

1-1-2001

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Recommended Citation

Brower II, Charles Hendrickson. Investor-State Disputes under NAFTA: A Tale of Fear and Equilibrium. 29 Pepp. L. Rev. 43, 86 (2001)
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Investor-State Disputes Under NAFTA: A Tale of Fear and Equilibrium

Charles H. Brower, II*

Writers initially regarded the North American Free Trade Agreement's investment chapter (Chapter 11)¹ as an "overwhelmingly positive"² regime that would protect Canadian and United States investors from arbitrary treatment at the hands of Mexican authorities.³ Despite some early warnings,⁴ few considered the possibility that Chapter 11 might also provide

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1. North American Free Trade Agreement, Dec. 17, 1992, Can.-Mex.-U.S., ch. 11, 32 I.L.M. 605, 639-49 [hereinafter NAFTA].

2. Richard C. Levin & Susan Erickson Marin, *NAFTA Chapter 11: Investment and Investment Disputes*, 2 NAFTA L. & BUS. REV. AM. 82, 115 (1996).

3. See HOWARD MANN & KONRAD VON MOLTKE, *NAFTA'S CHAPTER 11 AND THE ENVIRONMENT: ADDRESSING THE IMPACTS OF THE INVESTOR-STATE PROCESS ON THE ENVIRONMENT* 12 (1999), available at <http://www.iisd.org/trade/Chapter11.htm>; Tim Kennish, *NAFTA and Investment – A Canadian Perspective*, in NAFTA AND INVESTMENT 1, 7 (Seymour J. Rubin & Dean C. Alexander eds., 1995); Levin & Marin, *supra* note 2, at 83; Howard Mann, *NAFTA and the Environment: Lessons for the Future*, 13 TUL. ENVTL. L.J. 387, 402 (2000); Julie A. Soloway, *Environmental Trade Barriers Under NAFTA: The MMT Fuel Additives Controversy*, 8 MINN. J. GLOBAL TRADE 55, 88 (1999) [hereinafter Soloway, *Environmental Trade Barriers under NAFTA*]; Julie A. Soloway, *NAFTA's Chapter 11: The Challenge of Private Party Participation*, 16 J. INT'L ARB. 1, 4 (1999) [hereinafter Soloway, *The Challenge of Private Party Participation*]; Samrat Ganguly, Note, *The Investor-State Dispute Mechanism (ISDM) and a Sovereign's Power to Protect Public Health*, 38 COLUM. J. TRANSNAT'L L. 113, 154 (1999); Tali Levy, Note, *NAFTA's Provision for Compensation in the Event of Expropriation: A Reassessment of the "Prompt, Adequate and Effective" Standard*, 31 STAN. J. INT'L L. 423, 444 (1995); Daniel R. Loritz, Comment, *Corporate Predators Attack Environmental Regulations: It's Time to Arbitrate Claims Filed Under NAFTA's Chapter 11*, 22 LOY. L.A. INT'L & COMP. L. REV. 533, 535 (2000); Stephen L. Kass, *Regulatory Takings Reopened: Surprising, Potentially Significant, Context Is NAFTA Chapter 11*, N.Y.L.J., Sept. 11, 2000, § 2, col. 1.

4. See Richard G. Dearden, *Arbitration of Expropriation Disputes Between an Investor and the State Under the North American Free Trade Agreement*, 29 J. WORLD TRADE 113, 114, 126-27

an instrument for vigorous scrutiny of measures adopted or maintained by Canadian and U.S. authorities.⁵ Following the initiation of several claims against their governments, however, Canadian and U.S. writers have denounced the purportedly “aggressive”⁶ use of investor-state arbitration as an “offensive” weapon⁷ that has “chilled”⁸ the exercise of regulatory authority and caused an “alarming” loss of sovereignty.⁹ Based on the wide variety of pending claims, writers warn that Chapter 11 provides foreign corporations with a reliable “tool for attacking any legislation or regulation that they do not find beneficial to their investment[s].”¹⁰ To combat this apparent threat, some writers advocate a retreat from liberal access to investor-state arbitration.¹¹

(Feb. 1995) (predicting the regular use of Chapter 11 in disputes alleging expropriation and explaining that Chapter 11 fetters the discretion of NAFTA Parties).

5. See MANN & VON MOLTKE, *supra* note 3, at 4; Lawrence L. Herman, *Settlement of International Trade Disputes – Challenges to Sovereignty – A Canadian Perspective*, 24 CAN.-U.S. L.J. 121, 133-34 (1998); Soloway, *The Challenge of Private Party Participation*, *supra* note 3, at 4; Soloway, *Environmental Trade Barriers Under NAFTA*, *supra* note 3, at 88; Julia Ferguson, Note, *California’s MTBE Contaminated Water: An Illustration of the Need for an Environmental Interpretive Note on Article 1110 of NAFTA*, 11 COLO. J. INT’L ENVTL L. & POL’Y 499, 503 (2000).

6. MANN & VON MOLTKE, *supra* note 3, at 4; Mann, *supra* note 3, at 405-06. See also J. Martin Wagner, *International Investment, Expropriation and Environmental Protection*, 29 GOLDEN GATE U. L. REV. 465, 466 (1999); Loritz, *supra* note 3, at 534.

7. MANN & VON MOLTKE, *supra* note 3, at 5; Mann, *supra* note 3, at 405; Ferguson, *supra* note 5, at 503; Ganguly, *supra* note 3, at 153.

8. See S.D. Myers, Inc. v. Canada, Partial Award, at para. 203 (Nov. 13, 2000) (separate opinion of Bryan Schwartz) (NAFTA/UNCITRAL), available at <http://www.appletonlaw.com/4b2myers.htm>; Mann, *supra* note 3, at 406; Justin Byrne, Note, *NAFTA Dispute Resolution: Implementing True Rule-Based Diplomacy Through Direct Access*, 35 TEX. INT’L L.J. 415, 432 (2000); Ferguson, *supra* note 5, at 500; Ganguly, *supra* note 3, at 119; Loritz, *supra* note 3, at 546. See also Dr. Rainer Geiger, *Towards a Multilateral Agreement on Investment*, 31 CORNELL INT’L L.J. 467, 471 (1998) (observing that “[e]nvironmental organizations are concerned about a chilling effect on governmental protection of the environment, resulting from investor claims that environmental regulation amounts to expropriation”).

9. Ganguly, *supra* note 3, at 126. See also S.D. Myers, Partial Award, at paras. 12, 86 (Nov. 13, 2000) (separate opinion of Bryan Schwartz); Kevin Banks, *NAFTA’s Article 1110—Can Regulation Be Expropriation?*, 5 NAFTA L. & BUS. REV. AM. 499, 499 (1999); Herman, *supra* note 5, at 123, 134; Pierre Sauve, *Canada, Free Trade, and the Diminishing Returns of Hemispheric Regionalism*, 4 UCLA J. INT’L L. & FOREIGN AFF. 237, 244 (1999-2000); Soloway, *Environmental Trade Barriers Under NAFTA*, *supra* note 3, at 88; Byrne, *supra* note 8, at 430; Loritz, *supra* note 3, at 546-47.

10. Ganguly, *supra* note 3, at 152. See also Banks, *supra* note 9, at 504; Herman, *supra* note 5, at 134; Soloway, *Environmental Trade Barriers Under NAFTA*, *supra* note 3, at 88-89; Ferguson, *supra* note 5, at 515.

11. See MANN & VON MOLTKE, *supra* note 3, at 58; Herman, *supra* note 5, at 135-37; Wagner, *supra* note 6, at 467-68; Ferguson, *supra* note 5, at 518-19; Ganguly, *supra* note 3, at 166.

Joined in part by the Canadian and U.S. governments,¹² writers also support the adoption of binding interpretive statements to limit the substantive obligations of Chapter 11.¹³ Such proposals express little confidence in arbitrators to render decisions that could mitigate popular concern.¹⁴

Over the past year, however, Chapter 11 tribunals have issued a number of decisions and awards that provide an important opportunity for reassessment of the criticisms that have been leveled at Chapter 11. Part I lays the foundation for such an analysis by reviewing the structure and purpose of Chapter 11. To explain why Chapter 11 has caused an outpouring of public concern, Part II describes the surprising variety of claims submitted to arbitration under its authority. Part III examines recent decisions of Chapter 11 tribunals to determine whether the emerging trends support the criticisms of Chapter 11. In so doing, Part III identifies a balanced interpretive strategy employed by most Chapter 11 tribunals. When construing Chapter 11's provisions on procedure and jurisdiction, most tribunals have adopted flexible interpretations that promote access to arbitration and a hearing on the merits. When construing the substantive obligations of Chapter 11, however, tribunals have hewed more closely to the treaty's text and specific rules of international law. This suggests that expansive claims will frequently survive procedural and jurisdictional objections, but are much less likely to pass through the more rigorous filter of substantive disciplines. Thus, condemnation of Chapter 11 may be premature; Chapter 11 provides broad opportunities to challenge measures adopted or maintained by host states, but the substantive disciplines offer adequate protection against abusive claims.

12. See *S.D. Myers*, Partial Award, at para. 205 (Nov. 13, 2000) (separate opinion of Bryan Schwartz); MANN & VON MOLTKE, *supra* note 3, at 10-11, 47-48; Mann, *supra* note 3, at 406; Sabrina Safrin et al., *International Legal Developments in Review: 1999: Public International Law/Environmental Law*, 34 INT'L LAW. 707, 725 n.56 (2000); Soloway, *The Challenge of Private Party Participation*, *supra* note 3, at 13; Ferguson, *supra* note 5, at 516; Loritz, *supra* note 3, at 547 n.105.

13. See MANN & VON MOLTKE, *supra* note 3, at 7-8, 20-21, 37, 47-48; Herman, *supra* note 5, at 136; Soloway, *The Challenge of Private Party Participation*, *supra* note 3, at 14; Ferguson, *supra* note 5, at 517-18. In July 2001, the Free Trade Commission (*i.e.*, cabinet-level representatives of the NAFTA Parties) adopted the first Notes of Interpretation of Certain Chapter 11 Provisions. See *infra* note 249.

14. See MANN & VON MOLTKE, *supra* note 3, at 17 ("[T]he legal uncertainties in the Chapter 11 disciplines are . . . unlikely to be significantly reduced by pending arbitrations.").

I. STRUCTURE AND PURPOSE OF CHAPTER 11

Structurally, Chapter 11 resembles bilateral investment treaties (BITs),¹⁵ which create standards for treatment of investors and establish procedures for resolving investor-state disputes. For example, Section A of Chapter 11 imposes the following key disciplines. First, Section A permits expropriation and measures tantamount to expropriation only for a public purpose, on a nondiscriminatory basis, in accordance with due process of law and the minimum standard of treatment under Chapter 11, and upon prompt payment of fair market value (plus interest) in freely-transferable funds.¹⁶ Second, Section A prohibits certain performance requirements, including requirements to export a given level or percentage of goods or services, or to achieve a given level or percentage of domestic content.¹⁷ Third, Section A requires NAFTA Parties to treat each other's investors in accordance with the relative standards of national treatment and most-favored-nation (MFN) treatment.¹⁸ Fourth, Section A establishes a minimum standard, which requires NAFTA Parties to treat each other's investors in accordance with international law, including fair and equitable treatment.¹⁹

Section B of Chapter 11 secures these obligations by providing for investor-state arbitration of claims alleging that a NAFTA Party (or one of its state enterprises or monopolies) has violated one of the provisions found in Section A.²⁰ Under Section B, NAFTA investors may demand arbitration under the ICSID Convention (if the investor's home state and the disputing NAFTA Party are both states parties to that convention), the Additional Facility Rules of ICSID (if *either* the investor's home state or the disputing NAFTA Party is a state party to the ICSID Convention), or the UNCITRAL Arbitration Rules.²¹

15. See *S.D. Myers*, Partial Award, at paras. 58, 77 (Nov. 13, 2000) (separate opinion of Bryan Schwartz); Michael P. Avramovich, *The Protection of International Investment at the Start of the Twenty-First Century: Will Anachronistic Notions of Business Render Irrelevant the OECD's Multilateral Agreement on Investment?*, 31 J. MARSHALL L. REV. 1201, 1240-41 (1998); Charles N. Brower & Lee A. Steven, *Who Then Should Judge?: Developing the International Rule of Law Under NAFTA Chapter 11*, 2 CHI. J. INT'L L. 193, 193-194 (2001); David A. Gantz, *Resolution of Investment Disputes Under the North American Free Trade Agreement*, 10 ARIZ. J. INT'L & COMP. L. 335, 339 (1993); Herman, *supra* note 5, at 133; Soloway, *The Challenge of Private Party Participation*, *supra* note 3, at 4; David R. Adair, Comment, *Investors' Rights: The Evolutionary Process of Investment Treaties*, 6 TULSA J. COMP. & INT'L L. 195, 204 (1999); Christopher N. Camponovo, Comment, *Dispute Settlement and the OECD Multilateral Agreement on Investment*, 1 UCLA J. INT'L L. & FOREIGN AFF. 181, 195 (1996); Ferguson, *supra* note 5, at 502; Ganguly, *supra* note 3, at 132-33; Levy, *supra* note 3, at 445, 446-47.

16. NAFTA, *supra* note 1, at art. 1110(1)-(6), 32 I.L.M. at 641-42.

17. *Id.* at arts. 1106(1)(a), (b), 1106(3)(b), 32 I.L.M. at 640.

18. *Id.* at arts. 1102, 1103, 32 I.L.M. at 639.

19. *Id.* at art. 1105(1), 32 I.L.M. at 639.

20. *Id.* at art. 1116(1), 32 I.L.M. at 642-43.

21. *Id.* at art. 1120(1), 32 I.L.M. at 643. Presently, the United States is a state party to the ICSID

Thus, Chapter 11 reiterates traditional principles of international investment law that favor investor security.²² Their incorporation into NAFTA represented an apparent victory for U.S. negotiators, who wanted to liberalize the Mexican investment regime,²³ protect U.S. investors from expropriation,²⁴ and remove investor-state disputes from the Mexican judicial process, which was “generally considered corrupt or at least compliant with the will of the state.”²⁵ Negotiators also expected this mechanism to relieve the U.S. government from intervening in, and thus politicizing, investment disputes between U.S. companies and the Mexican state.²⁶

II. PUBLIC CONCERN ABOUT RECENT CLAIMS

While Chapter 11 builds on the familiar structure of BITs, it “places the regime in a novel context.”²⁷ For the first time, the substantive and procedural obligations appear in an investment treaty whose adherents include two developed states, Canada and the United States.²⁸ “Thus, NAFTA investors can now hold Canada and the United States to the demands traditionally placed on developing states.”²⁹ Inevitably, this

Convention, but Canada and Mexico are not. See *Ethyl Corp. v. Canada, Decision Regarding the Place of Arbitration* (Nov. 28, 1997) (NAFTA/UNCITRAL), reprinted in 38 I.L.M. 702, 703 n.5 (1999).

22. See *International Law in Ferment: Recent Developments in Private International Law*, 94 AM. SOC'Y INT'L L. PROC. 11, 13 (2000) (remarks of Charles H. Brower, II) [hereinafter Brower Remarks]. See also Herman, *supra* note 5, at 133-34 (describing Chapter 11 as an apparently “straightforward application of acceptable international standards of treatment”); Gloria L. Sandrino, *The NAFTA Investment Chapter and Foreign Direct Investment in Mexico: A Third World Perspective*, 27 VAND. J. TRANSNAT'L L. 259, 326 (1994) (observing that the NAFTA's “investment provisions reaffirm[] . . . traditional rules governing foreign property”); Ferguson, *supra* note 5, at 502 (“[U]S negotiators aimed to secure treaty language that adequately reflected US interpretations of the international law of expropriations.”).

23. See MANN & VON MOLTKE, *supra* note 3, at 11; Daniel M. Price, *An Overview of the NAFTA Investment Chapter: Substantive Rules and Investor-State Dispute Settlement*, 27 INT'L LAW. 727, 727 (1993); Levin & Marin, *supra* note 2, at 83; Ganguly, *supra* note 3, at 133.

24. See Ferguson, *supra* note 5, at 503; Ganguly, *supra* note 3, at 154; Loritz, *supra* note 3, at 533, 535; Kass, *supra* note 3, § 2, col. 1.

25. Mann, *supra* note 3, at 402. See also Soloway, *Environmental Trade Barriers Under NAFTA*, *supra* note 3, at 88; Kass, *supra* note 3, § 2, col. 1.

26. See Brower & Steven, *supra* note 15, at 195.

27. Brower Remarks, *supra* note 22, at 14. See also Brower & Steven, *supra* note 15, at 194-195.

28. See MANN & VON MOLTKE, *supra* note 3, at 4; Brower & Steven, *supra* note 15, at 195; Price, *supra* note 23, at 731; *Towards an Effective International Investment Regime*, 91 AM. SOC'Y INT'L L. PROC. 485, 492 (1997) (remarks of Daniel M. Price); Safrin et al., *supra* note 12, at 723.

29. Brower Remarks, *supra* note 22, at 14. See also Price, *supra* note 23, at 736.

encourages claimants to use the investor-security bias of international law as a platform from which to challenge venerable policies and institutions.³⁰

In 1998, two events highlighted the significance of Chapter 11 as an “untapped source of . . . investor rights.”³¹ First, Canada withdrew a ban on the importation of (and inter-provincial trade in) the fuel additive MMT rather than defend itself against the \$251 million claim of Virginia-based Ethyl Corporation.³² Second, a Canadian investor brought a \$725 million claim against the United States based on Mississippi state court proceedings, in which (a) race and nationality may have contributed to a \$500 million damage award, and (b) the state’s 125% appellate bonding requirement foreclosed an appeal.³³ These cases quickly established Chapter 11 as the foundation for a surprising range of claims.

The ensuing two years witnessed the initiation of at least five new claims, four of which were directed at Canada or the United States.³⁴ Taking the claims in chronological order, a United States company, Pope & Talbot, Inc., brought its \$125 million claim against Canada in March 1999.³⁵ Pope

30. See Brower Remarks, *supra* note 22, at 14.

31. Gary N. Horlick & Alicia L. Marti, *NAFTA Chapter 11B: A Private Right of Action to Enforce Market Access Through Investments*, 14 J. INT’L ARB. 43, 54 (1997).

32. See Christopher Dugan & John Nalbandian, *Introductory Note to NAFTA Chapter 11 Arbitral Tribunal: Ethyl Corporation v. The Government of Canada (Decision Regarding the Place of Arbitration)*, 38 I.L.M. 700, 702 (1999) (observing that, following an adverse award on jurisdiction, Canada settled Ethyl Corp.’s claim by agreeing to withdraw the ban on MMT and to pay \$13 million in compensation).

33. See *Loewen Group, Inc. v. United States*, Notice of Claim, at 2-3 (on file with the Pepperdine Law Review).

34. Because many of the submissions in Chapter 11 proceedings are confidential, writers frequently cannot obtain sufficient information about the existence and nature of pending disputes. See MANN & VON MOLTKE, *supra* note 3, at 7; Banks, *supra* note 9, at 501; Chi Carmody, *Beyond the Proposals: Public Participation in International Economic Law*, 15 AM. U. INT’L L. REV. 1321, 1342-43 & n.67 (2000); Safrin et al., *supra* note 12, at 725 n.54; Wagner, *supra* note 6, at 487; Ferguson, *supra* note 5, at 506, 513; Kass, *supra* note 3, § 2, col. 1.

The Freedom of Information Act (FOIA) should provide access to relevant documents within the possession, custody, or control of the Department of Justice (which is handling *Loewen Group Inc. v. United States*) and the State Department (which is handling all other Chapter 11 claims). In response to the author’s FOIA request of October 5, 2000, the Department of Justice provided documents on the *Loewen* case and waived copying and search fees. The State Department’s regulations indicate that it “shall” waive or reduce search and copying fees, provided that “[d]isclosure of the information is in the public interest . . . and is not primarily in the commercial interest of the requester.” 22 C.F.R. § 171.15. Surprisingly, the State Department initially denied the author’s October 5, 2000 request for a fee waiver on the grounds that disclosure would not serve the public interest. Following an administrative appeal, the State Department agreed in principle to some fee reduction during the summer of 2001. As of this writing, the author and the State Department have not agreed on the amount or nature of the fee reduction. Therefore, the author has not received any responsive documents from the State Department.

Under the circumstances, the author has endeavored to provide accurate information, but recognizes that it may not be complete. Because readers may have difficulty in obtaining primary documents, the author discusses the underlying facts of claims and the reasoning adopted by tribunals to a greater extent than he otherwise would.

35. *Pope & Talbot, Inc. v. Canada*, Statement of Claim Under the Arbitration Rules of the United

& Talbot challenged Canadian regulations that implemented the 1996 Softwood Lumber Agreement by requiring producers in four Canadian provinces to obtain permits for – and pay fees on – certain lumber exports to the United States.³⁶ According to Pope & Talbot, Canada's administration of these measures denied its Canadian subsidiary national treatment, and fair and equitable treatment;³⁷ constituted a performance requirement;³⁸ and represented a measure tantamount to expropriation.³⁹ As explained below, the tribunal has rendered a series of partial awards on jurisdiction and the merits.⁴⁰

In April 1999, a United States citizen initiated a \$50 million claim against Mexico for the tax treatment of his Mexican company, Corporacion de Exportaciones Mexicanas, S.A. (CEMSA). The claim alleged that Mexican tax authorities arbitrarily (and in violation of court orders) denied CEMSA excise tax rebates.⁴¹ The investor described these measures as an expropriation and the denial of justice.⁴² Of the five new claims, only this one fits the paradigm of investor-state disputes that U.S. negotiators contemplated when drafting Chapter 11.

In July 1999, a Canadian company, Methanex Corporation, served its Notice of Intent to file a \$970 million claim against the United States.⁴³ Methanex asserted that California's ban of the fuel additive MTBE constitutes a measure tantamount to expropriation and a denial of "fair and equitable" treatment,⁴⁴ inasmuch as California did not rely on scientific evidence, failed to consider alternative regulations, and adopted measures

Nations Commission on International Trade Law and the North American Free Trade Agreement, at 29, available at <http://www.appletonlaw.com/4b3P&T.htm> [hereinafter Pope & Talbot, Statement of Claim].

36. *Id.* at 5-7.

37. *Id.* at 20-22. Pope & Talbot initially asserted that the measures also violated the principle of MFN treatment, but later withdrew that part of its claim. Pope & Talbot v. Canada, Interim Award at para. 14 (June 26, 2000) (NAFTA/UNCITRAL), available at <http://www.appletonlaw.com/4b3P&T.htm>.

38. Pope & Talbot, Statement of Claim, *supra* note 35, at 22-23.

39. *Id.* at 23-27.

40. See *infra* notes 78-84, 87-92, 119-32, 163-65, 167-68, 179, 188-90, 194-98, 237, 245, 249 and accompanying text.

41. See Feldman v. Mexico, Notice of Arbitration, at 5-6 (on file with the Pepperdine Law Review).

42. See *id.* at 8-11.

43. Methanex Corp. v. United States, Notice of Intent to Submit a Claim to Arbitration Under Article 1119, Section B, Chapter 11 of the North American Free Trade Agreement, available at <http://www.methanex.com/investorcentre/MTBE.htm>.

44. *Id.* at 2-4.

not reasonably necessary to protect legitimate public interests.⁴⁵ “By casting its argument in these terms, Methanex implies that ‘fair and equitable treatment’ incorporates the types of restrictions that Article XX(b) of the General Agreement of Tariffs and Trade (GATT) places on health, safety, and environmental laws.”⁴⁶

In September 1999, a Canadian company, Mondev International, Ltd., filed its Notice of Arbitration in a \$50 million claim against the United States. While it lacked the colorful facts of the Mississippi court proceedings in *Loewen*, this claim also involved state court proceedings.⁴⁷ Mondev claimed that a combination of actions taken by Boston city authorities, the state trial court, and the Massachusetts Supreme Judicial Court resulted in a denial of justice, a measure tantamount to expropriation, and a denial of fair and equitable treatment.⁴⁸ Mondev asserted that the Supreme Judicial Court contributed to these NAFTA violations by reweighing jury findings, ignoring its own standard of review, adopting a novel legal theory that the parties never asserted, and applying it retroactively to reverse a multi-million dollar jury award.⁴⁹

Finally, in January 2000, United Parcel Service of America, Inc. (UPS) served its Notice of Intent to pursue a \$100 million claim against Canada.⁵⁰ UPS claimed that Canada unlawfully permitted Canada Post (the national mail service) to use its monopoly on letter mail to cross-subsidize non-monopolized businesses, including parcel delivery and courier services.⁵¹ UPS also alleged that Canada Post violated the obligation of national treatment by giving its own courier businesses access to the national mail distribution system, while denying similar access to United Parcel Service Canada Ltd.⁵² Furthermore, UPS asserted that these and several other alleged violations of NAFTA (some of which do not fall within Chapter 11) constituted a violation of the minimum standard of treatment, including fair and equitable treatment.⁵³

These claims indicate that Chapter 11 provides the tool for challenging a wide variety of “measures,” including laws and regulations that allegedly protect public health, safety, and the environment; create import and export

45. *Id.* at 2-3.

46. Brower Remarks, *supra* note 22, at 14.

47. *See Lafayette Place Assocs. v. Boston Redev. Auth.*, 694 N.E.2d 820 (Mass. 1998).

48. *See Mondev Int’l Ltd. v. United States*, Notice of Arbitration, at paras. 127-33, 138-39, 141-48, 150 (on file with Pepperdine Law Review).

49. *See id.* at paras. 130, 138, 141.

50. *United Parcel Serv. of Am., Inc. v. Canada*, Notice of Intent to Submit a Claim to Arbitration Under Section B of Chapter 11 of the North American Free Trade Agreement (on file with Pepperdine Law Review).

51. *Id.* at paras. 5-16.

52. *See id.* at para. 19.

53. *See id.* at paras. 25-31.

controls; and implement treaties. In addition, Chapter 11 permits scrutiny of important governmental services, including a judicial system that we regard as a model for the rest of the world. This intrusion of international law into the daily affairs of NAFTA countries has provoked an outcry against the perceived chilling effect on regulatory programs and the corresponding diminution of sovereignty.⁵⁴ Chapter 11 has even drawn criticism from a prominent international lawyer who describes Chapter 11 as a “bizarre human rights treaty . . . for a special-interest group” that provides NAFTA investors with “direct access to . . . denationalized adjudication of any governmental measure that interferes with their ample rights.”⁵⁵

Herein lies the irony of Chapter 11: the U.S. government expected it to provide a depoliticized method of protecting U.S. investors against the arbitrary conduct of Mexican officials. Instead, the promiscuous use of Chapter 11 to challenge public regulatory laws in Canada and the U.S. has thrust it into the center of a highly politicized debate, in which participants question the compatibility of Canadian and U.S. sovereignty with traditional principles of international law. While Mexico remains committed to Chapter 11 as written,⁵⁶ the Canadian government and parts of the U.S. government have proposed the adoption of binding interpretive statements to limit Chapter 11’s substantive obligations.⁵⁷ Most writers either concur⁵⁸ or urge a retreat from unfettered access to investor-state arbitration of Chapter 11 claims.⁵⁹

54. See *supra* notes 6-14 and accompanying text.

55. José E. Alvarez, *Critical Theory and the North American Free Trade Agreement’s Chapter Eleven*, 28 U. MIAMI INTER-AM. L. REV. 303, 307-08 (1997).

56. See Safrin et al., *supra* note 12, at 726 n.56 (observing that the Mexican government opposes any changes to the Chapter 11 process); Ferguson, *supra* note 5, at 516 (describing the Mexican government’s satisfaction with the Chapter 11 process and its corresponding reluctance to make any changes). See also Mann, *supra* note 3, at 407 (stating that Mexico expects pending cases to resolve public concerns).

57. See *supra* notes 12-13 and accompanying text.

58. See *supra* note 13 and accompanying text.

59. See *supra* note 11 and accompanying text. *But see* Brower & Steven, *supra* note 15, at 194; Byrne, *supra* note 8, at 433; Loritz, *supra* note 3, at 549-51.

III. BALANCING ACCESS AND THE MERITS

Any system for resolving investor-state disputes must balance two objectives. First, it must provide investors with liberal access to a forum in which to present complaints.⁶⁰ Second, the selected mechanism must not create ideal standards that conflict with the regulatory practices of most orderly states.⁶¹ It seems evident that public anxiety about Chapter 11 rests on the untested premise that it lacks balance and favors the interests of foreign investors over the public interest; hence, the perceived need to restore equilibrium by limiting access to investor-state arbitration or by restricting the substantive obligations of Chapter 11. Several recent awards provide an important opportunity to determine whether arbitral tribunals can strike a balance that should diminish the opposition to Chapter 11.

Part III argues that most Chapter 11 tribunals have adopted interpretive strategies that promote access to investor-state arbitration but do not impose unrealistic standards of conduct on NAFTA Parties. Part III(A) explains that most tribunals have adopted flexible interpretations of Section B's provisions on procedure and jurisdiction, thus promoting access to arbitration and a hearing on the merits. Part III(B) describes the countervailing tendency of tribunals to adhere more rigorously to the treaty's text and specific rules of international law in construing Section A's provisions on liability. As critics feared, extravagant claims will often survive procedural and jurisdictional objections. Yet, critics have overestimated the capacity of such claims to pass through the rigorous filter of substantive disciplines. Thus, the emerging case law suggests that Chapter 11 gives investors broad opportunities to complain, but subjects their allegations to a level of scrutiny that provides adequate protection against abusive claims.

A. Access to Investor-State Arbitration

Section B of Chapter 11 "establishes a mechanism for the settlement of investment disputes that assures . . . due process before an impartial [arbitral] tribunal."⁶² Viewed in isolation, however, certain provisions of Section B seem to impose requirements that limit access to investor-state arbitration. For example, claimants must establish that they qualify as

60. John T. Schmidt, *Arbitration Under the Auspices of the International Centre for Settlement of Investment Disputes (ICSID): Implications of the Decision on Jurisdiction in Alcoa Minerals of Jamaica, Inc. v. Government of Jamaica*, 17 HARV. INT'L L.J. 90, 103-04 (1976).

61. Philip C. Jessup, *Responsibility of States for Injuries to Individuals*, 46 COLUM. L. REV. 903, 914 (1946).

62. NAFTA, *supra* note 1, at art. 1115, 32 I.L.M. at 642.

“investors” in another NAFTA Party.⁶³ Their claims must also involve “investment disputes” in the sense that they challenge measures “relating to” investors or investments.⁶⁴ Furthermore, in submitting claims, investors must include a written consent to arbitration and a waiver of the right to initiate or continue any other dispute resolution proceedings with respect to the allegedly offending measure, *except* for certain proceedings for extraordinary relief not involving the payment of damages.⁶⁵ If the investor initiates a claim on behalf of an enterprise of another NAFTA Party that it owns or controls, the investor must also submit a waiver executed by that enterprise.⁶⁶

Citing these provisions, disputing NAFTA Parties frequently seek partial or complete dismissal on the grounds that the claimants lack an investment; the claims do not involve investment disputes; claimants have improperly raised “new claims” based on events that occurred after the commencement of arbitration; and the claimants have submitted untimely or insufficient waivers. While individual provisions of Chapter 11 might appear to support such objections, most tribunals have construed those provisions in light of their purpose and context, which includes the creation of a dispute resolution process that assures “due process” before an impartial tribunal. Because “[l]adding th[e] process with a long list of mandatory preconditions . . . would defeat that objective,” most tribunals have flexibly construed procedural and jurisdictional rules to promote access to arbitration and examination of claims on the merits.⁶⁷ Nonetheless, tribunals have indicated that they will not use flexible constructions to reward claimants who engage in seriously abusive behavior.

63. *Id.* at art. 1116 (authorizing “investors” to submit claims on their own behalf); *id.* at 1117 (authorizing “investors” to submit claims on behalf of enterprises they own or control), 32 I.L.M. at 642-43.

64. *Id.* at arts. 1101(1), 1115, 32 I.L.M. at 639, 642.

65. *Id.* at art. 1121(1), 32 I.L.M. at 643.

66. *Id.* at art. 1121(2), 32 I.L.M. at 643. In addition, investors cannot submit a claim to arbitration until six months have elapsed since the events giving rise to the claim. *Id.* at art. 1120(1), 32 I.L.M. at 643. Before actually submitting a claim, investors must also wait for 90 days after giving the disputing NAFTA Party notice of intent to submit the claim to arbitration. *Id.* at art. 1119, 32 I.L.M. at 642. Finally, investors may not submit a claim to arbitration if more than three years have elapsed from the date on which the investor acquired (or should have acquired) both knowledge of the alleged breach and the occurrence of loss or damage. *See id.* at arts. 1116(2), 1117(2), 32 I.L.M. at 642-43.

67. *Pope & Talbot, Inc. v. Canada, Award Concerning the Motion by Government of Canada Respecting the Claim Based Upon Imposition of the “Super Fee,”* at para. 26 (Aug. 7, 2000) (NAFTA/UNCITRAL), available at <http://www.appletonlaw.com/4b3P&T.htm>.

1. Lack of an Investment

Section A of Chapter 11 regulates measures that relate to “investors” and “investments.”⁶⁸ Likewise, Section B of Chapter 11 establishes procedures for resolving “investment disputes.”⁶⁹ Disputing NAFTA Parties have frequently sought dismissal on the grounds that claimants lacked investments or did not challenge measures “relating” to investments.

In *S.D. Myers, Inc. v. Canada*, the claimant (SDMI) alleged that its operations in Canada alone and jointly with S.D. Myers (Canada), Inc. (Myers Canada) constituted an investment within the meaning of Article 1139.⁷⁰ Canada requested dismissal on the grounds that Myers Canada did not constitute an investment of SDMI because the individual members of the Myers family held the stock of both corporations.⁷¹ Thus, although the two businesses were affiliates, SDMI technically did not own or control Myers Canada.⁷² Because the three-year limitations period of Chapter 11 would likely have prevented the individual owners of Myers Canada from bringing a separate claim,⁷³ SDMI sought to establish a Canadian investment on a number of other alternative grounds.⁷⁴

“Taking into account the objectives of the NAFTA,” the tribunal could “not accept that an otherwise meritorious claim should fail solely by reason of the [formal] corporate structure” adopted by a family business.⁷⁵ Since the evidence established that both corporations remained within the Myers family and under the control of one individual, the tribunal concluded that Myers Canada qualified as an investment of SDMI for purposes of Chapter 11.⁷⁶ As a result, the tribunal did not address SDMI’s alternative arguments on jurisdiction.⁷⁷

In *Pope & Talbot, Inc. v. Canada*, a U.S. investor claimed that its investment in a Canadian lumber company had been expropriated by regulations requiring export permits for – and payment of fees on – certain lumber exports to the United States.⁷⁸ Canada responded that the claim did not relate to the investment of an investor because access to the U.S. market does not constitute “property included within the definition of an investment

68. NAFTA, *supra* note 1, at art. 1101(1), 32 I.L.M. at 639.

69. *Id.* at art. 1115, 32 I.L.M. at 642.

70. *S.D. Myers, Inc. v. Canada*, Partial Award, at para. 222 (Nov. 13, 2000) (NAFTA/UNCITRAL), available at <http://www.appletonlaw.com/4b2myers.htm>.

71. *Id.*

72. *Id.* at para. 227.

73. SDMI challenged a measure imposed on November 20, 1995, but did not submit the claim to arbitration until October 30, 1998. *Id.* at paras. 12, 123.

74. *Id.* at para. 232.

75. *Id.* at para. 229.

76. *Id.* at paras. 227, 229, 231.

77. *Id.* at para. 232.

78. *Pope & Talbot*, Statement of Claim, *supra* note 35, at 23-27.

under Article 1139.”⁷⁹ Instead of trying to bring the concept of “market access” within the specific definition of an investment, the tribunal ruled that the Canadian subsidiary was an investment, that U.S. sales constituted a large part of the investment’s business, and that those sales affected the investment’s value.⁸⁰ Viewed from this broader perspective, the tribunal denied Canada’s objection because the export restrictions related to an “investment” as defined in Article 1139.⁸¹

2. Investment Disputes

Several U.S. investors have challenged Canadian restrictions on the import or export of goods. In these cases, Canada has routinely argued that such claims do not involve investment disputes, but constitute “trade disputes” falling within the substantive disciplines of Chapter 3 (trade in goods) and the remedial provisions of Chapter 20 (state-to-state disputes).⁸² Citing the text of Article 1101 and GATT jurisprudence, Canada has maintained that the challenged measures do not “relate to” investments because they are “primarily aimed at” trade in goods.⁸³ In two of three awards to consider this issue, Chapter 11 tribunals held outright that measures directed at trade in goods may also “relate to” investments if the measures directly affect the value of investments.⁸⁴ In the third award, the tribunal declined to issue a definitive ruling, but indicated that Canada’s objection lacked merit.⁸⁵ Thus, while isolated quotes from Article 1101 and GATT jurisprudence might have supported a dichotomy between trade and investment disputes, arbitrators evidently realized that this distinction would

79. *Pope & Talbot v. Canada*, Interim Award, at paras. 87, 95 (June 26, 2000) (NAFTA/UNCITRAL), available at <http://www.appletonlaw.com/4b3P&T.htm>.

80. *Id.* at para. 98.

81. *Id.*

82. *See S.D. Myers*, Partial Award, at paras. 236, 297. *See also Pope & Talbot v. Canada*, Award in Relation to the Preliminary Motion by the Government of Canada, at paras. 19(3), 31-32 (Jan. 26, 2000) (NAFTA/UNCITRAL), available at <http://www.appletonlaw.com/4b3P&T.htm>; *Ethyl Corp. v. Canada*, Award on Jurisdiction, at para. 62 (June 24, 1998) (NAFTA/UNCITRAL), reprinted in 38 I.L.M. 708, 725 (1999).

83. *Pope & Talbot*, Award in Relation to the Preliminary Motion by the Government of Canada, at paras. 27-28 (Jan. 26, 2000).

84. *S.D. Myers*, Partial Award, at paras. 294-95 (Nov. 13, 2000). *See also id.* at paras. 61-62 (separate opinion of Bryan Schwartz); *Pope & Talbot*, Award in Relation to the Preliminary Motion by the Government of Canada, at paras. 33-34 (Jan. 26, 2000).

85. *Ethyl Corp.*, Award on Jurisdiction, at paras. 63-64 (June 24, 1998), 38 I.L.M. at 725 (noting that Canada “cite[d] no authority” and did not “elaborate any argument” to support its position, observing that Canada did not require an immediate decision of the issue, and declining to exclude Ethyl’s claim at the present time).

frustrate the purpose of investor-state arbitration by permitting NAFTA Parties to avoid scrutiny of harmful measures directed at the goods that investments consume or produce.

3. New Claims

Like many international tribunals, Chapter 11 tribunals have no authority to enjoin disputing parties from engaging in behavior alleged to constitute a violation of their treaty obligations.⁸⁶ This leaves NAFTA Parties free to maintain or modify challenged measures, thus increasing the likelihood of injury during the course of arbitration. When investors have claimed damages for subsequently occurring events, however, NAFTA Parties have objected on the grounds that they constitute “new claims” that must be submitted to separate arbitrations in accordance with the procedural requirements of Section B. Although Chapter 11 tribunals have consistently rejected the inadmissibility of such claims *per se*, they have not adopted a uniform conceptual framework for dealing with this issue.

In *Pope & Talbot, Inc. v. Canada*, the investor submitted a claim challenging Canadian regulations imposing fees on certain lumber exports to the United States. Nine months later, the Canadian and U.S. governments agreed to impose additional fees on exports from British Columbia.⁸⁷ The investor first challenged this “super fee” in its memorial some thirteen months after commencement of the arbitration.⁸⁸ Canada objected on the grounds that (1) the regulations implementing the “super fee” represented a new measure that required submission of a separate claim in accordance with the procedural requirements of Section B, and (2) the UNCITRAL Arbitration Rules require claimants to identify their positions clearly in their statements of claim.⁸⁹ The investor replied that (1) the new regulations merely adjusted existing measures so as to cause additional harm, (2) its statement of claim covered any modifications of the challenged regulations, and (3) disputing parties should not escape review by modifying challenged measures during the course of an arbitration.⁹⁰ The tribunal agreed that the investor’s statement of claim challenged the export regulations as an evolving phenomenon and that the “super fee” simply represented a new

86. *Pope & Talbot Inc. v. Canada*, Ruling by Tribunal on Claimants’ Motion for Interim Measures (Jan. 7, 2000) (NAFTA/UNCITRAL), available at <http://www.appletonlaw.com/4b3P&T.htm>. See also Dearden, *supra* note 4, at 127.

87. *Pope & Talbot Inc. v. Canada*, Award Concerning the Motion by Government of Canada Respecting the Claim Based Upon Imposition of the “Super Fee,” at para. 3 (Aug. 7, 2000) (NAFTA/UNCITRAL), available at <http://www.appletonlaw.com/4b3P&T.htm>.

88. *Id.* at paras. 2, 4.

89. *Id.* at paras. 4-8.

90. *Id.* at paras. 12-13.

aspect of the challenged regime.⁹¹ As a result, the circumstances did not require amendment of the investor's claim.⁹²

In *Ethyl Corp. v. Canada*, the notice of arbitration challenged a legislative proposal to ban the importation of (and inter-provincial trade in) the fuel additive MMT and did not specifically refer to a product known as "Greenburn."⁹³ The statement of claim, however, referred to the subsequently enacted Canadian legislation and its effect on "Greenburn."⁹⁴ Canada objected on the grounds that the investor had asserted "new claims" lying beyond the tribunal's competence.⁹⁵ The tribunal acknowledged that the references to "Greenburn" arguably constituted an elaboration of claims identified in the notice of arbitration but held that, "if anything," they amended the notice of arbitration.⁹⁶ In discussing the propriety of amendments under the UNCITRAL Rules, the tribunal noted that Article 20 generally permits amendments unless the tribunal considers them inappropriate given the likelihood of delay or prejudice.⁹⁷ Finding nothing to rebut this "presumption of amendability," the tribunal rejected Canada's objections.⁹⁸

In *Metalclad Corp. v. Mexico*, the investor filed a notice of intent, in which it challenged the denial of a construction permit.⁹⁹ Later, the investor submitted a memorial that referred to a subsequent decree that transformed the construction site into an ecological preserve. Mexico objected on the grounds that "Chapter Eleven does not contemplate the amendment of ripened claims to include post-claim events."¹⁰⁰ The investor responded that policies related to the administration of justice favored consideration of such "new claims."¹⁰¹ For example, the failure to hear such claims could deprive investors of redress during the period in which NAFTA Parties would be most inclined to disregard their treaty obligations.¹⁰² Likewise, the

91. *Id.* at paras. 24-25.

92. *Id.* at para. 28.

93. *Ethyl Corp. v. Canada*, Award on Jurisdiction, at para. 93 (June 24, 1998) (NAFTA/UNCITRAL), reprinted in 38 I.L.M. 708, 730 (1999).

94. *Id.*

95. *Id.*

96. *Id.* at paras. 94-95, 38 I.L.M. at 730.

97. *Id.* at para. 95.

98. *Id.*

99. *Metalclad Corp. v. Mexico*, Arbitral Award, at para. 64 (Aug. 30, 2000) (NAFTA/ICSID Add'l Facility), available at <http://www.pearcelaw.com/metalclad.html>.

100. *Id.*

101. *Id.* at para. 65.

102. *Id.*

presentation of related claims *ad seriatim* would create serious inefficiencies.¹⁰³

The tribunal evidently treated the situation as one involving the amendment of a claim. It agreed that efficiency and equity require some opportunity for amendment; however, the tribunal also recognized that principles of fairness and clarity impose certain limitations on the amendment process.¹⁰⁴ The tribunal held that Article 48(2) of the Additional Facility Rules strikes an appropriate balance by generally requiring investors to present ancillary claims no later than in their replies.¹⁰⁵ Since the investor had challenged the ecological decree in its memorial, the tribunal concluded that it had presented the claim “in a timely manner and consistently with the principles of fairness and clarity.”¹⁰⁶

As the foregoing cases demonstrate, tribunals have rejected the formalistic argument that “new claims” require the initiation of separate proceedings. In so doing, they have paid respect to Chapter 11’s objective of providing liberal access to investor-state arbitration. Chapter 11 tribunals, however, have not adopted a uniform analytical framework for dealing with such claims. At least two tribunals (the *Pope & Talbot* and *Ethyl Corp.* tribunals) have suggested that related events may fall within the scope of the original claim and, therefore, may not require amendment. On the other hand, two tribunals have recognized that the assertion of some claims may require formal amendment in accordance with the applicable arbitration rules. While the UNCITRAL Rules appear to provide an open-ended presumption of amendability, the Additional Facility Rules apply this presumption only until the claimant’s reply, after which they apply the opposite presumption.

Thus, the admissibility of “new claims” depends in part on how investors draft their notices of arbitration and the arbitration rules they select. Investors who want to assert “new claims” without amendment should draft notices of arbitration and statements of claim that describe the offending measures at a high level of generality and challenge them as evolving phenomena. In addition, investors who wish to maintain an open-ended presumption of amendability may prefer the UNCITRAL Rules to the Additional Facility Rules. Investors should, however, recognize certain limits on the assertion of “new claims.” While Chapter 11 tribunals have given liberal consideration to “new claims” made in good faith, they have recognized the need to ensure that the assertion of “new claims” does not result in undue delay, prejudice, or unfairness to disputing NAFTA Parties.

103. *See id.*

104. *Id.* at paras. 67-68.

105. *Id.* at para. 68.

106. *Id.* at para. 69.

It seems unlikely that Chapter 11 tribunals will permit investors to raise “new claims” in situations that might create an unfair advantage.

4. Waivers

Article 1121 sets forth the “conditions precedent” to “submission of a claim to arbitration.”¹⁰⁷ Among other things, Article 1121(1)(b) requires investors to waive their right to initiate or continue any other dispute settlement procedures with respect to the measures alleged to breach Chapter 11, except for certain actions for extraordinary relief not involving the payment of damages.¹⁰⁸ When investors assert claims on behalf of their owned or controlled enterprises, Article 1121(2)(b) also requires the submission of waivers executed by those enterprises.¹⁰⁹ The waivers “shall” be in writing and included in the “submission to arbitration,” which means the notice of arbitration under the UNCITRAL and Additional Facility Rules.¹¹⁰ In a number of cases, NAFTA Parties have sought dismissal on the grounds that investors submitted untimely waivers, provided substantively insufficient waivers, or continued to pursue related claims for damages before domestic tribunals.

In *Ethyl Corp. v. Canada*, the investor failed to include written waivers in its notice of arbitration, but submitted them instead with its statement of claim.¹¹¹ Relying on the clear textual references to “conditions precedent” and the time for submitting waivers, Canada argued that the untimely waivers created a jurisdictional defect.¹¹² While conceding that a substantively sufficient waiver represents a condition precedent to consideration of the merits, the investor argued that Article 1121 establishes the conditions for *admissibility* of claims as opposed to the tribunal’s *jurisdiction*.¹¹³ These arguments required the tribunal to decide whether the NAFTA Parties intended to give jurisdictional significance to the contemporaneous submission of waivers and notices of arbitration.¹¹⁴ After examining Article 1121, the tribunal gained “no insight” into its purpose beyond the evident function of memorializing a waiver already implied by

107. NAFTA, *supra* note 1, at art. 1121, 32 I.L.M. 605, 643 (1993).

108. *Id.* at art. 1121(1)(b).

109. *Id.*

110. *Id.* at art. 1137(1), 32 I.L.M. at 646.

111. *See Ethyl Corp. v. Canada*, Award on Jurisdiction, at para. 89 (June 24, 1998) (NAFTA/UNCITRAL), *reprinted in* 38 I.L.M. 708, 729 (1999).

112. *See id.*

113. *See id.* at para. 74-75, 38 I.L.M. at 727 (emphasis added).

114. *See id.* at para. 74.

the act of initiating arbitral proceedings.¹¹⁵ Under the circumstances, the tribunal could not accept Canada's argument that the NAFTA Parties intended to give timely submission of waivers the "drastically preclusive effect" of determining jurisdiction.¹¹⁶ Accordingly, the tribunal held that the investor's delayed compliance with Article 1121 lacked jurisdictional significance.¹¹⁷ The tribunal suggested, however, that persistent or prolonged noncompliance with Article 1121 could warrant dismissal on the grounds of inadmissibility.¹¹⁸

In *Pope & Talbot, Inc. v. Canada*, the investor timely submitted its own waiver and the waiver of a Canadian investment, Pope & Talbot Ltd., in March 1999.¹¹⁹ Later, in its statement of claim, the investor referred to damages arising out of its investment in another Canadian company, Harmac Pacific Inc.¹²⁰ Since Harmac had not executed its own waiver, Canada argued that the investor could not state a claim on its behalf.¹²¹ Although the investor submitted a waiver on behalf of the Harmac business in January 2000, Canada urged the tribunal to dismiss the "Harmac claim" because the three-year limitations period expired before submission of the waiver.¹²² The tribunal rejected the limitations argument on factual grounds and, further, disagreed "that the underlying claim is perfected only when the waiver is submitted."¹²³ Like its counterpart in *Ethyl Corp.*, the tribunal viewed "the initiation of arbitral proceedings . . . as a constructive waiver."¹²⁴ The *Pope & Talbot* tribunal, however, held that the Article 1121 waiver qualifies the constructive waiver in a significant way.¹²⁵ According to the tribunal, the initiation of arbitration arguably waives the right to initiate or maintain *any* other proceedings, whereas the written waiver establishes an intention of *not* waiving the right to seek certain extraordinary relief under the law of the disputing NAFTA Party.¹²⁶ Thus, written waivers do not protect the

115. *Id.* at para. 90, 38 I.L.M. at 729.

116. *Id.* at para. 91.

117. *See id.*

118. *Id.* at paras. 75, 91, 38 I.L.M. at 727, 729.

119. *See Pope & Talbot, Inc. v. Canada*, Award in Relation to Preliminary Motion by Government of Canada to Strike Paragraphs 34 and 103 of the Statement of the Claim from the Record (the "Harmac Motion"), at paras. 3-4 (Feb. 24, 2000) (NAFTA/UNCITRAL), available at <http://www.appletonlaw.com/4b3P&T.htm>.

120. *See id.* at para. 15.

121. *See id.* at para. 2.

122. *See id.* at paras. 5-9.

123. *Id.* at paras. 12-13.

124. *Id.* at para. 16.

125. *See id.*

126. *See id.* (emphasis added).

disputing NAFTA Parties, they protect investors.¹²⁷ As a result, the failure to execute a waiver cannot by itself prejudice a disputing NAFTA Party.¹²⁸

Although the *Pope & Talbot* tribunal declined to interpret Article 1121 as a provision of jurisdictional significance, it recognized that two consequences may flow from non-compliance with Article 1121. First, the tribunal explicitly held that Article 1121 prevents tribunals from entertaining the merits of claims before submission of a proper waiver, thus implying that it establishes conditions for the admissibility of claims.¹²⁹ Second, the tribunal implied that dismissal might be warranted if the non-compliance resulted in prejudice, for example through the contemporaneous initiation of related claims for damages before domestic tribunals.¹³⁰

In subsequent proceedings, Canada objected to Pope & Talbot's assertion of "new claims" without the submission of new waivers.¹³¹ Exasperated at Canada's continued use of formalistic arguments to obstruct the adjudication of claims brought in good faith, the tribunal provided explicit guidance for the interpretation of Chapter 11's provisions on procedure and jurisdiction:

[A]s rulings by this Tribunal and the *Ethyl* Tribunal have found, strict adherence to the letter of . . . NAFTA [A]rticles [1116-1122] is not necessarily a precondition to arbitrability, but must be analyzed within the *context of the objective* of NAFTA in establishing investment dispute arbitration in the first place. That objective, found in Article 1115, is to provide a mechanism for the settlement of investment disputes that assures "due process" before an impartial tribunal. Lading that process with a long list of mandatory preconditions, applicable without consideration of their context, would defeat that objective, particularly if employed with draconian zeal.¹³²

Taken together, the *Ethyl Corp.* and *Pope & Talbot* awards reinforce the emerging trend of flexibly interpreting Section B to promote access to investor-state arbitration. At the same time, both tribunals carefully

127. *See id.*

128. *Id.*

129. *See id.* at para. 18.

130. *See id.*

131. *Pope & Talbot, Inc. v. Canada, Award Concerning the Motion by Government of Canada Respecting the Claim Based Upon Imposition of the "Super Fee,"* at paras. 7-8 (Aug. 7, 2000) (NAFTA/UNCITRAL), available at <http://www.appletonlaw.com/4b3P&T.htm>.

132. *See id.* at para. 26 (second emphasis added).

affirmed their inherent power to control their dockets and to deal with serious prejudice by dismissing claims.

According to one observer, however, the *Ethyl Corp.* and *Pope & Talbot* awards conflict with the subsequent decision in *Waste Management, Inc. v. Mexico*.¹³³ In that case, a U.S. investor submitted a claim on behalf of itself and its Mexican investment.¹³⁴ With its claim, the investor submitted waivers of its own and its investment's rights to initiate or continue other proceedings with respect to the challenged measures, subject to the "understanding" that the waiver did not apply to "any dispute settlement proceedings involving allegations that [Mexico] . . . violated duties imposed by sources of law other than Chapter Eleven . . . including the municipal law of Mexico."¹³⁵ Following submission of the claim to arbitration, the investment maintained two related claims for damages in Mexican courts and initiated a third claim before a Mexican arbitral tribunal.¹³⁶ Under the circumstances, Mexico argued that the Chapter 11 tribunal lacked jurisdiction because the investor had not provided the waiver required by Article 1121 and, moreover, had acted in a manner inconsistent with the waiver required by Article 1121.¹³⁷

In an award dismissing the claim for lack of jurisdiction, the tribunal made several assertions that arguably contradict the letter and the spirit of the *Ethyl Corp.* and *Pope & Talbot* awards. For example, all members of the tribunal agreed that a substantively deficient waiver would constitute a *jurisdictional* defect.¹³⁸ In addition, all members of the tribunal agreed that they had an obligation to monitor the investor's post-submission conduct.¹³⁹ Finally, observers have identified a number of statements that seem to restrict access to investor-state arbitration, including the tribunal's insistence on "clear, explicit, and categorical" waivers and the tribunal's recognition of its obligation to devote the "utmost attention" to assessing the fulfillment of conditions precedent.¹⁴⁰

133. William S. Dodge, *International Decision*, 95 AM. J. INT'L L. 186, 190 (2001).

134. *Waste Mgmt. Inc. v. United Mexican States*, Arbitral Award (June 2, 2000) (NAFTA/ICSID Add'l Facility), available at <http://www.worldbank.org/icsid/cases/awards.htm>.

135. *Id.* at §5.

136. *See id.* at §§ 6, 25.

137. *See id.* at §§ 6-7.

138. The majority held that the investor submitted a substantively insufficient waiver in the sense that the investor did not waive the right to pursue related claims for damages under Mexican law. *See id.* at §§ 27(b), 28, 30, 31. The dissenting arbitrator agreed that a substantively insufficient waiver would create a jurisdictional defect. *See id.* at para. 58 (dissenting opinion of Keith Hight). However, the dissenting arbitrator concluded that Article 1121 does not require the waiver of claims under Mexican law that partially overlap with Chapter 11 claims but do not by themselves constitute Chapter 11 claims. *See id.* at paras. 41-43.

139. The majority indicated that conduct frustrating the waiver's purpose constitutes a jurisdictional defect, while the dissenting arbitrator concluded that such behavior only affects the admissibility of claims. *See id.* (majority award) §§ 26-31, (dissenting opinion) at paras. 58-59.

140. *See Dodge, supra* note 133, at 190. *See also Waste Mgmt.*, Arbitral Award, at §§ 17-18 (June

Certainly, the *Waste Management* award does not suggest an unflagging commitment to the promotion of access to investor-state arbitration. The award may encourage NAFTA Parties to make jurisdictional objections based on formalistic arguments. One hopes, however, that arbitrators will recognize that the result in *Waste Management* remains absolutely consistent with the *Ethyl Corp.* and *Pope & Talbot* awards. The *Waste Management* tribunal ordered dismissal because the investor, by word and deed, persisted (for fourteen months) in denying any intention to waive the right to pursue related claims for damages under Mexican law, as required by Article 1121.¹⁴¹ The *Ethyl Corp.* tribunal suggested that such prolonged non-compliance with Article 1121 might warrant dismissal, albeit on the grounds of inadmissibility.¹⁴² After the investor in *Waste Management* explicitly discontinued all Mexican proceedings at the eleventh hour and expressed a desire to cure any jurisdictional defects, the dissenting arbitrator argued that remediation was possible.¹⁴³ The *Pope & Talbot* tribunal, however, suggested that delayed compliance with Article 1121 might *not* cure defects if the investor's conduct resulted in prejudice.¹⁴⁴ Thus, the *Ethyl Corp.* and *Pope & Talbot* awards support dismissal of the *Waste Management* claim.

While all the three tribunals probably would have dismissed the claim in *Waste Management*, one possible inconsistency remains: whereas the *Ethyl Corp.* and *Pope & Talbot* tribunals arguably would have held the claim to be inadmissible, the *Waste Management* tribunal concluded that it lacked jurisdiction. One may resolve this apparent tension by distinguishing between vexatious behavior that seriously impedes the process of adjudication and conduct that repudiates, waives, or vitiates consent to arbitration. When parties seriously obstruct the arbitral process, tribunals may respond by invoking their inherent power to manage their dockets and to dismiss vexatious claims over which jurisdiction exists.¹⁴⁵ In other words,

2, 2000).

141. See *Waste Mgmt.*, Arbitral Award, at §§ 25-31 (June 2, 2000).

142. See *supra* note 118 and accompanying text.

143. See *Waste Mgmt.*, Arbitral Award, at para. 52 & n.41 (June 2, 2000) (dissenting opinion).

144. See *supra* note 130 and accompanying text.

145. See English Arbitration Act of 1996, § 41(3), reprinted in 36 I.L.M. 155, 174 (1997) (authorizing tribunals to dismiss claims if the claimant has caused "inordinate and inexcusable delay" that creates "a substantial risk that it is not possible to have a fair resolution of . . . that claim" or is likely to cause "serious prejudice to the respondent"). A number of U.S. federal courts have likewise described *forum non conveniens* dismissals as an exercise of the "inherent power . . . to control the administration of the litigation . . . and to prevent its process from becoming an instrument of abuse, injustice and oppression." *Baumgart v. Fairchild Aircraft Corp.*, 981 F.2d 824, 828 (5th Cir. 1993). See also *Sibaja v. Dow Chem. Co.*, 757 F.2d 1215, 1218 (11th Cir. 1985) (exercising inherent power is essential to the administration of justice); *Karim v. Finch Shipping*

the tribunal may declare all or part of the claim inadmissible. When parties conduct themselves in prejudicial ways that are totally inconsistent with consent to arbitration, they may be deemed to have repudiated or waived their consent to arbitration.¹⁴⁶ Likewise, an investor's behavior might become so abusive that it vitiates the consent of a NAFTA Party to arbitration because no sovereign state would agree to arbitration under such conditions. In either case, the conduct effectively destroys the arbitration agreement and, with it, the tribunal's jurisdiction.¹⁴⁷

The *Waste Management* tribunal admittedly did not rely on the distinction between merely prejudicial behavior and conduct that vitiates consent to arbitration. The facts of the case, however, support the application of this distinction,¹⁴⁸ which restores a sense of harmony to the three awards.¹⁴⁹ If accepted, this distinction could frustrate Waste Management's subsequent effort to refile its claim.¹⁵⁰ Assuming that the jurisdictional defect resulted from destruction of the arbitration agreement, the majority's award would seem to constitute *res judicata* on that issue. Presumably, termination of the arbitration agreement would leave the second tribunal with no basis for jurisdiction. This seems consistent with the first tribunal's award, which did not contemplate that the investor could refile its claim.¹⁵¹

Co., 94 F. Supp. 2d 727, 736 (E.D. La. 2000) (preventing abuse of Court's process is inherent power); *Tjontveit v. Den Norske Bank ASA*, 997 F. Supp. 799, 803 (S.D. Tex. 1998) (declining to exercise jurisdiction is inherent in Court's power to control litigation).

146. See, e.g., *Worldsource Coil Coating, Inc. v. McGraw Constr. Co.*, 946 F.2d 473, 476 (6th Cir. 1991) (holding that a party waives its right to arbitration where "its action . . . is so inconsistent with arbitration as to indicate an abandonment of that act"); *Fisher v. A.G. Becker Paribas, Inc.*, 791 F.2d 691, 694 (9th Cir. 1986) (holding waiver to be disfavored but found where the party asserting waiver: "(1) has knowledge of an existing right . . . ; (2) acts inconsistent with that existing right, and (3) prejudice to the party opposing arbitration . . ."); Jeffrey W. Stempel, *A Better Approach to Arbitrability*, 65 TUL. L. REV. 1377, 1403 (1991) (illustrating that parties may waive an arbitration right).

147. Article II(3) of the New York Convention does not require enforcement of "inoperable" arbitration agreements. See Convention on the Recognition and Enforcement of Foreign Arbitral Awards, June 10, 1958, art. II(3), 21 U.S.T. 2517, 330 U.N.T.S. 3. These include agreements that a party has waived, revoked, or terminated. See GARY B. BORN, *INTERNATIONAL COMMERCIAL ARBITRATION IN THE UNITED STATES* 301 (2d ed. 1994); ALBERT J. VAN DEN BERG, *THE NEW YORK ARBITRATION CONVENTION OF 1958*, at 158 (1981). They also include agreements to which one party's consent has been vitiated. See Toby Landau, *Composition and Establishment of the Tribunal: Articles 14 to 36*, 9 AM. REV. INT'L ARB. 45, 104 (1998) (explaining that a "total challenge" to an arbitration clause exists when "consent to arbitration has been vitiated").

148. See BORN, *supra* note 147, at 281-82 (explaining that the initiation of and substantial participation in judicial proceedings "would often constitute a waiver of arbitration" if the proceedings are inconsistent with the arbitration agreement).

149. See *Ethyl Corp. v. Canada, Award on Jurisdiction*, at para. 59 (June 24, 1998) (NAFTA/UNCITRAL), *reprinted in* 38 I.L.M. 708, 724 (1999) (recognizing that consent provides the "sole basis of jurisdiction" in Chapter 11 proceedings).

150. See *NAFTA: U.S. Waste Control Firm Refiles Case Under NAFTA Investor-State Provisions*, 17 Int'l Trade Rep. (BNA) 1528 (Oct. 5, 2000).

151. See Dodge, *supra* note 133, at 190.

5. Conclusions on Access

The foregoing cases indicate that, when required to interpret Section B of Chapter 11, tribunals have adopted a flexible approach favoring the promotion of access to investor-state arbitration – even when isolated treaty provisions might support a different result. In addition to the rulings already discussed, one might also mention *Azinian v. Mexico*, in which the investor brought an expropriation claim based on the alleged breach of a concession agreement.¹⁵² The tribunal held that the claim failed because Mexican courts had ruled that *no contract* existed and the investor did not challenge the Mexican court proceedings as a denial of justice.¹⁵³ Even so, the tribunal examined the Mexican proceedings because it did not “wish to create the impression that the Claimants [lost] on account of an improperly pleaded case.”¹⁵⁴ Another tribunal refused to dismiss a claim, in which the challenged action (a legislative *proposal*) did not initially constitute a measure “adopted” or “maintained” by a Party, but subsequently achieved that status following submission of the claim to arbitration.¹⁵⁵ The same tribunal also refused to dismiss the claim even though the investor commenced arbitral proceedings before the expiration of the six-month cooling-off period prescribed by Article 1120(1).¹⁵⁶ The tribunal explained that “dismissal . . . would disserve, rather than serve, the object and purpose of NAFTA.”¹⁵⁷

These decisions suggest that NAFTA Parties will rarely secure dismissal of extravagant claims at an early stage. Opponents of Chapter 11 will likely characterize the procedural victories of investors as proof of an unbalanced investment regime. For two reasons, such arguments fall wide of the mark. First, tribunals have indicated that they will not use flexible interpretations of Section B to permit the assertion of truly abusive claims. Second, as described in Part III(B), tribunals have rigorously examined the merits of claims in light of the treaty’s text and specific rules of international law. The public should not fear decisions that favor the creation of opportunities for foreign investors to assert large claims against NAFTA Parties; those

152. *Azinian v. Mexico*, Arbitral Award, at para. 100 (Nov. 1, 1999) (NAFTA/ICSID AdJ Facility), available at <http://www.worldbank.org/icsid/cases/awards.htm>.

153. *Id.*

154. *Id.* at para. 101.

155. See *Ethyl Corp.*, Award on Jurisdiction, at paras. 65-69 (June 24, 1998) (NAFTA/UNCITRAL), 38 I.L.M. at 725-26.

156. See *id.* at paras. 79-85, 38 I.L.M. at 728-29.

157. See *id.* at para. 85, 38 I.L.M. at 729.

decisions merely represent the initial phase of a mechanism that achieves balance in due course.¹⁵⁸

B. Examination of the Merits in Investor-State Arbitration

A recent article about Chapter 11 asks “what all the furor is about” and concludes that it boils down to a fear that “arbitral tribunals . . . may not make the right decisions.”¹⁵⁹ The article responds to such apprehensions by referring to the “long history” of investor-state disputes and the “highly competent members of academia and the international bar” who serve as arbitrators.¹⁶⁰ While accurate, these statements do not necessarily contradict Philip Jessup’s observation that “writers and judges . . . have all too often set up . . . an ideal condition which rarely exists and have tended to assert a perfect international standard which does not reflect actual conditions in the most orderly states.”¹⁶¹ To diffuse the opposition to Chapter 11, one must demonstrate that tribunals have not exposed the NAFTA Parties to unrealistic standards of conduct or liability.

As explained below, Chapter 11 tribunals have decided the merits of several claims alleged to involve expropriation, performance requirements,

158. Some writers argue that the expense of defending meritless claims can threaten the regulatory sovereignty of NAFTA Parties. See Byrne, *supra* note 8, at 434; Ganguly, *supra* note 3, at 115. See also MANN & VON MOLTKE, *supra* note 3, at 17 (“Just the ability . . . to launch Chapter 11 challenges . . . presents a serious obstacle to regulatory action.”). Investors, however, have brought only thirteen claims against NAFTA Parties before the end of 1999 and a fourteenth claim in 2000. See Safrin et al., *supra* note 12, at 724. See also *supra* notes 50-53 and accompanying text. Investors failed to pursue two of those claims, and a tribunal dismissed a third claim on jurisdictional grounds. See Soloway, *The Challenge of Private Party Participation*, *supra* note 3, at 12. See also *supra* notes 133-51 and accompanying text. When compared to the volume of investment between NAFTA Parties, the number of Chapter 11 claims is fairly modest. See GOVERNMENT OF CANADA, DEPARTMENT OF FOREIGN AFFAIRS AND INTERNATIONAL TRADE, *THE NAFTA AT FIVE YEARS 8* (1999) (stating that, in 1998, U.S. investment in Canada reached CDN\$147.3 billion and that Canadian investment in the United States reached CDN\$126 billion). The expense of defending a few meritless claims may be substantial, but it does not pose a serious threat to the regulatory sovereignty of NAFTA Parties.

One should not forget that the pursuit of Chapter 11 claims also imposes substantial costs on investors and that rational claimants will pursue only those actions that either have a reasonable chance of success or great symbolic importance. Cf. David G. Victor, *The Sanitary and Phytosanitary Agreement of the World Trade Organization: An Assessment After Five Years*, 32 N.Y.U. J. INT’L L. & POL. 865, 897-98 (2000) (attributing the small number of claims under the SPS Agreement to “extremely high” transaction costs, which limit claimants to bringing “winner cases . . . or highly symbolic cases in which the challenger is politically unable to avoid a dispute”). As tribunals continue to affirm the high threshold for establishing liability under Chapter 11, one can expect a corresponding decrease in the number of claims and the aggregate cost of defending Chapter 11 claims.

159. Brower & Steven, *supra* note 15, at 200. For avoidance of ambiguity, the reader should note that Judge Brower is not the author of the present article and bears no responsibility for the views expressed herein.

160. *Id.*

161. Jessup, *supra* note 61, at 914.

national treatment, and the minimum standard of treatment. They have examined claims rigorously in light of treaty provisions and specific rules of international law. They have deferred substantially to municipal decision-makers and have preserved the authority of NAFTA Parties to regulate in the public interest. Two tribunals have imposed liability, but given the treaty objectives of encouraging and protecting investment, it should come as no surprise that tribunals have sustained meritorious claims.

1. Expropriation

Two issues have dominated cases involving allegations of expropriation and measures tantamount to expropriation. First, these claims have required tribunals to identify the degree of interference or deprivation that must occur for liability to attach. Second, they have called on tribunals to determine whether non-discriminatory regulations or, more narrowly, the exercise of police powers can ever expose NAFTA Parties to liability. Contrary to the predictions of some observers, tribunals have followed the principle that governmental measures “may affect foreign interests considerably without amounting to expropriation.”¹⁶²

Article 1110(1) requires NAFTA Parties to compensate investors for “expropriation” and measures “tantamount to expropriation” of investments, but does not define either term. Some investors have described the latter term as a *lex specialis* that requires compensation for measures that do not rise to the level of a taking as defined by customary international law.¹⁶³ According to this view, NAFTA Parties must provide compensation for measures that constitute a substantial *interference* with investments.¹⁶⁴ Examples of such measures supposedly include export fees that reduce profits¹⁶⁵ and temporary or partial prohibitions of exports to the investor’s natural market.¹⁶⁶

Tribunals have uniformly rejected such arguments on the grounds that the word “tantamount” means “equivalent.”¹⁶⁷ Because Article 1110 only

162. IAN BROWNLIE, *PRINCIPLES OF INTERNATIONAL LAW* 535 (5th ed. 1998).

163. *S.D. Myers, Inc. v. Canada*, Partial Award, at para. 285 (Nov. 13, 2000) (NAFTA/UNCITRAL), available at <http://www.appletonlaw.com/4b2myers.htm>; *Metalclad Corp. v. Mexico*, Arbitral Award, at para. 27 (Aug. 30, 2000) (NAFTA/ICSID Add'l Facility), available at <http://www.pearcelaw.com/metalclad.html>; *Pope & Talbot v. Canada*, Interim Award, at para. 84 (June 26, 2000) (NAFTA/UNCITRAL), available at <http://www.appletonlaw.com/4b3P&T.htm>.

164. *Pope & Talbot*, Interim Award, at para. 103 (June 26, 2000). See also Dearden, *supra* note 4, at 119-20; Mann, *supra* note 3, at 247.

165. See *Pope & Talbot*, Interim Award, at para. 101 (June 26, 2000).

166. See *S.D. Myers*, Partial Award, at paras. 285-87 (Nov. 13, 2000).

167. *Id.* at paras. 285-86; *Pope & Talbot*, Interim Award, at para. 104 (June 26, 2000).

requires compensation for measures “equivalent to expropriation,” it does not impose any greater liability than would otherwise exist under customary international law.¹⁶⁸ Thus, in accordance with the prevailing view of international law,¹⁶⁹ Chapter 11 tribunals require a substantial *deprivation* of property rights for liability to attach.¹⁷⁰ Applying this standard, tribunals have found no liability for export fees that reduce profits¹⁷¹ or export prohibitions that temporarily cut off access to an investment’s market.¹⁷² These decisions reinforce international law’s tolerance of significant interference with property rights.¹⁷³ They also suggest that many of the pending expropriation claims are doomed to failure, particularly where they seek to turn routine governmental actions into international disputes.¹⁷⁴

Tribunals have been willing to find liability in situations that involve the virtual confiscation of property or complete deprivation of control over investments. For example, in *Metalclad Corp. v. Mexico*, local authorities in Guadalupe denied a construction permit for a hazardous waste facility that had received all necessary environmental approvals from the competent

168. *S.D. Myers*, Partial Award, at para. 286 (Nov. 13, 2000); *Pope & Talbot*, Interim Award, at paras. 96, 104 (June 26, 2000).

169. See Tippetts, Abnett, McCarthy & Stratton v. TAMS-AFFA Consulting Eng’rs of Iran, 6 Iran-U.S. Cl. Trib. Rep. 219, 225 (1984); RESTATEMENT (SECOND) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 192 (1965); BROWNLIE, *supra* note 162, at 534; George H. Aldrich, *What Constitutes a Compensable Taking of Property? The Decisions of the Iran-United States Claims Tribunal*, 88 AM. J INT’L L. 585, 589, 609 (1994); Rosalyn Higgins, *The Taking of Property by the State: Recent Developments in International Law*, 176 RECUEIL DES COURS 259, 324 (1982 III); Giorgio Sacerdoti, *Bilateral Treaties and Multilateral Instruments on Investment Protection*, 269 RECUEIL DES COURS 251, 382-83 (1997).

170. *S.D. Myers*, Partial Award, at para. 282 (Nov. 13, 2000); *id.* at para. 211 (separate opinion of Bryan Schwartz); *Metalclad Corp. v. Mexico*, Arbitral Award, at para. 103 (Aug. 30, 2000) (NAFTA/ICSID Add’l Facility), available at <http://www.pearcelaw.com/metalclad.html>; *Pope & Talbot*, Interim Award, at para. 102 (June 26, 2000).

171. *Pope & Talbot*, Interim Award, at paras. 101-02 (June 26, 2000).

172. *S.D. Myers*, Partial Award, at para. 288 (Nov. 13, 2000). Under international law, temporary deprivations of property rights generally do not constitute expropriations. See RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 712 reporters’ note 6 (1987); G.C. Christie, *What Constitutes a Taking of Property Under International Law?*, 1962 BRIT. Y.B. INT’L L. 307, 337. Likewise, in cases involving the partial prohibition of a commercial activity, the tendency is to resolve all doubts against the claimant. Christie, *supra*, at 335.

173. RESTATEMENT (SECOND) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 192 cmt. b. (1965) (“Conduct attributable to a state may deprive an alien’s property of value without constituting a taking.”); BROWNLIE, *supra* note 162, at 535 (observing that “[s]tate measures . . . may affect foreign interests considerably without amounting to expropriation”); Christie, *supra* note 172, at 318 (recognizing situations in which “interference, although very substantial, has been held not to constitute a ‘taking’”); Higgins, *supra* note 169, at 331 (stating that “interferences with property for economic and financial regulatory purposes are tolerated to a significant degree”); Philip C. Jessup, *Confiscation*, 21 AM. SOC’Y INT’L L. PROC. 38, 39 (1927) (warning against the “hasty” condemnation of governmental measures that injuriously affect property rights).

174. *Azinian v. United Mexican States*, Arbitral Award, at para. 87 (Nov. 1, 1999) (NAFTA/ICSID Add’l Facility), available at <http://www.worldbank.org/icsid/cases/awards.htm> (declining to construe Article 1110 to create a regime that would elevate “a multitude of ordinary transactions with public authorities into potential international disputes”).

federal authorities.¹⁷⁵ In reaching their decision, the local authorities gave the investor no notice, provided no opportunity to be heard, and identified no construction defects in the facility.¹⁷⁶ Later, the outgoing governor of the Mexican State of San Luis Potosi issued a decree incorporating the site into an ecological preserve.¹⁷⁷ The tribunal held that these two actions permanently barred any operation of the facility and, therefore, constituted an indirect expropriation and a measure tantamount to expropriation.¹⁷⁸

The *Metalclad* award establishes that Chapter 11 places limits on the extent to which NAFTA Parties may interfere with investments. It lends no support, however, to the proposition that Chapter 11 undermines legitimate regulatory programs. Since the competent federal authorities granted Metalclad all necessary environmental approvals, the case does not challenge Mexico's right to adopt appropriate environmental regulations. Nor does the award challenge the right of Guadalupe city authorities to review applications for construction permits; it only prohibits them from disregarding fundamental tenets of procedural justice and denying requests without some identification of construction defects. Finally, the award does not challenge the authority of Mexican state governors to establish ecological preserves. It only requires them to provide compensation for the economic destruction of investments operating lawfully and in compliance with Mexican environmental laws. Such obligations pose no credible threat to regulatory sovereignty.

Even though tribunals have adopted a fairly narrow definition of expropriation, Canada has sought to prevent its application to regulatory measures. According to Canada, international law does not require compensation for "any loss sustained by the imposition of a non-discriminatory, regulatory measure."¹⁷⁹ This formulation appears to conflate two related principles.¹⁸⁰ First, bona fide regulations may substantially *interfere* with the use of property, but they usually do not constitute a substantial *deprivation* of property rights.¹⁸¹ Therefore, most regulations do

175. *Metalclad*, Arbitral Award, at paras. 52, 78, 80, 85-90 (Aug. 30, 2000).

176. *Id.* at paras. 91, 93.

177. *Id.* at paras. 109-10.

178. *Id.* at paras. 107, 109, 111.

179. Pope & Talbot v. Canada, Interim Award, at para. 90 (June 26, 2000) (NAFTA/UNCITRAL), available at <http://www.appletonlaw.com/4b3P&T.htm>.

180. It would also seem to make liability for regulatory takings coextensive with the obligation of national treatment.

181. B.A. WORTLEY, EXPROPRIATION IN PUBLIC INTERNATIONAL LAW 51 (1959) (explaining that restrictions based on the principle of neighbourliness may be imposed without a deprivation of property rights, but acknowledging that expropriation may occur when "the restrictions imposed extend beyond the obligations of neighbourliness").

not meet the threshold definition of expropriation.¹⁸² Second, the non-discriminatory exercise of police powers (a narrow subset of regulations) *generally* justifies deprivations that would otherwise constitute takings of property.¹⁸³ Even here, there are some exceptions. For example, outside of criminal proceedings, the exercise of police powers does not justify the outright transfer of title without compensation.¹⁸⁴ Similarly, when exercising legitimate police powers, states bear responsibility for the adoption of clearly excessive measures that bear no reasonable relationship to the regulatory objective.¹⁸⁵

While recognizing that the “general body of precedent *usually* does not treat regulatory action as amounting to expropriation,” the tribunal in *S.D. Myers, Inc. v. Canada* rejected Canada’s absolute formulation of the rule.¹⁸⁶ Instead, the tribunal distinguished between expropriation and regulation on the grounds that the former involves a deprivation of ownership rights, while the latter constitutes a lesser interference.¹⁸⁷ The *Pope & Talbot* tribunal likewise held that the distinction between takings and bona fide regulations may depend on the degree of interference.¹⁸⁸ Therefore, Canada’s absolute formulation went “too far” and would create a “gaping loophole in international protections against expropriation.”¹⁸⁹ While agreeing that regulations can be applied in ways that constitute “creeping expropriation,”

182. Christie, *supra* note 172, at 337 (recognizing that “no one can ordinarily claim exemption from even substantial regulation in the public interest”). See also Sacerdoti, *supra* note 169, at 384 (“Deprivation of property should be distinguished from regulation, especially in relation to the use of property.”)

183. See RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 712 cmt. g (1987); RESTATEMENT (SECOND) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES §§ 196(b) & cmt. d, 197(1)(a)-(b) (1965); 8 MARJORIE M. WHITEMAN, DIGEST OF INTERNATIONAL LAW 980 (1967) (quoting Louis Sohn & Richard Baxter, 1961 *Harvard Draft Convention on International Responsibility of States for Injuries to Aliens*, art. 10(5), 55 AM. J. INT’L L. 554, 562 (1961)); BROWNLIE, *supra* note 162, at 538; Aldrich, *supra* note 169, at 605; Christie, *supra* note 172, at 331-32, 338; John H. Herz, *Expropriation of Foreign Property*, 35 AM. J. INT’L L. 243, 251-52 (1941).

184. See *Sedco, Inc. v. Nat’l Iranian Oil Co.*, 9 Iran-U.S. Cl. Trib. Rep. 248, 275 (1985).

185. *Id.* at 275 n.10 (suggesting that the exercise of police power may constitute a taking if it has “damaged the property to a[n] . . . excessive degree”); *Bischoff Case* (Ger. v. Venez.), 10 R.I.A.A. 420, 420 (1903) (finding the initial taking of a carriage justified as an exercise of the police power, but imposing liability because of the unreasonable period of detention); WHITEMAN, *supra* note 183, at 1010 (“Even where the original taking of property is lawful, its unreasonable detention has been held to warrant an award.”). See also Christie, *supra* note 172, at 338 (requiring a “plausible relationship” between the objectives served by the police power and the action taken); Sohn & Baxter, *supra* note 183, at 553 (indicating that a state would be liable for destroying a bridge as a hazard to navigation if the bridge spanned a non-navigable river).

186. *S.D. Myers, Inc. v. Canada*, Partial Award, at para. 281 (Nov. 13, 2000) (NAFTA/UNCITRAL) (emphasis added), available at <http://www.appletonlaw.com/4b2myers.htm>.

187. See *id.* at para. 282.

188. *Pope & Talbot v. Canada*, Interim Award, at para. 99 & n.73 (June 26, 2000) (NAFTA/UNCITRAL), available at <http://www.appletonlaw.com/4b3P&T.htm>.

189. *Id.* at para. 99.

however, the tribunal also recognized that not all regulations are susceptible to challenge; in particular, the tribunal mentioned that the analysis of police powers would require “special care.”¹⁹⁰

These rulings should diminish the opposition to Chapter 11. They do not support the principle of absolute regulatory sovereignty for NAFTA Parties, but absolute regulatory sovereignty does not exist under customary international law and it would be surprising to find that principle established by an investment treaty. Nevertheless, the emerging trend suggests that investors will face great difficulty in establishing claims for “regulatory takings” and even greater obstacles to the assertion of expropriation claims directed at the exercise of police powers.

2. Performance Requirements

Article 1106 prohibits NAFTA Parties from establishing certain performance requirements.¹⁹¹ Article 1106(1)(a) states that no Party shall, in connection with the conduct or operation of an investment, impose a requirement to export at a given level.¹⁹² Likewise, Articles 1106(1) and 1106(3) provide that no Party shall impose the following requirements either as conditions for the conduct or operation of an investment, or for the receipt of an advantage: achievement of a given level or percentage of domestic content; the purchase, use, or granting of preferences to locally produced goods or services; and the restriction of local sales in relation to the volume or value of exports.¹⁹³ Article 1106(5), clarifies that “[p]aragraphs 1 and 3 do not apply to any requirement other than the requirements set out in those paragraphs.”

Chapter 11 tribunals have considered – and denied – two claims alleging the application of unlawful performance requirements. In *Pope & Talbot, Inc. v. Canada*, the investor claimed that the imposition of export fees constituted a performance requirement because the fees reduced the level of its exports.¹⁹⁴ The investor also argued that the export fees forced it to restrict sales of goods in Canada by relating them to the volume of exports.¹⁹⁵ The tribunal rejected both arguments. Although the tribunal recognized that

190. *Id.*

191. NAFTA, *supra* note 1, at art. 1106(1), 32 I.L.M. at 640.

192. *Id.*

193. *Id.* arts. 1106(1)(b), (c), (e), 1106(3)(a), (b), (d), 32 I.L.M. at 640.

194. *Pope & Talbot*, Interim Award, at paras. 47, 59 (June 26, 2000).

195. *Id.* at para. 49.

the fees deterred exports,¹⁹⁶ they did not require any particular level of exports¹⁹⁷ or place any limitations on domestic sales.¹⁹⁸

In *S.D. Myers, Inc. v. Canada*, the investor claimed that a ban on the export of PCBs required it to undertake the destruction and disposal of PCBs in Canada.¹⁹⁹ According to the investor, the export ban constituted an unlawful performance requirement because it forced the investor to achieve a given level of domestic content and to purchase or use local goods and services.²⁰⁰ One arbitrator would have upheld the claim because the destruction operations had to occur in Canada, thus establishing a required level of “Canadian content.”²⁰¹ The majority disagreed and held that the export prohibition “clearly” did not require the investor to achieve a given level of domestic content.²⁰² Although the majority did not explain the basis for that conclusion, it seems correct. While destruction operations might have to take place in Canada, the export ban did not prevent the investor from using U.S. labor, technology, equipment, and supplies in those operations. Under these circumstances, the measure did not require the investor to achieve any particular level of Canadian content.

Thus, Chapter 11 tribunals have not defined unlawful performance requirements to include measures that merely encourage the reduction of exports or the consumption of local goods and services. Tribunals have, instead, conditioned liability on the presence of actual *requirements* that fall within the specific prohibitions of Article 1106. In other words, tribunals have adhered rigorously to the letter of Article 1106 and have preserved the broad powers of states to create regulatory incentives without triggering liability.

3. National Treatment

Article 1102 requires each NAFTA Party to accord the others’ investors and their investments “treatment no less favorable than it accords, in like circumstances, to its own investors” and their investments “with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.”²⁰³ Thus far, one tribunal has ruled on a national treatment claim. Although the tribunal determined that Canada violated its obligations, the tribunal preserved a wide discretion for

196. *Id.* at para. 75.

197. *Id.*

198. *Id.* at para. 80.

199. *S.D. Myers, Inc. v. Canada*, Partial Award (Nov. 13, 2000) (NAFTA/UNCITRAL), available at <http://www.appletonlaw.com/4b2myers.htm>.

200. *Id.* at para. 270.

201. *Id.* at paras. 277 (award), 193 (separate opinion of Bryan Schwartz).

202. *Id.* at para. 276 (award).

203. NAFTA, *supra* note 1, at art. 1102(1), (2), 32 I.L.M. at 639.

states to adopt necessary environmental regulations that disproportionately affect foreign investors and investments.

S.D. Myers, Inc. v. Canada involved the claim of a U.S. company (SDMI) that specialized in the destruction and disposal of PCBs and hoped to enter the Canadian market.²⁰⁴ Located in close proximity to Canada's industrial centers, SDMI had a clear cost advantage over Canadian competitors located in Alberta.²⁰⁵ To facilitate its business plans, SDMI lobbied the U.S. government for an administrative exemption from a U.S. ban on the importation of PCBs.²⁰⁶ After U.S. authorities granted this request, SDMI's Canadian competitors asked Canada's Minister for the Environment to close the border from the other side.²⁰⁷ Thereafter, the Minister adopted a policy favoring PCB disposal "in Canada by Canadians."²⁰⁸ To implement that policy, the Minister banned the export of PCBs based on a "significant danger to the environment and to human life and health."²⁰⁹ Lower-level Canadian officials consistently opposed the Minister's decision because the export of PCBs presented no significant danger to the environment or to human life or health.²¹⁰ To the contrary, open borders represented a positive development,²¹¹ since lower costs encouraged destruction of PCBs and the shorter transportation distances reduced the likelihood of accidents.²¹² In fact, these considerations prompted the Canadian government to reopen the border some sixteen months later.²¹³

When SDMI challenged the measure as a denial of national treatment, Canada responded that the export ban applied equally to Canadians and foreign investors.²¹⁴ The tribunal rejected Canada's "one dimensional" argument and explained that Article 1102 prohibits more than explicit distinctions between domestic and foreign investors.²¹⁵ Article 1102 also requires consideration of the intent behind, and practical effect of, the challenged measures.²¹⁶ With respect to intent, the tribunal held that "the

204. *S.D. Myers*, Partial Award, at para. 110 (Nov. 13, 2000).

205. *Id.* at para. 112.

206. *Id.* at para. 113.

207. *Id.* at paras. 122, 168.

208. *Id.* at paras. 116, 169, 171, 185.

209. *Id.* at para. 184.

210. *Id.* at paras. 176, 179.

211. *Id.* at paras. 162, 164, 166, 167, 173.

212. *Id.* at paras. 177, 179.

213. *Id.* at para. 127.

214. *Id.* at para. 241.

215. *Id.* at paras. 242, 252-54.

216. *Id.* at paras. 252-54.

documentary record as a whole *clearly* indicate[d] that the [measures] were intended *primarily* to protect the Canadian PCB disposal industry from U.S. competition.”²¹⁷ In addition, the tribunal concluded that the “practical effect of the [ban] was that SDMI . . . [was] prevented from carrying out the business [it] planned to undertake, which was a clear disadvantage in comparison to its Canadian competitors.”²¹⁸

Even though the investor established that the Canadian measures discriminated in favor of Canadian nationals, disparate treatment would not violate Article 1102 absent a showing that SDMI and its Canadian competitors were in “like circumstances.”²¹⁹ Thus, interpretation of that phrase became a dispositive issue. In examining the meaning of “like circumstances,” the tribunal recognized its obligation to consider the “overall legal context” of Article 1102.²²⁰ According to the tribunal, that context includes “the various provisions of NAFTA, its companion agreement the [North American Agreement on Environmental Cooperation (NAAEC)], and principles that are affirmed by the NAAEC.”²²¹ This context establishes that NAFTA Parties have the right to establish high levels of environmental protection and an obligation to avoid the creation of trade distortions.²²²

In defining the phrase “like circumstances,” the tribunal also considered OECD practice with respect to the phrase “in like situations.”²²³ This led the tribunal to observe that comparisons are only valid between enterprises operating in the same sector.²²⁴ The tribunal also construed OECD practice to justify the use of policy objectives to define the permissible circumstances for comparing treatment of domestic and foreign-controlled enterprises.²²⁵ Thus, the “assessment of ‘like circumstances’ must . . . take into account circumstances that would justify governmental regulations that treat them differently in order to protect the public interest.”²²⁶ Put more simply, SDMI would not prevail if Canada could demonstrate that a legitimate environmental concern required the differential and adverse treatment of SDMI.²²⁷

217. *Id.* at para. 194 (emphasis added).

218. *Id.* at para. 193.

219. *Id.* at para. 243.

220. *Id.* at para. 245.

221. *Id.* at para. 247.

222. *Id.*

223. *Id.* at para. 248.

224. *Id.*

225. *Id.*

226. *Id.* at para. 250.

227. *Id.* at para. 173 (separate opinion of Bryan Schwartz).

Applying these principles, the tribunal concluded that SDMI and its Canadian competitors operated in the same economic sector.²²⁸ In fact, Canada imposed the export ban to prevent SDMI from competing with Canadian-owned businesses.²²⁹ The tribunal also found that Canada had “no legitimate environmental reason for introducing the ban.”²³⁰ The tribunal recognized that Canada had an indirect environmental objective of ensuring the existence of a domestic PCB remediation industry.²³¹ Although the tribunal described this as a “legitimate goal,” it held that Canada could have achieved it through less trade-distorting means, including subsidies or government procurement policies. Given these facts, the tribunal unanimously found a violation of Article 1102.²³²

While a defeat for Canada, the *S.D. Myers* award represents a distinct victory for legitimate environmental regulation by NAFTA Parties. The tribunal established that the NAAEC and the principles reaffirmed therein form part of the interpretive context for Chapter 11. This context establishes that NAFTA Parties have the right to adopt high levels of environmental protection that do not create unnecessary trade barriers. Second, the tribunal recognized that legitimate environmental concerns could place domestic and foreign investors in different circumstances and, thereby, justify disparate treatment. In other words, Article 1102 does not prohibit regulatory discrimination when necessary to protect the public interest.

4. Minimum Standard of Treatment

Article 1105(1) creates a minimum standard of treatment, which requires NAFTA Parties to treat each other’s investors in accordance with “international law,” including “fair and equitable treatment.”²³³ Attempts to interpret these two phrases have generated considerable debate. Construed according to its ordinary meaning, the phrase “international law” refers to all sources of international law, including treaty obligations.²³⁴ This view

228. *Id.* at para. 251 (award).

229. *Id.*

230. *Id.* at para. 195.

231. *Id.*

232. *Id.* at para. 255.

233. NAFTA, *supra* note 1, at art. 1105(1), 32 I.L.M. at 640.

234. See Statute of the International Court of Justice, art. 38(1), June 26, 1945, 59 Stat. 1055, T.S. No. 993, 3 Bevans 1179 (identifying the sources of international law); RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 102 (1987) (stating that “international law” includes rules established by “customary law,” “international agreement,” or “general principles common to the major legal systems of the world”). See also Clyde C. Pearce & Jack Coe, Jr., *Arbitration Under NAFTA Chapter 11: Some Pragmatic Reflections upon the First Case Filed*

suggests that Article 1105 permits NAFTA investors to file claims against NAFTA Parties based *inter alia* on the adoption or maintenance of measures that (1) relate to investors of other NAFTA Parties (or their investments); (2) cause loss or damage to those investors (or their investments); and (3) violate a treaty obligation owed to the investors or their home states.²³⁵ Others take the position that the phrase “international law” only refers to customary international law.²³⁶ According to certain proponents of this view, Article 1105(1) only prohibits host states from engaging in egregious, outrageous or shocking conduct.²³⁷ In a recent article, a sitting Chapter 11 arbitrator offers a third understanding of Article 1105, which would require compliance with customary international law plus the provisions of the NAFTA to the extent that they provide additional protection.²³⁸

Against Mexico, 23 HASTINGS INT'L & COMP. L. REV. 311, 314 n.10 (2000) (suggesting that the phrase “international law” refers to treaty text, customary international law, and general principles of law); Sacerdoti, *supra* note 169, at 344 (quoting Article 10 of the Energy Charter Treaty, which requires treatment in accordance with “international law, including treaty obligations”).

235. See Pearce & Coe, *supra* note 234, at 314 n.10 (arguing that the phrase “international law” refers *inter alia* to treaty text). See also Robert Stumberg, *Sovereignty by Subtraction: The Multilateral Agreement on Investment*, 31 CORNELL INT'L L.J. 491, 502, 562-63 & n.498 (1998) (describing the use of similar language in the draft Multilateral Agreement on Investment and suggesting that it could incorporate the obligations of WTO agreements).

Others reach a similar result by using external treaty provisions to inform the requirements of “fair and equitable treatment.” See *S.D. Myers, Inc. v. Canada, Partial Award*, at para. 264 (Nov. 13, 2000) (NAFTA/UNCITRAL), available at <http://www.appletonlaw.com/4b2myers.htm>. See also THOMAS M. FRANCK, *FAIRNESS IN INTERNATIONAL LAW AND INSTITUTIONS* 472-73 (1995) (stating, in the context of international investment law, that treaty violations clearly constitute actionable violations of fairness); Sacerdoti, *supra* note 169, at 341 n.143, 344 n.150 (defining “fair and equitable treatment” to include “respect for international law”).

236. See Máximo Romero Jiménez, *Considerations of NAFTA Chapter 11*, 2 CHI. J. INT'L L. 243, 244 (2001); Daniel M. Price, *Chapter 11—Private Party vs. Government, Investor-State Dispute Settlement: Frankenstein or Safety Valve?*, 26 CAN.-U.S. L.J. 107, 111 (2000). See also KENNETH J. VANDEVELDE, *UNITED STATES INVESTMENT TREATIES* 78 (1992) (interpreting similar language in BITs as “serv[ing] simply to incorporate customary international law by reference”).

One should, however, take great care in reading commentary on this issue. Although two writers indicate that the phrase “international law” incorporates “customary” principles or standards “of international law [that] exist external to the treaty,” they do not say that the phrase incorporates “principles or standards of customary international law.” See K. Scott Gudgeon, *United States Bilateral Investment Treaties: Comments on Their Origin, Purposes, and General Treatment Standards*, 4 INT'L TAX & BUS. LAW. 105, 124 (1986); Sandrino, *supra* note 22, at 311. The difference in word order may be highly significant because one of those authors (a former Assistant Legal Adviser with responsibility for the U.S. BIT program) specifically notes that the “customary standards of international law” include all of the “usual sources of international law” described in Article 38 of the Statute of the International Court of Justice. Gudgeon, *supra*, at 124 n.70. As explained above, Article 38 identifies treaties, customary law, and general principles of law as the usual sources of international law. See *supra* note 234 and accompanying text.

237. See *Pope & Talbot v. Canada, Award on the Merits of Phase 2*, at paras. 108-09, 118 (Apr. 10, 2000) (NAFTA/UNCITRAL) (recounting Canada’s arguments to this effect), available at <<http://www.appletonlaw.com/4b3P&T.htm>>. See also BROWNIE, *supra* note 162, at 527-28 (stating that “the treatment of an alien in order to constitute an international delinquency should amount to an outrage”).

238. David A. Gantz, *Reconciling Environmental Protection and Investor Rights Under Chapter 11 of NAFTA*, 31 *Envtl. L. Rep. (Envtl. L. Inst.)* 10646, ___ (June 2001), available in WESTLAW,

Attempts to define “fair and equitable treatment” have encountered similar difficulties. Although the phrase has become a familiar term in BITs,²³⁹ virtually no case law addressed its meaning before the advent of Chapter 11 disputes.²⁴⁰ Furthermore, the thin commentary on “fair and equitable treatment” has yet to produce a consistent theme. Some authorities indicate that the term prohibits discriminatory and arbitrary treatment.²⁴¹ Other writers suggest that fairness in the context of international investment law forbids the unconscionable frustration of reasonable expectations, for example by breaching treaty obligations.²⁴² Construing the phrase even more expansively, one highly respected writer (Dr. F.A. Mann) states that unfair and inequitable treatment may include measures that “are not plainly illegal in the accepted sense of international law.”²⁴³ Because fair and equitable treatment would be “distinct . . . from . . . principles of international law,”²⁴⁴ this view might suggest an open-ended mandate to second-guess the governmental decisions of NAFTA Parties.²⁴⁵

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239. See PETER MUCHLINSKI, *MULTINATIONAL ENTERPRISES AND THE LAW* 625 (1995); Mohamed I. Khalil, *Treatment of Foreign Investment in Bilateral Investment Treaties*, in IBRAHIM F.I. SHIHATA, *LEGAL TREATMENT OF FOREIGN INVESTMENTS* 221, 233 (1993); F.A. Mann, *British Treaties for the Promotion and Protection of Investments*, 1981 BRIT. Y.B. INT'L L. 241, 243; *Report to the Development Committee on the Legal Framework for the Treatment of Foreign Investments*, 31 I.L.M. 1368, 1373 (1992); Sacerdoti, *supra* note 169, at 345; K.P. Sauvant & V. Aranda, *The International Legal Framework for Transnational Corporations*, in TRANSNATIONAL CORPORATIONS 83, 96 (A.A. Fatouros ed., 1994); John A. Westberg & Bertrand P. Marchais, *General Principles Governing Foreign Investment as Articulated in Recent International Tribunal Awards and Writings of Publicists*, in SHIHATA, *supra*, at 337, 353.

240. See Mann, *supra* note 239, at 243; Westberg & Marchais, *supra* note 239, at 353. Two writers assert that the Iran-United States Claims Tribunal addressed the standard of “fair and equitable treatment” in *Rankin v. Iran*, 17 Iran-U.S. Cl. Trib. Rep. 135 (1987). See Westberg & Marchais, *supra* note 239, at 353-54. The conclusion seems dubious.

241. See Edward A. Laing, *Equal Access/Non-Discrimination and Legitimate Discrimination in International Economic Law*, 14 WIS. INT'L L.J. 246, 286 n.201 (1996); A.F.M. Maniruzzaman, *Expropriation of Alien Property and the Principle of Non-Discrimination in International Law of Foreign Investment*, 8 J. TRANSNAT'L L. & POL'Y 57, 76 (1998) (quoting MUCHLINSKI, *supra* note 239, at 625); Sandrino, *supra* note 22, at 311.

242. See FRANCK, *supra* note, 235, at 473. See also Sacerdoti, *supra* note 169, at 341 n.143 (construing “fair and equitable treatment” to require “respect for international law”). Cf. Brower Remarks, *supra* note 22, at 14 (suggesting that the claimant in *Methanex Corp. v. United States* had attempted to use “fair and equitable treatment” to incorporate WTO norms).

243. Mann, *supra* note 239, at 243. See also VANDEVELDE, *supra* note 236, at 76 (suggesting that the obligation of “fair and equitable treatment” covers situations “where other substantive provisions of international and national law provide no protection”).

244. Gudgeon, *supra* note 236, at 125. See also Mann, *supra* note 239, at 244.

245. In its latest award, the *Pope & Talbot* tribunal adopted Dr. Mann's definition of “fair and equitable treatment,” but declined “to substitute its judgment . . . for Canada's” and denied almost all challenges to Canadian export regulations because they represented a “reasonable response to the circumstances.” See *Pope & Talbot v. Canada*, Award on the Merits of Phase 2, at paras. 121, 123,

These debates about the interpretation of “international law” and “fair and equitable treatment” border on the absurd, albeit for different reasons. Because “international law” has a clearly established meaning,²⁴⁶ current disagreements about the scope of that phrase reflect an attempt to create ambiguity where none exists. Conversely, the debates about “fair and equitable treatment” constitute a futile effort to reduce a general concept to a precise statement of legal obligation.²⁴⁷ Proponents of this effort seem oblivious to the fact that the inclusion of “fair and equitable treatment” in Article 1105(1) represents the exemplification of an intentionally vague term, designed to give adjudicators a quasi-legislative authority to articulate a variety of rules necessary to achieve the treaty’s object and purpose in particular disputes.²⁴⁸

Thus far, three Chapter 11 tribunals have rendered decisions that shed light on the minimum standard of treatment required by Article 1105.²⁴⁹

125, 128, 155, 185 (Apr. 10, 2000) (NAFTA/UNCITRAL), available at <http://www.appletonlaw.com/4b3P&T.htm>. This suggests that Dr. Mann’s views do not necessarily invite open-ended scrutiny of measures adopted or maintained by host states.

246. See *supra* note 234 and accompanying text.

247. Cf. David A. Gantz, *Potential Conflicts Between Investor Rights and Environmental Regulation Under NAFTA’s Chapter 11*, 33 GEO. WASH. INT’L L. REV. 651, 746 (2001) (“Perhaps like Justice Potter Stewart and pornography, it will be easier to identify denials of fair and equitable treatment than to define them more specifically.”).

248. When treaty drafters intentionally use ambiguous phrases to gloss over differences, they effectively grant the competent judicial body a quasi-legislative power to formulate specific rules of conduct. See 1 GEORG SCHWARZENBERGER, *INTERNATIONAL LAW* 495 (3d ed. 1957). The phrase “fair and equitable treatment” evidently falls within this category of treaty provisions. See J.G. MERRILLS, *INTERNATIONAL DISPUTE SETTLEMENT* (3d ed. 1998) (“When an arbitrator is asked by the parties to have regard to equitable considerations . . . he . . . begins to assume the role of a legislator, creating law for the case in hand.”); UNITED NATIONS CENTRE ON TRANSNATIONAL CORPORATIONS, *BILATERAL INVESTMENT TREATIES* 41 (1988) (“It is in the nature of a very general concept like fair and equitable treatment that there can be no precise definition. What is fair and what is equitable may largely be a matter of interpretation in each individual case.”); VANDELDE, *supra* note 236, at 76 (“The phrase is vague and its precise content will have to be defined over time through treaty practice, including perhaps arbitration under the disputes provisions.”). See also C. WILFRED JENKS, *THE PROSPECTS OF INTERNATIONAL ADJUDICATION* 426, 767 (1964) (explaining that “equity . . . is . . . largely a matter of adapting principles to circumstances,” and arguing that “equitable concepts . . . should play an important part in adapting principles to circumstances in a world in which the law is constantly confronted with new problems and new needs”).

249. In July 2001, the Free Trade Commission (*i.e.*, cabinet-level representatives of the NAFTA Parties) also adopted the first Notes of Interpretation of Certain Chapter 11 Provisions, which purport *inter alia* to make the following three interpretations Article 1105(1). See Notes of Interpretation of Certain Chapter 11 Provisions, July 31, 2001, § B, available at <http://www.dfait-maeci.gc.ca/tna-nac/NAFTA-Interpr-e.asp>. First, the Notes of Interpretation provide that “Article 1105(1) prescribes the *customary* international law minimum standard of treatment as the minimum standard of treatment” required by Chapter 11. *Id.*, § B(1) (emphasis added). Second, “[t]he concept[] of ‘fair and equitable treatment’ . . . do[es] not require treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens.” *Id.*, § B(2). Third, “[a] determination that there has been a breach of another provision of the NAFTA, or of a separate international agreement, does not establish that there has been a breach of Article 1105(1).” *Id.*, § B(3).

The NAFTA Parties state that the Notes of Interpretation “clarify” the meaning of Article

Although they have found violations in two cases, the tribunals have uniformly avoided expansive constructions and have attempted to minimize the intrusion of international review into substantive governmental decisions.

In *Azinian v. Mexico*, the tribunal reviewed Mexican judicial proceedings to determine if they constituted a denial of justice as defined by

1105(1) and indicate that the Notes of Interpretation bind all sitting and future Chapter 11 tribunals. *See id.*, Preamble (stating that the Notes of Interpretation “clarify” Article 1105); *NAFTA Trade Ministers Clarify Chapter 11 Investment Provision*, 18 Int’l Trade Rep. (BNA) 1234 (Aug. 2, 2001) (indicating that the U.S. Trade Representative expects the Notes of Interpretation to “apply to all future and pending cases”). The Notes of Interpretation, however, resolve few (if any) debates about the meaning of Article 1105(1). Without trying to undertake a comprehensive analysis, one should immediately perceive three facts that will prevent the Notes of Interpretation from settling existing disagreements. First, it is not clear that the Notes of Interpretation have any binding force. While Article 1131(2) authorizes cabinet-level representatives to adopt binding “interpretations” of NAFTA’s provisions, Article 2202 governs “amendments” of NAFTA’s provisions. According to Article 2202, the NAFTA Parties may agree on any “modification of or addition to” NAFTA, but such amendments become “an integral part” of NAFTA only upon approval by the NAFTA Parties “in accordance with the applicable legal procedures of each Party.” In other words, NAFTA draws a fundamental distinction between interpretation and modification: cabinet-level officials have the authority to resolve ambiguities, but not the power to modify obligations without submitting the proposed text for domestic political approval. If, as the author believes, the Free Trade Commission’s purported “interpretation” of Article 1105 actually constitutes a “modification,” it represents an *ultra vires*, attempted amendment that has no binding force.

Even if the Notes of Interpretation have some binding force, one must seriously doubt the U.S. contention that they are binding on Chapter 11 tribunals in pending disputes. Although Article 1131(2) of NAFTA does not specifically prohibit retroactive application of interpretive statements, Article 1131(1) requires Chapter 11 tribunals to “decide the issues in dispute in accordance with . . . applicable rules of international law.” Because those rules include the principle that “no one may be the judge of his own cause,” it seems highly unlikely that a Chapter 11 tribunal would construe Article 1131(1) as authorizing the use of interpretive statements by NAFTA Parties to resolve the outcome of pending disputes in which they have demonstrable interests. *See* RESTATEMENT (THIRD) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 102 cmt. 1 (1987) (identifying the rule that no one may be judge in his own cause as a general principle that has achieved the status of international law).

Assuming that the Notes of Interpretation constitute a binding interpretation of Article 1105(1), NAFTA investors may still argue that Article 1103 entitles them to a level of “fair and equitable treatment” that exceeds the requirements of customary international law. Article 1103 requires the NAFTA Parties to give NAFTA investors and their investments treatment no less favorable than given to investors and investments of countries that have concluded BITs with NAFTA Parties. NAFTA, *supra* note 1, at art. 1103, 32 I.L.M. at 639. The “fair and equitable treatment” provisions of BITs, in turn, have been construed to exceed the requirements of customary international law. *See* Pope & Talbot v. Canada, Award on the Merits of Phase 2, at paras. 110-13 (Apr. 10, 2000). Thus, whatever the meaning of Article 1105(1), NAFTA investors may use Article 1103 to bring claims based on the more generous standards of BITs, and Chapter 11 tribunals may interpret the BITs without regard to the Free Trade Commission’s Notes of Interpretation. *See id.* at para. 117 (concluding that a limited interpretation of Article 1105 would not prevent claims for the denial of “fair and equitable treatment” under the broader interpretations of BITs). *See also* NAFTA, *supra* note 1, art. 1131(2), 32 I.L.M. at 645 (only authorizing the Free Trade Commission to make binding interpretations “of this Agreement”).

customary international law. As noted above, the investor never asserted a claim under this heading and the tribunal raised the issue out of an abundance of caution.²⁵⁰ Although this part of the award probably constitutes dicta, it provides strong evidence of how other Chapter 11 tribunals would approach claims that a NAFTA Party has violated the minimum standard. Consistent with prevailing views on international adjudication, the *Azinian* tribunal first recognized that it did not serve an appellate function and had no warrant to set aside domestic court judgments for a lack of persuasive force.²⁵¹ To challenge domestic court proceedings in the particular case, the investors would have to establish a denial of justice,²⁵² which might include a refusal to hear their claim, creation of “undue delay,” grossly deficient administration of justice, or clearly malicious or arbitrary applications of municipal law.²⁵³ The tribunal, however, found no deficiencies in the Mexican proceedings.²⁵⁴ The tribunal also found that the evidentiary record was not so insubstantial as to render the Mexican judgment an arbitrary decision.²⁵⁵ Thus, the tribunal found no denial of justice and, correspondingly, no violation of Article 1105.

As noted above, the investor in *Metalclad Corp. v. Mexico* planned to construct and operate a hazardous waste facility. To this end, it obtained all necessary environmental approvals from the competent federal authorities, who assured the investor that it required no additional approvals.²⁵⁶ When local authorities in Guadalupe unexpectedly instructed Metalclad to apply for a construction permit, federal authorities advised it to do so as a courtesy.²⁵⁷ The federal authorities also stated that local authorities lacked any basis to deny the permit.²⁵⁸ After receiving Metalclad’s application, however, the local authorities denied the construction permit without giving Metalclad notice or an opportunity to be heard.²⁵⁹ In addition, the local authorities cited no defects in the facility’s construction.²⁶⁰ Metalclad submitted that these actions constituted unfair and inequitable treatment. Consistent with the views expressed above,²⁶¹ the *Metalclad* tribunal did not try to formulate a precise definition of fair and equitable treatment. At the

250. *Azinian v. Mexico*, Arbitral Award, at paras. 100-01 (Nov. 1, 1999) (NAFTA/ICSID Add’l Facility), available at <http://www.worldbank.org/icsid/cases/robert-awards.pdf>.

251. *Id.* at paras. 84, 99.

252. *Id.* at para. 99.

253. *Id.* at paras. 102-03.

254. *Id.* at para. 102.

255. *Id.* at paras. 105, 120.

256. *See Metalclad Corp. v. Mexico*, Arbitral Award, at paras. 52, 78, 80, 85-90 (Aug. 30, 2000) (NAFTA/ICSID Add’l Facility), available at <http://www.pearcelaw.com/metalclad.html>.

257. *See id.* at paras. 40-41.

258. *Id.* at para. 88.

259. *Id.* at para. 91.

260. *Id.* at para. 93.

261. *See supra* notes 247-48 and accompanying text.

outset of its decision, however, the tribunal held that Metalclad's investment did not receive "fair and equitable treatment *in accordance with international law*."²⁶² By linking "fair and equitable treatment" to the requirements of "international law," the tribunal avoided the open-ended and subjective interpretation advocated by Dr. Mann and, instead, prescribed an assessment of fairness and equity in light of specific rules of international law.

The tribunal thus turned its attention to the principles established by NAFTA. Prominent among these, the tribunal found several references to transparency.²⁶³ The tribunal noted that the NAFTA Parties agreed to "ensure a predictable commercial framework for business planning and investment" and to "ensure that [their] laws, regulations, procedures, and administrative rulings . . . are promptly . . . made available in such a manner as to enable interested persons . . . to become acquainted with them."²⁶⁴ From these principles, the tribunal concluded that NAFTA Parties have the obligation to make sure that all legal requirements affecting investment are capable of being readily known.²⁶⁵ According to the tribunal, "[t]here should be no room for doubt or uncertainty on such matters."²⁶⁶ Once a NAFTA Party "become[s] aware of any scope for misunderstanding or confusion," it must "ensure that the correct position is promptly determined and clearly stated."²⁶⁷

Mexico failed to meet this standard because it did not establish a clear rule on the need or procedures for obtaining local construction permits.²⁶⁸ In addition, the failure of local authorities to give the investor notice of a town meeting that resulted in the denial of its request for a construction permit, to provide an opportunity to be heard, or to identify any relevant considerations for the denying the permit demonstrated the lack of a transparent or predictable framework for business planning and investment.²⁶⁹

Observers have variously described the *Metalclad* award as a "monumental development" for claimants²⁷⁰ and an excessive limitation on

262. *Metalclad*, Arbitral Award, at para. 74 (Aug. 30, 2000) (emphasis added).

263. *See id.* at para. 76.

264. *Id.* at para. 71 (quoting NAFTA, Preamble and art. 1802(1), 32 I.L.M. at 605, 648).

265. *See id.* at para. 76.

266. *Id.*

267. *Id.*

268. *Id.* at para. 88.

269. *See id.* at paras. 91-93, 99.

270. *See NAFTA: U.S. Waste Control Firm Refiles Case Under NAFTA Investor-State Provisions*, *supra* note 150, at 1528.

the regulatory authority of NAFTA Parties.²⁷¹ One wonders, however, if either assessment withstands rigorous scrutiny. To begin with, it should come as no surprise that an acute lack of transparency would constitute unfair and inequitable treatment in the context of an investment treaty. The most qualified writers support this conclusion.²⁷² In a related context, WTO precedent establishes that the lack of transparency may constitute “arbitrary discrimination” against international trade.²⁷³ Nor is it particularly astonishing that the tribunal would have found an acute lack of transparency on the facts of *Metalclad*. Again, WTO precedent establishes that regulatory systems lack transparency if they deny individual applications without notice, an opportunity to be heard, or the provision of reasoned, written decisions.²⁷⁴

Perhaps the assessments of *Metalclad* rest on the tribunal’s statement that NAFTA Parties “*should*” leave “no room for doubt or uncertainty” with respect to investment regulations.²⁷⁵ The tribunal, however, did not hold that the NAFTA Parties “*must*” leave “no room for doubt and uncertainty.”²⁷⁶ Rather, it decided that NAFTA Parties may face liability if they first become aware of uncertainties and then fail to correct them with reasonable dispatch.²⁷⁷ This obligation does not seem particularly onerous. Furthermore, the award does nothing to interfere with the substantive regulatory policies of NAFTA Parties; it only requires them to describe and apply their policies in clear and predictable ways.

Observers may believe that the definition of “fair and equitable treatment” by reference to external treaty obligations will expose NAFTA Parties to a variety of new claims. The *Metalclad* award does not, however,

271. See, e.g., Stephen L. Kass & Jean M. McCarroll, *The “Metalclad” Decision Under NAFTA’s Chapter 11*, N.Y.L.J., Oct. 27, 2000, at 3 (observing that the *Metalclad* award “has shocked those environmentalists and governmental officials . . . who have been working to . . . prevent the ‘race to the bottom’ predicted by [those] who view free trade as a . . . way to circumvent . . . environmental standards”).

272. See, e.g., Daniel M. Price, *Some Observations on Chapter Eleven of NAFTA*, 23 HASTINGS INT’L & COMP. L. REV. 421, 423-24 (2001) (concluding that “fair and equitable treatment” requires host states to deal “transparently in their relations with foreigners”); Sacerdoti, *supra* note 169, at 344 n.150 (explaining that “fair and equitable treatment” under the Lomé Convention requires “all rules and practices affecting an investor’s interest [to] be transparent[] [and] predictable.”). Mr. Price served as the principal U.S. negotiator of Chapter 11, and Sacerdoti serves as a judge on the WTO Appellate Body.

273. United States – Import Prohibition of Certain Shrimp and Shrimp Products, WT/DS58/AB/R, at paras. 180-84 (Oct. 12, 1998), available in 1998 WL 720123 (W.T.O.), at *54-*55. See also Gantz, *supra* note 247, at 746-47 (identifying “arbitrary” and “discriminatory” treatment as functional equivalents of “unfair and inequitable” treatment).

274. See United States – Import Prohibition of Certain Shrimp and Shrimp Products, WT/DS58/AB/R, at para. 180.

275. See *Metalclad Corp. v. Mexico, Arbitral Award*, at para. 76 (Aug. 30, 2000) (NAFTA/ICSID Add’l Facility) (emphasis added), available at <http://www.pearcelaw.com/metalclad.html>.

276. See *id.*

277. See *supra* note 267 and accompanying text.

define “fair and equitable treatment” in a surprising or expansive way. To begin with, the most highly qualified writers have concluded that the violation of treaty obligations “clearly” constitutes unfair treatment in the context of international investment.²⁷⁸ Furthermore, by anchoring “fair and equitable treatment” in specific rules of international law, the award limits the potential for subjective analysis by individual tribunals.

In addressing the minimum standard of treatment, the *S.D. Myers* tribunal took a similar – but more explicitly deferential – approach. The tribunal recognized that it had no “open-ended mandate to second-guess” the controversial policy choices of NAFTA Parties.²⁷⁹ To preserve the decision-making powers of NAFTA Parties, the tribunal construed the phrase “fair and equitable treatment” in conjunction with the words “in accordance with international law.”²⁸⁰ Interpreted this way, Article 1105 only prohibits unjust or arbitrary treatment that is “unacceptable from the international perspective.”²⁸¹ Claimants can usually establish such treatment by demonstrating the breach of a rule of international law specifically designed to protect investors.²⁸² The tribunal cautioned, however, that not every violation of international law constitutes unfair and inequitable treatment.²⁸³ Furthermore, in making determinations, tribunals must consider the “high measure of deference that international law generally extends to . . . domestic authorities to regulate matters within their . . . borders.”²⁸⁴

Notwithstanding this explicitly deferential framework, a majority of the tribunal held that Canada’s violation of Article 1102 (national treatment) established a denial of fair and equitable treatment.²⁸⁵ In a separate opinion, one member of the tribunal indicated that Canada had also acted unfairly and inequitably by failing to give SDMI notice of the proposal to ban exports of

278. FRANCK, *supra* note 235, at 473. *See also* Sacerdoti, *supra* note 169, at 341 n.143 (construing “fair and equitable treatment” to require “respect for international law”).

279. *See S.D. Myers, Inc. v. Canada, Partial Award*, at para. 261 (Nov. 13, 2000) (NAFTA/UNCITRAL), available at <http://www.appletonlaw.com/4b2myers.htm>.

280. *See id.* at para. 262.

281. *Id.* at para. 263.

282. *See id.* at para. 264.

283. *See id.*

284. *Id.* at para. 263. Put more simply, it appears that the tribunal would generally consider a violation of international investment law to constitute a sufficient (but not necessary) showing of unfair and inequitable treatment. This leaves open the possibility that state conduct might be “unacceptable from the international perspective” without violating international law. For example, a technically proper, but abusive, exercise of treaty rights might constitute unfair and inequitable treatment. *See Price, supra* note 272, at 423-24 (indicating that “fair and equitable” treatment requires adherence to the principle of good faith).

285. *See S.D. Myers, Partial Award*, at para. 266 (Nov. 13, 2000).

PCBs, granting its Canadian competitors privileged access to decision-makers, and not responding to SDMI's communications regarding the ban.²⁸⁶ According to the separate opinion, these actions probably violated principles of procedural fairness and transparency established by Article 1802 of NAFTA and other widely accepted treaties, including the WTO agreements and BITs.²⁸⁷ The separate opinion declined to find Canada in violation of the particular treaty provisions, however, because the pleadings did not specifically address those provisions and Canada, therefore, lacked a meaningful opportunity to respond to the analysis.²⁸⁸

In addressing the minimum standard of treatment, Chapter 11 tribunals have uniformly shown deference to domestic institutions. They have recognized that Article 1105 creates very limited opportunities to review the actions of NAFTA Parties. Accordingly, they have adopted constructions that avoid open-ended, subjective, and unpredictable analysis. These decisions should reassure the public that Article 1105 does not threaten the regulatory sovereignty of NAFTA Parties. It chiefly requires NAFTA Parties to observe in good faith specific rules of international law to which they have voluntarily consented.

IV. CONCLUSION

This article does not aim to denigrate the opponents of Chapter 11; the author recognizes their genuine concern for the public interest. The article suggests, however, that popular anxiety rests on the untested premise that Chapter 11 lacks balance and favors foreign corporate interests over the public interest. To challenge that premise, the article has examined a number of recent decisions and awards rendered by Chapter 11 tribunals. The emerging case law suggests that tribunals have adopted a balanced interpretive strategy, which promotes access to arbitration but does not impose unrealistic standards of conduct on NAFTA Parties. When applying procedural and jurisdictional provisions, tribunals have preferred flexible constructions that promote access to arbitration and a hearing on the merits – even when the isolated text might support a different result. Despite this commitment to access, tribunals have carefully preserved – and in one case exercised – the authority to dismiss abusive claims.

This trend might confirm fears that NAFTA Parties will rarely succeed in eliminating extravagant claims at an early stage of arbitration. When considering claims on their merits, however, tribunals have adhered rigorously to the text of Chapter 11 and specific rules of international law. In so doing, tribunals have deferred to municipal decision-makers and

286. *See id.* at paras. 241, 246-47, 252 (separate opinion of Bryan Schwartz).

287. *See id.* at paras. 249-50, 253-55, 257.

288. *See id.* at paras. 253, 258.

reaffirmed their authority to regulate in the public interest. Furthermore, tribunals have recognized their limited powers of review and have adopted constructions that avoid open-ended and subjective examination of governmental actions. While it may be premature to draw definitive conclusions, Chapter 11 tribunals show every sign of maintaining an appropriate balance between the rights of NAFTA investors to air their complaints and the obligations of NAFTA Parties to regulate in the public interest.

That said, a balanced approach still requires tribunals to find violations and award damages in meritorious cases. Canada and Mexico have already experienced that indignity, and the United States seems unlikely to emerge from Chapter 11 proceedings unscathed. When our government loses a substantial claim, the public will become understandably distressed. Let us hope that we will have the fortitude to acknowledge the deficiencies of our institutions, instead of vilifying Chapter 11 as an “outrageous”²⁸⁹ or “bizarre”²⁹⁰ regime.

289. See Ferguson, *supra* note 5, at 519 (quoting the Executive Director of the Council of Canadians for the proposition that “NAFTA gives outrageous powers to corporations”).

290. See Alvarez, *supra* note 55, at 307 (referring to Chapter 11 as “the most bizarre human rights treaty ever conceived”).