Chapter 11 proceedings may be discomfoting in their openness.” Coe, *supra* note 150, at 1434. While this argument is facially tenable, it ignores the crucial difference between conventional international commercial arbitration and investor-state disputes—that the latter do not involve purely commercial questions that do not implicate state policy or public interest.

183. Interestingly, NAFTA Parties that are not party to a particular Chapter 11 proceeding are entitled to make submissions on interpretive questions. NAFTA, *supra* note 1, at art. 1128. For further discussion, see Coe, *supra* note 150, at 1409.

184. Tollefson, *supra* note 179, at 185.

185. See *United Parcel Serv. Of Am. v. Canada*, Decision of the Tribunal on Petitions for Intervention and Participation as Amici Curiae ¶¶ 61–62 (Oct. 17, 2001), available at http://www.dfait-maeci.gc.ca/tna-nac/documents/IntVent_oct.pdf; *Methanex Corp. v. United States*, Decision of the Tribunal on Petitions from Third Persons to Intervene as “Amici Curiae,” ¶ 31 (Jan. 15, 2001), available at <http://www.international->

Commission issued a statement supporting the participation of non-disputing parties in arbitration proceedings.¹⁸⁶ In addition, the United States has issued a statement that it will support open hearings in arbitration proceedings under Chapter 11 and will attempt to obtain the consent of the investor party as well.¹⁸⁷ These represent a welcome step towards democratization of the arbitration process.¹⁸⁸

IV. NEW DIRECTION FOR NAFTA'S CHAPTER 11: RENEGOTIATION OR FRESH INTERPRETIVE METHODOLOGY?

With this background and analysis of NAFTA's legitimacy problem, there remains little doubt that there needs to be some change in status quo. That change can be achieved in one of two ways, or perhaps a combination of the two, depending on the political will of the Parties and the extent to which they perceive the legitimacy problem: renegotiate NAFTA provisions or change the existing approach to NAFTA interpretation by tribunals. The discussion that follows considers these alternatives, both in the limited context of Article 1110 and the NAFTA Investment Chapter in general.

A. Is there a Need to Re-Negotiate the Investment Provisions of NAFTA?

i. Re-crafting Article 1110

The question that remains is whether the relative ambiguity in Article 1110 and the unpredictability of future outcomes are sufficient to warrant re-negotiation of Chapter 11 by the Parties. Some authors have

economic-law.org/Methanex/Methanex%20-%20Amicus%20Decision.pdf.

186. Statement of the Free Trade Commission on non-disputing party participation (Oct. 7, 2003), available at <http://www.ustr.gov/regions/whemisphere/nafta2003/statement-non-disputingparties.pdf>. The role of the Free Trade Commission and its relationship to NAFTA tribunals presents a separate set of legitimacy questions, addressed in Stefan Matiation, *Arbitration with Two Twists: Loewen v. United States and Free Trade Commission Intervention in NAFTA Chapter 11 Disputes*, 24 U. PA. J. INT'L ECON. L. 451 (2003).

187. Statement on Open Hearings in NAFTA Chapter 11 Arbitrations (Oct. 7, 2003), at http://www.ustr.gov/assets/Trade_Agreements/Regional/NAFTA/asset_upload_file212_3601.pdf.

188. Brower urges that "[I]n light of the manifestly important public policy considerations at stake in NAFTA cases, NAFTA tribunals should continue to encourage the parties to make pleadings publicly available, permit amicus curi interventions, and limit confidential filings and redactions." Brower, *supra* note 142, at 252.

expressed skepticism over whether any international regime should compensate indirect expropriation, given its definitional ambiguity and scope for expansive interpretation.¹⁸⁹ The view propounded here is that the concept of indirect expropriation in international law is fluid by definition. It is the non-obviousness of both the intent and the effect of the government action in these that warrants the use of the adjective “tantamount,” or else it would have fallen under the clear category of direct expropriation. Fluidity of definition alone, however, should not suffice to preclude compensation. Ease of interpretation *per se* is seldom the touchstone for compensability in other areas of the law and expropriation should be no different.

Apart from some basic guiding principles, whether or not there has been a compensable act of indirect expropriation will in every case have to be a fact-based inquiry, which can only be undertaken by a tribunal.¹⁹⁰ No amount of negotiation by the Parties can result in an exhaustive list of “compensable takings.”¹⁹¹ On the other hand, greater specificity than the current provision is desirable. Perhaps a qualifying paragraph should be inserted in Article 1110 stating that the phrase “tantamount to expropriation” does not refer to every case of government regulation and that certain types of regulation are specifically exempt from arbitration.¹⁹² This would make explicit what the tribunals have found as being implicit in the Chapter’s provisions and thereby put to rest all interpretive doubts.

ii. Uniform Standard for Judicial Review of Chapter 11 Awards

If judicial review of arbitral awards is a trend not likely to be reversed in the near future,¹⁹³ or if judicial review is found to be an essential

189. Been & Beauvais, *supra* note 31, at 141, 142. The authors’ position is that the definitional ambiguity of indirect expropriation is “notoriously susceptible to expansive interpretation and threatens to capture efficient nondiscriminatory land use and environmental regulation.” *Id.* As a result, they suggest that “the United States should seek to limit treaty-based expropriation clauses to the traditional concerns of international law: direct nationalization, physical invasion or seizure of property, and ‘creeping expropriation’ or ‘constructive takings’ involving transfer of control of the property to the government rather than mere diminution in the property’s value.” *Id.* at 142.

190. This view is also supported by COMEAUX & KINSELLA, *supra* note 35, at 15.

191. Soloway, *supra* note 59, at 11.

192. It is true that Chapter 11 specifically excludes certain governmental acts and programs from being considered expropriatory, such as compulsory licensing, public education, social welfare, and health. NAFTA, *supra* note 1, at art. 1101(4). However, these are hardly controversial in that they fall within the traditional police powers of the state. Other types of governmental regulation are less clear—environmental regulations, for instance.

193. There have been at least two other instances of judicial review of arbitral

check on the arbitration process, then it is imperative that NAFTA Chapter 11 contain a provision imposing a clear standard for review of arbitral awards by national courts that applies to all three NAFTA Parties. Otherwise, Parties that may have a less deferential standard of review may have an opportunity to review the validity of Chapter 11 awards more frequently and more searchingly than others. Providing for a uniform degree of deference would provide a great deal of certainty as well as legitimacy to the judicial review process, were it to take place.

iii. General Considerations

Overall, the textual indeterminacy question has been addressed by the numerous NAFTA disputes that have resulted in awards over the years, and any residual ambiguity can be resolved in the manner just described. The real question is whether such interpretation should be left to arbitrators rather than to some judicial or seemingly more legitimate mechanism. This may require a fundamental reconsideration of arbitration as the preferred mode of dispute resolution in the context of investment disputes. A less drastic approach would call for the NAFTA Parties to create a permanent supranational judicial body to resolve investment disputes. This body could be composed of retired judges from the domestic courts of the Parties, as well as renowned arbitration experts that currently play the role of arbitrators in NAFTA ad hoc tribunals. The legitimacy of the judicial body can be established and preserved by rules providing for mandatory publication of its decisions. The rules should provide for some form of summary procedure, although not as detailed or intricate as domestic court procedure—this would meet NAFTA's goal of efficient dispute resolution while leaving little room

awards apart from the Metalclad case discussed in Part III B of this Comment. See generally, Rajeev Sharma, Adam Goodman, Ontario Court of Appeal Upholds NAFTA Chapter 11 Award, ASIL Insight February 2005, at http://www.asil.org/insights/2005/02/insight040214.html#_ednref7 (last visited Apr. 19, 2005). In all three, Canadian courts were reviewing the NAFTA Chapter 11 award. In two of the cases, Mexico was the appellant. While sovereignty issues are not as salient when the moving party is another sovereignty (and hence submits to the jurisdiction of the other sovereign)—these cases could spell the beginning a more pronounced trend of investors attacking awards in the national courts of a NAFTA Party that is not the host state. Another problem is inconsistency in formulating and applying an appropriate standard of review even within a single state. See Alan Meck, *The Standard of Review of Chapter 11 Arbitrations: Deference*, at <http://www.alanmacek.com/legal/Chapter11StandardOfReview.pdf> (last visited Apr. 19, 2005), suggesting the stark difference in the approach of Canadian courts in Metalclad and Feldman (Karpa).

for arbitrary decision-making. Some authors have suggested introducing provisions that would make decisions by the judicial body binding.¹⁹⁴ While curing consistency problems at a normative level, it will probably leave the dispute resolution process in a state of inflexibility that will undermine effective decision-making. In the end, the quest of NAFTA negotiators should be to find a happy medium between *ad hoc* arbitration as it exists today and a rigid permanent judicial institution that is constrained not only by transparency and procedure but also precedent.

B. Suggestions for Interpretive Methodology

Given the limited usefulness and perhaps feasibility of renegotiation by the Parties, arbitral tribunals should undertake a deeper investigation and application of international legal principles before arriving at decisions.¹⁹⁵ In doing so, the tribunals should refine their interpretive methodology. There has already been a steady trend of arbitral awards resembling well-reasoned judicial opinions.¹⁹⁶ That approach provides the arbitral tribunal with an aura of legitimacy that only improves with increasingly effective transparency measures. Even without the formal constraint of precedent, the fact that arbitral tribunals borrow reasoning and language from prior awards lends some measure of logical consistency to the decision-making process. Another suggestion has been for arbitral tribunals to take a restrictive view of their competence as one way to avoid deciding issues that directly affect the public interest of the host state.¹⁹⁷ While that may be possible in some cases, the bifurcation of issues or wholesale rejection of the entire claim on public policy may be more difficult in others. Also, the question is how those issues of public interest are to be eventually decided¹⁹⁸—should they be

194. See *supra* note 163 and accompanying text.

195. Ari Afilalo suggests:

An explicit articulation of the applicable norms would . . . resolve the legitimacy concerns inherent in a potential conflict between sensitive domestic norms and international standards that is adjudicated under ambiguous language, confine Chapter 11 to its proper place in the world of international trade an investment in light of the object and purpose of the treaty, and further the international common law enterprise.

Ari Afilalo, *Meaning, Ambiguity and Legitimacy: Judicial (Re-)Construction of NAFTA Chapter 11*, 25 *NW. J. INT'L L. & BUS.* 279, 310 (2005).

196. Afilalo points to recent tribunal awards that suggest the trend towards reasoned elaboration is the developing norm in decision-making. *Id.* at 313, 314.

197. *Id.*

198. In the domestic context, courts are able to duck questions that are heavily laden with public policy implication through doctrines like separation of powers and political question. The difference, however, is that it is (at least in theory) possible to resolve those questions through the political process, i.e., elections. No such alternative exists

left to courts of the host state despite its clear conflict of interest with the foreign investor? That may perhaps lead to a resurgence of protectionist measures that NAFTA and other investment treaties sought to end.

i. Interpretation of Article 1110

A proper interpretation of the phrase “tantamount to expropriation” in Article 1110 should take into account the rules laid down in the Vienna Convention on the Law of Treaties.¹⁹⁹ Section 3 of Part III of the Vienna Convention contains provisions on the interpretation of multilateral treaties. In particular, Article 31 states that a treaty should be interpreted in good faith and that its terms should be given their ordinary meaning in their context and in the light of its object and purpose.²⁰⁰ Such context encompasses (in addition to the other terms of the treaty) any agreement relating to the treaty which was made between all the parties in connection with the conclusion of the treaty.²⁰¹

Based on Article 31, due importance ought to be given to other provisions in NAFTA. Article 1114, for instance, is a provision within the Investment Chapter that deals with environmental measures. Article 1114(1) provides that “[n]othing in Chapter 11 shall be construed to prevent a party from adopting any environmental measure otherwise consistent with that chapter.” It thus provides a specific exemption in relation to environmental regulation that becomes especially significant, in light of the fact that most of the impugned government measures so far have been environmental measures. Placed in Part A of Chapter 11, it is no less important a substantive provision than Article 1110, and interpretation of the latter must be tempered by the former. Some scholars have criticized Article 1114 as being of limited value in protecting environmental regulation from being labeled as expropriation. One author is of the opinion that the phrase “otherwise inconsistent” in Article 1114(1) acts as a qualifier and limits its usefulness, in that an environmental measure will not necessarily comply with Chapter 11 simply by virtue of being an environmental measure.²⁰² Others state that the provisions in Article

for the foreign investor.

199. Vienna Convention on the Law of Treaties, U.N. Doc. A/CONF.39/27 (1969) 8 I.L.M. 679 (1969).

200. *Id.*

201. *Id.* at art. 31(2).

202. Kevin Banks, *NAFTA's Article 1110—Can Regulation be Expropriation?*, 5 NAFTA: L. & BUS. REV. AM. 499, 511 (1999); see also Wiltse, *supra* note 143, at 1157.

1114 lack teeth because there is no enforcement mechanism to back it and it offers no sanctions for non-compliance.²⁰³ Much has been made of the ambiguity in Article 1114(2) and its reference to ‘derogation’ or ‘relaxation’ of environmental measures.²⁰⁴

In spite of these valid criticisms of the weakness and ambiguity in Article 1114, it can and ought to be used as a significant interpretive tool by jurists and arbitrators. First, the criticism about the absence of an enforcement mechanism is irrelevant when Article 1114 is used to aid in the interpretation of other provisions. Second, Article 1114 is not a blanket provision in that it leaves open the possibility that an environmental measure may in fact be consistent with Chapter 11, in which case it is a lawful non-compensable measure. The only way to ascertain if the environmental measure falls under this category is if the tribunal in each case examines it in the light of Article 1114. Third, the assessment of whether there has been a “derogation” or “relaxation” of environmental measures is a fact-based determination, and the tribunal faced with the facts is in the best position to make this determination, rather than an *ex ante* elaboration in the NAFTA text.

In addition, the Environmental Side Agreement²⁰⁵ that was entered into between the NAFTA Parties cannot be ignored or overridden when interpreting Article 1110. This could be a powerful interpretive tool in cases where the impugned government action is an environmental measure.

V. CONCLUDING REMARKS

It would be incorrect to dismiss the entire Chapter 11 investment dispute settlement process as an assault on state sovereignty. The investor-state mechanism is a valuable component of the NAFTA framework and one that finds its place in other similar investment arrangements. Article 1110 in particular is an important part of this redressal mechanism. By itself, it is an excellent safeguard against arbitrary actions taken by the host state, as long as it is understood in its proper context using the proper interpretive tools. Even in domestic law, a statute comes to life

203. Bruce Campbell, *Moving in the Wrong Direction—The North American Free Trade Agreement and Environmental Sustainability*, available at <http://www.ap.harvard.edu/mainsite/papers/tne/campbel/Campbell.pdf>.

204. Daniel Esty & Damien Geradin, *Market Access, Competitiveness and Harmonization: Environmental Protection in Regional Trade Agreements*, at <http://www.yale.edu/envirocenter/publications/Esty-Geradin.Market.Access.pdf> (last visited Jan. 17, 2005).

205. North American Agreement for Environmental Cooperation (NAAEC). In its Preamble, the NAAEC affirms the “importance of the environmental goals and objectives of the NAFTA, including enhanced levels of environmental protection.” Article 1 states that those goals also form part of the objectives of the NAAEC.

only after the judge infuses into it her opinion about its proper scope. The same is true in the NAFTA dispute context, although of course in a less structured fashion. The trend in the NAFTA investor-state dispute resolution process is encouraging and greater clarity is being brought to the provisions. As more cases end in final awards determined by tribunals, the public and indeed the legal community will be less in the dark about the scope of "tantamount to expropriation." In fact, the textual indeterminacy question has presently receded to the background. Transparency and participation of non-party stakeholders in the arbitration process has also been achieved with some success. The questions of private party access and the institutional legitimacy of arbitral tribunals in addressing questions of public policy remain on the table, however, along with newer questions relating to the wisdom and propriety of judicial review of these arbitral awards. These are likely to remain unanswered until a consensus can be reached about a feasible and just alternative to arbitration as a mechanism to resolve investor-state disputes.

NAVEEN GURUDEVAN

