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NAFTA Chapter 11 Investor-to-State Dispute Resolution: A Shield to Be Embraced or a Sword to Be Feared?

I. INTRODUCTION

When the North American Free Trade Agreement (“NAFTA” or “Agreement”) celebrated its five-year anniversary in 1999, all of the trade statistics compiled at the time suggested that the NAFTA was an unparalleled success. For example, from 1994 to 1999, Canada’s trade with the United States rose 80%, while its trade with Mexico doubled.¹ By 1998, “the total three-way trade among Canada, Mexico, and the United States reached approximately \$752 billion, with Canada-U.S. and Canada-Mexico trade accounting for \$484 billion.”² Also, from 1993 to 1999, foreign direct investment in Canada rose 54% to \$218 billion, of which about 68% came from NAFTA countries.³ Despite the glowing reviews about the increase in trade and investment among NAFTA countries, the Agreement has come under rising criticism, in particular for the Chapter 11 investor-to-state dispute resolution regime.

In fact, Chapter 11 proceedings have resulted in broader interpretations and far wider applications of the statutory framework than many of the NAFTA’s drafters envisioned.⁴ However, given NAFTA’s lofty objectives and purposes, it is not surprising that Chapter 11 has been interpreted broadly.⁵

1. David R. Haigh, *The Management and Resolution of Cross Border Disputes as Canada/U.S. Enter the 21st Century: Chapter 11—Private Party vs. Governments, Investor-State Dispute Settlement: Frankenstein or Safety Valve?*, 26 CAN.-U.S. L.J. 115, 115 (2000).

2. *Id.*

3. *Id.*

4. For example, many “current and former Canadian officials have commonly claimed that they seriously believed that the NAFTA’s investor-state provisions would only be used by Canadians and Americans against measures imposed by Mexico.” Todd Weiler, *Arbitral & Judicial Decision: The Ethyl Arbitration: First of Its Kind and a Harbinger of Things to Come*, 11 AM. REV. INT’L ARB. 187, 192 (2000).

5. For example, Article 102 of the NAFTA states that “the objectives of this Agreement . . . are to”:

(a) eliminate barriers to trade in, and facilitate the cross border movement of, goods and services between the territories of the Parties;

The strongest critics of Chapter 11 claim that the NAFTA countries have risked their national sovereignty and their ability to freely engage in democratic law-making processes without the fear of having to compensate foreign investors for every regulation that negatively affects them. These critics claim that Chapter 11 has become a “sword” for investors, allowing them to attack the NAFTA countries, rather than the “shield” it was intended to be. This Comment will show that the Chapter 11 dispute resolution regime is indeed a “shield” necessary to protect foreign investors, while at the same time containing the potential to become an offensive “sword” to be used against the NAFTA countries. This Comment will also recommend possible solutions and demonstrate that by making appropriate amendments to Chapter 11, foreign investors will still be afforded a viable forum in which to address grievances with their host nations, and the NAFTA countries will be able to better protect their vital interests.

Part II reviews the historical background of Chapter 11 dispute resolution as well as its substantive and procedural structures. Part III considers key case studies forming the foundation of many of the various issues and points of contention among NAFTA’s critics and proponents. Part IV specifically outlines some of the most contentious points regarding Chapter 11 dispute resolution and considers whether the most common criticisms of Chapter 11 are warranted. For the sake of brevity, this discussion focuses only on issues related to sovereignty, constitutional questions, statutory definitions and the environment. Part IV also recommends several ways to improve upon the Chapter 11 dispute resolution regime. Finally, Part V concludes that the Chapter 11 regime can be improved by providing more openness in the arbitral process, clearer statutory definitions, and improved procedural safeguards.

(b) promote conditions of fair competition in the free trade area;

(c) increase substantially investment opportunities in the territories of the Parties;

.....

(f) establish a framework for further trilateral, regional and multilateral cooperation to expand and enhance the benefits of this Agreement.

North American Free Trade Agreement, Dec. 17, 1992, Can.-Mex.-U.S., 32 I.L.M. 289 (1993) [hereinafter NAFTA]. In addition, the Preamble of the NAFTA states that the parties resolve to: “ENSURE a predictable commercial framework for business planning and investment; CREATE new employment opportunities and improve working conditions and living standards in their respective territories; [and] PRESERVE their flexibility to safeguard the public welfare.” *Id.* pmbl.

II. FOUNDATIONS OF CHAPTER 11 INVESTOR-TO-STATE DISPUTE RESOLUTION

A. Historical Underpinnings

Throughout the eighteenth and nineteenth centuries, colonial powers usually resolved disputes in foreign investment matters by imposing their will upon their subjected colonies either by implied or actual force. This inequitable method of resolving foreign investment problems has been referred to as “gun-boat diplomacy.”⁶ Surprisingly, it was not until the 1950s that the United Nations (“UN”) Charter outlawed the use of force in settling foreign investment disputes.⁷

Prior to the enactment of the UN Charter, disputes were commonly waged between states because private investors lacked standing under international law.⁸ If private investors sought action against a foreign state, the investors had to rely on their home governments⁹ to bring the claim in accordance with an international dispute resolution treaty, assuming the two countries were a part of a bilateral or multilateral agreement. Unfortunately for investors, the home government was under no obligation to bring the claim, and few investors were able to obtain relief. This lack of representation for private investors was one of the biggest reasons why NAFTA included Chapter 11 investor-to-state dispute resolution. Too often under the old system investors had no recourse, so Chapter 11 was created to act as a “shield” for foreign investors who needed a mechanism to protect their interests from host nations.

The state-centric colonial model of dispute resolution began to crumble between 1868 and 1896 when Carlos Calvo, an Argentine jurist, developed the Calvo doctrine.¹⁰ This theory was based on the following two main points:

6. Matthew B. Cobb, *The Development of Arbitration in Foreign Investment*, 16 MEALEY'S INT'L ARB. REP. April 2001, LEXIS, Secondary Legal, Mealey's Publication, Mealey's International Arbitration Reports Hot File, at *2.

7. *Id.*

8. *Id.*

9. This concept is known as the “doctrine of espousal.” Daniel M. Price, *Investment, Sovereignty, and Justice: Arbitration Under NAFTA Chapter 11: Some Observations on Chapter Eleven of NAFTA*, 23 HASTINGS INT'L & COMP. L. REV. 421, 426 (2000).

10. See Cobb, *supra* note 6, at 2.

(1) sovereign states, being internationally equal and independent, should enjoy the right to absolute freedom from interference by other states, either through force or diplomacy; and (2) while aliens should be given equal treatment with nationals, they are not entitled to “extra” rights and privileges and thus may only seek redress in local courts.¹¹

This doctrine proved to be very popular among Latin American countries seeking to minimize paternalistic and unfair actions taken by powerful U.S. investors within their borders. Under the Calvo Doctrine, “rules governing foreign investment were to be based on the concept of national treatment and [the notion] that the rules of domestic law should not be modified by international law principles.”¹² Interestingly, Mexico has recently turned toward more modern, international-law-driven dispute resolution approaches and away from the principles of the Calvo doctrine that it vigorously espoused in the past. This significant movement away from the Calvo doctrine, as it applies to Mexico, will be discussed further in Part IV.

Another historical underpinning of Chapter 11 dispute resolution was the development of the International Center for the Settlement of Investment Disputes (“ICSID”) in 1966 and the UNCITRAL Model Law on International Arbitration in 1985, which enabled private investors to bring claims before binding arbitral bodies without dependence upon their home governments.¹³ These arbitral bodies established arbitration rule regimes that parties could rely on to solve international investment disputes.

A further key historical underpinning of Chapter 11 dispute resolution was a veritable explosion in the number of Bilateral Investment Treaties (“BITs”) that were formed worldwide. BITs have in and of themselves created the current international investment regime. Many of these agreements have binding arbitration clauses—either under ICSID or UNCITRAL Rules—that have developed as a result of the “prohibition of the use of force for the protection of foreign property and the assumption that the liberal economic theory requires a legal system to protect foreign investment.”¹⁴ The inclusion of such arbitration clauses has “helped fill the gap in dispute set-

11. *Id.*

12. Haigh, *supra* note 1, at 131.

13. *See* Cobb, *supra* note 6, at 16–18.

14. *Id.* at 20.

tlement by creating an alternative to gun-boat diplomacy . . . and . . . has helped to encourage foreign investment by giving investors assurance that their disputes with the host country can be resolved in a fair manner.”¹⁵ As of 1998, over 160 countries had entered into at least one BIT, and over 1300 BITs in total had been signed.¹⁶

It is no surprise, considering the history of moving away from “gun-boat diplomacy” toward peaceful dispute resolution, that the drafters of the NAFTA decided to include binding arbitration clauses for dispute resolution. Although some critics claim that Chapter 11 is a radical departure from established norms in the area of investor dispute resolution, the concept of direct access is not without precedent. In defending Chapter 11’s dispute resolution regime, David Haigh states:

NAFTA’s Chapter 11 is, in essence, a tri-lateral investment treaty grafted onto an arrangement which is otherwise largely directed at establishing liberalization and fairness in the trade of goods and services. As with “virtually all modern treaties” of this nature . . . there is provision for the settlement of investor-state investment disputes under either the ICSID Convention, the Additional Facility Rules of ICSID, or the UNCITRAL Arbitration Rules [A]s an investment treaty, it has simply followed the already well-established model for investor-state dispute resolution.¹⁷

Haigh also claims that the fundamental objective of creating the Chapter 11 dispute resolution was “to create a bargain between host states and investors.”¹⁸ Investors agree to invest in the host country with the understanding and assurance that they will enjoy the basic standards of fairness outlined in Section A of Chapter 11.¹⁹ This protection is essential to foreign investors who are subject to the host country’s law-making authority but do not enjoy the “usual political recourse nor any legitimate role in the public policy process. They are, therefore, uniquely vulnerable to the legislative or regulatory whims of their host.”²⁰ Creating the mechanism to resolve disputes according to international standards reduces the need for investors to

15. *Id.*

16. *Id.*

17. Haigh, *supra* note 1, at 129–30.

18. *Id.* at 128.

19. *Id.*; *see infra* Part II.B.

20. Haigh, *supra* note 1, at 128.

resort to the “vast uncertainties” of pursuing claims in local forums.²¹ The assertion that investors are “uniquely vulnerable” in foreign countries has led to the development of investor-to-state dispute resolution. Subsequent sections of this paper will consider whether this assertion is accurate given the seemingly large amount of power that foreign investors wield under the investor-to-state dispute resolution umbrella of Chapter 11.

B. Structure of Substantive and Procedural Provisions of Chapter 11

Before this consideration, an overview of Chapter 11 will be helpful. Chapter 11 has three main sections. Articles 1101 to 1114 define the substantive obligations each NAFTA party owes to the investors of the others, Articles 1115 to 1138 outline the procedural rules parties must adhere to in an arbitration and Article 1139 contains definitions of the terms used in the other articles of Chapter 11.

The first substantive obligations set forth by Articles 1102 and 1103 include national treatment and most-favored nation principles.²² These provisions provide that “each NAFTA Party must accord investors of the other Parties, or their investments, treatment no less favorable than the treatment it accords its own investors and their investments.”²³ Also, Article 1105 imposes an obligation to meet international minimum standards of treatment, including “fair and equitable treatment and full protection and security.”²⁴ Next, Article 1106 prohibits NAFTA Parties from attempting to gain host-country benefits by imposing certain “performance requirements” on foreign investors.²⁵ In addition, Article 1109 sets forth the rules regarding the transfer and repatriation of profits or capital. Host countries may not employ exchange controls that create delays or otherwise impede investors from attempting to transfer “profits,

21. Jacob S. Lee, *No “Double-Dipping” Allowed: An Analysis of Waste Management, Inc. v. United Mexican States and the Article 1121 Waiver Requirement for Arbitration Under Chapter 11 of NAFTA*, 69 FORDHAM L. REV. 2655, 2656 (2001).

22. Robert K. Paterson, *A New Pandora’s Box? Private Remedies for Foreign Investors under the North American Free Trade Agreement*, 8 WILLAMETTE J. INT’L & DISPUTE RES. 77, 87 (2000).

23. *Id.* at 88.

24. *Id.* at 95.

25. *Id.* at 98. Examples of performance requirements by a host country that are not permitted include mandatory export levels by the investor, mandatory domestic content levels in the products produced by the investor and mandatory purchase of goods or services from persons in the host country’s territory by the investor.

dividends, capital gains, royalty payments, proceeds of the sale of all or part of an investment, repayment of loans and payments for breaches of treaty obligations.”²⁶ Finally, Article 1110 sets forth the rules for expropriation of an investment, indicating that an expropriation is prohibited “unless it is done for a public purpose, on a non-discriminatory basis, in accordance with due process of law, and on payment of prompt, adequate and effective compensation.”²⁷ The payment must be made without delay, valued at the fair market value the day prior to the expropriation—taking into account any negative effects on the value of the property from an imminent expropriation—and in a G7 currency.²⁸ Taken together, Articles 1101 to 1116 establish the five primary elements of a NAFTA Chapter 11 claim:

- (1) a qualifying NAFTA “investor” with (2) an “investment” in another NAFTA party; (3) a “measure” relating to investors or investments of another NAFTA party; (4) an allegation that the measure breached a covered NAFTA provision, and (5) an allegation of harm to the investor and/or investment connected to the alleged breach.²⁹

Articles 1116 and 1117 provide Chapter 11’s first procedural requirements. These articles require that a claim cannot be brought “if more than three years have elapsed from the date on which the investor first acquired, or should have first acquired, knowledge of the alleged breach and knowledge that the investor has incurred loss or damage.”³⁰ Also, Article 1119 provides that investors must provide the country with which they have a dispute ninety-day written notice of their plans to submit a claim to arbitration.³¹ Finally, Article 1120(1) provides that investors must wait a period of six months after the events giving rise to a claim took place before initiating an arbitration.³²

C. Choice of Arbitration Regimes

Under Chapter 11 dispute resolution, parties may choose be-

26. *Id.* at 102.

27. *Id.* at 103.

28. *Id.*

29. Weiler, *supra* note 4, at 190.

30. *Id.* (quoting NAFTA, *supra* note 5, arts. 1116-17).

31. *Id.*

32. *Id.*

tween three arbitration regimes in settling a dispute. First, parties may choose the ICSID Convention, “provided that both the disputing Party and the Party of the investor are parties to the Convention.”³³ As a second alternative, the parties may choose the Additional Facility Rules of ICSID, “provided that either the disputing Party or the Party of the investor, but not both, is a party to the ICSID Convention.”³⁴ Finally, the parties may choose the UNCITRAL Arbitration Rules.³⁵ Among the parties to the NAFTA, only the United States has ratified the ICSID Convention. Therefore, an arbitration claim brought by an American investor against either Canada or Mexico would need to be governed by either ICSID’s Additional Facility Rules or the UNCITRAL Rules.³⁶ Since 1997, about half of all Chapter 11 arbitrations have been governed by the UNCITRAL Rules and the other half by the ICSID Convention.³⁷

D. Blueprint of a Chapter 11 Arbitration

Once the timing provisions of Articles 1116 to 1120 have been satisfied, investors must still exhaust all available local remedies before they may initiate a Chapter 11 arbitration.³⁸ The drafters of Chapter 11 did not want investors rushing indiscriminately into Chapter 11 arbitrations to resolve every minor dispute. Once local remedies have been exhausted, the parties must select an arbitral tribunal panel. As one author mused, “[t]he adage that the arbitral process is only as good as the arbitrators forming the tribunal holds true in relation to NAFTA investment arbitration.”³⁹ Normally, a tribunal panel is comprised of three arbitrators; each party to the dis-

33. See NAFTA, *supra* note 5, art. 1120(a).

34. *Id.* art. 1120(b).

35. *Id.* art. 1120(c).

36. Clyde Pearce & Jack Coe, Jr., *Arbitration Under NAFTA Chapter Eleven: Some Pragmatic Reflections upon the First Case Filed Against Mexico*, 16 MEALEY’S INT’L ARB. REP. Jan. 2001, LEXIS, Secondary Legal, Mealey’s Publications, Mealey’s International Arbitration Reports Hot File, at *10.

37. PUBLIC CITIZEN & FRIENDS OF THE EARTH, NAFTA CHAPTER 11 INVESTOR-TO-STATE CASES: BANKRUPTING DEMOCRACY: LESSONS FOR FAST TRACK AND THE FREE TRADE OF THE AMERICAS xii (2001), available at <http://www.citizen.org/publications/release.cfm?ID=7076> (hereinafter BANKRUPTING DEMOCRACY).

38. This concept is known as the “local remedies rule.” See Pearce & Coe, *supra* note 36, at 12.

39. *Id.* at 14.

pute selects one arbitrator, and the two selected arbitrators in turn choose a third arbitrator who will preside over the proceeding.⁴⁰

Article 1130 provides that, unless the disputing parties otherwise agree, the place of the arbitration must be in the territory of a NAFTA Party that is also a party to the New York Convention,⁴¹ selected in accordance with the ICSID Convention Rules, the ICSID Additional Facility Rules, or the UNCITRAL Arbitration Rules.⁴² Often the two disputing parties will elect to hold the arbitration in the third country not involved in the dispute to add a measure of neutrality to the proceedings.⁴³

Once the arbitration panel is selected, it is not uncommon for all interested parties to meet and allow the panel to hear an outline of each respective case “on the merits.”⁴⁴ Before the formal oral hearing, the claimant in the case will submit a “memorial,” the “chief moving document” of the arbitration, containing “a statement of relevant facts; a statement of law; and the submissions.”⁴⁵ The respondent will then issue his “counter-memorial.”⁴⁶ This interaction may take place a second time if the parties agree. Also, before the oral hearing, post-brief/pre-hearing conferences may take place to accomplish the “marshaling of evidence” that the parties plan to present at the hearing.⁴⁷ According to modern international arbitration rules, the parties have the option to forgo the oral hearing and to rest on their written submissions.⁴⁸ However, very few claimants rest on their written submissions, as the overwhelming majority considers the oral hearing to be invaluable to their case.

A distinctive feature of a Chapter 11 proceeding is Article 1128,

40. *Id.* at 14–15.

41. The New York Convention is an international agreement that outlines the manner in which international arbitration awards may be enforced in the domestic courts of the signatories. For example, if Party *A* wins a decision against Party *B* in Country *X*, but Party *B* refuses to pay the judgment in Country *X*, then Party *A* can go to Country *Y*, assuming that Country *Y* is a signatory of the New York Convention and Party *B* has assets in Country *Y*, and can enforce the judgment there. The Convention gives added weight and validity to international arbitrations and the awards resulting therefrom.

42. *See* NAFTA, *supra* note 5, art. 1130.

43. *See* Pearce & Coe, *supra* note 36, at 16.

44. *Id.* at 18.

45. *Id.* at 20 (quoting Article 38 of the ICSID Additional Facility Rules).

46. *Id.*

47. *Id.* at 21.

48. *Id.* at 22.

which allows third-party intervention by a NAFTA Party regarding the interpretation of NAFTA.⁴⁹ Tribunals have a great deal of discretion in determining the timing and manner of third party submissions that will be allowed. Also, on its face, Article 1128 grants no affirmative right to present oral arguments on a particular issue, so the value of the “right” of intervention depends largely on how the panel decides to allow the third party to proceed.⁵⁰

Although in principle neither party is afforded the “last word” and the rules’ texts do not explicitly say that disputants may submit post-hearing briefs, it is common practice for the parties to do so by accepting an invitation from the panel to clarify particularly difficult issues.⁵¹ These submissions may help dispel any remaining doubts in the arbitrators’ minds. The award is decided when each arbitrator engages in private deliberations and brings back an impartial assessment of the case to the panel and at least two of the three arbitrators agree with the result.⁵² Chapter 11 arbitrations have been greatly influenced by the New York Convention, which stresses the desirability of upholding international arbitral rulings. Nevertheless, an unhappy party may still object to a ruling and seek to have it set aside in a domestic court of the country where the arbitration took place.⁵³

III. CASE STUDIES

The following case studies illustrate some of the controversial issues surrounding Chapter 11 dispute resolution and how opponents of Chapter 11 have used these examples to support their contention that Chapter 11 is a “sword” to be feared, rather than a “shield” to be embraced.

49. *Id.* at 25.

50. *Id.*

51. *Id.* at 26.

52. *Id.*

53. *Id.* at 27. For example, in *Metalclad* the Mexican government appealed the \$16.7 million award to the Supreme Court of British Columbia, the location of the Chapter 11 arbitration. Ultimately, the court held that the decision by the arbitral panel was correct but amended the manner in which the claimed damages were calculated. The court concluded that the interest portion of the \$16.7 million should not be included in the final award, a difference of almost \$1 million. *Portion of \$16.7 Million Metalclad Award Set Aside*, 16 MEALEY’S INT’L ARB. REP. May 2001, LEXIS, Secondary Legal, Mealey’s Publications, Mealey’s International Arbitration Reports Hot File, at *1.

A. Metalclad Corp. v. United Mexican States

In 1990, the federal government of Mexico allowed a Mexican company named Coterin to open a hazardous waste transfer station in the State of San Luis Potosi.⁵⁴ Coterin intended to make the site a hazardous waste landfill but was denied the necessary municipal construction permits in 1991 and 1992.⁵⁵ In 1993, Metalclad, a California-based company, bought Coterin and the waste transfer station.⁵⁶ Metalclad continued in Coterin's efforts to construct the hazardous waste landfill and succeeded in securing the various federal permits but not the municipal construction permits.⁵⁷ Nevertheless, Metalclad proceeded to construct the landfill in 1994 because the Mexican federal government assured the company that it did not need the municipal construction permits to do so.⁵⁸

Upon completion of the project in 1995, threatening demonstrations by local residents of the municipality effectively denied Metalclad the opportunity to open and operate the landfill.⁵⁹ From May to December of 1996, Metalclad and the municipality sought to resolve their issues with respect to the operation of the landfill but were unable to produce a suitable solution.⁶⁰ Ultimately, the municipality denied Metalclad the necessary construction permits and the Governor of the municipality declared the site in question a permanent "special ecological zone."⁶¹ On January 2, 1997, Metalclad initiated a Chapter 11 arbitration, seeking \$90 million in damages.⁶² Metalclad contended that Mexico, through its municipal government, interfered with the operation of Metalclad's landfill in violation of Articles 1105 and 1110 of Chapter 11.⁶³ Metalclad asserted that it was denied fair and equitable treatment and that because it could not utilize the waste disposal facility, the Mexican government had perpetrated an expropriation. A Chapter 11 arbitration tribunal found

54. *Metalclad Corp. v. United Mexican States*, ICSID Case No. ARB(AF)/97/1, ¶ 28 (2000) [hereinafter *Metalclad*].

55. *Id.* ¶ 50.

56. *Id.* ¶ 30.

57. *Id.* ¶ 40.

58. *Id.* ¶ 38.

59. *Id.* ¶ 46.

60. *Id.* ¶ 58.

61. See BANKRUPTING DEMOCRACY, *supra* note 37, at 11.

62. *Id.* at 12.

63. See *Metalclad*, *supra* note 54, ¶ 72.

that the Mexican government's denial of the construction permit and its creation of the "special ecological zone" constituted an indirect expropriation in violation of Article 1110. An arbitration tribunal found that the Mexican federal government had violated the minimum standards of treatment provisions of Article 1105 when it indicated to Metalclad that the municipal permits were not necessary for construction and operation of the landfill.⁶⁴ The tribunal awarded Metalclad almost \$16.7 million in damages.⁶⁵

B. Ethyl v. Canada

Ethyl Corporation, a Virginia-based chemical company, is North America's main producer of methylcyclopentadienyl manganese tricarbonyl (MMT), which is used as an additive in gasoline to enhance engine performance.⁶⁶ Ethyl Canada, an Ethyl subsidiary, imported this additive into Canada and sold it to Canadian refineries.⁶⁷ In April, 1997, the Canadian Parliament imposed a ban on the import and inter-provincial transport of MMT,⁶⁸ thus preventing Ethyl from exporting its product to Canada. Conflicting evidence existed regarding the health implications of exposure to MMT. Because it had been banned in California in 1977 and contained a known human neurotoxin, manganese, many of MMT's critics believed it was dangerous, yet the Canadian government found that the "current scientific information" at the time did not adequately demonstrate its toxicity.⁶⁹

Before the Canadian law was passed, Ethyl threatened a Chapter 11 suit against the government of Canada, claiming that it would be perpetrating an expropriation under Article 1110 if Canada denied it the right to export MMT to Canada without due compensation.⁷⁰ After the Canadian Parliament ratified the law banning MMT in April, 1997, Ethyl followed through with its initial threat and sued for \$251 million.⁷¹ Canada objected to the suit primarily because Ethyl had not waited six months after the passage and implementa-

64. See BANKRUPTING DEMOCRACY, *supra* note 37, at 12.

65. *Id.*

66. *Id.* at 8.

67. *Id.*

68. *Id.*

69. *Id.* at 8-9.

70. *Id.* at 9.

71. *Id.*

tion of the ban before filing a claim, a violation of the timing provisions contained in Article 1120.⁷² The tribunal ignored the timing violations and allowed the suit to proceed. Before a tribunal could rule on the merits of the case, Canada rescinded its law, permitting Ethyl to resume operation in Canada, and paid Ethyl over \$13 million in legal fees and damages.⁷³

C. Loewen v. United States

In 1994, a Mississippi businessman sued the Loewen Group, a Canadian-based funeral conglomerate, for anti-competitive and predatory acts, claiming \$105 million in damages.⁷⁴ A Mississippi jury awarded the plaintiff \$500 million, including \$400 million in punitive damages, the largest punitive damages award in Mississippi's history.⁷⁵ Loewen decided to settle the claim with the businessman for approximately \$150 million rather than appealing the case to a higher court, which would have required posting a bond worth 125% of the damages owed.⁷⁶ In its subsequent Chapter 11 suit, Loewen claimed that the trial had been biased because of Loewen's foreign status and that the result violated Article 1105 and amounted to a substantive denial of justice, a procedural denial of justice, and a denial of "fair and equitable treatment."⁷⁷ Loewen also claimed that the "excessive verdict, denial of appeal, and coerced settlement were tantamount to an uncompensated expropriation in violation of Article 1110 of NAFTA."⁷⁸ A Chapter 11 tribunal ruled that it possessed the necessary jurisdiction to adjudicate the case, but as of September 2001, the tribunal had not reached a decision on the merits.⁷⁹

D. S.D. Myers v. Canada

In the 1990s, S.D. Myers, an Ohio-based waste treatment company, sought to import polychlorinated biphenyls (PCBs) from Can-

72. *Id.*

73. *Id.*

74. See Paterson, *supra* note 22, at 96.

75. *Id.*

76. See BANKRUPTING DEMOCRACY, *supra* note 37, at 19.

77. See Paterson, *supra* note 22, at 97.

78. BANKRUPTING DEMOCRACY, *supra* note 37, at 20 (quoting *Loewen Group Inc. v. United States*, Notice of Claim Under Ch. 11 of the NAFTA, ICSID, Oct. 30, 1998, at 59).

79. *Id.*

ada to process in its Ohio treatment plant.⁸⁰ S.D. Myers supposedly wanted to engage in the PCB trade by using a Canadian affiliate, Myers Canada. During the early 1990s, the United States Environmental Protection Agency (EPA) issued contradictory laws regarding the import of PCBs, banning them under the 1976 Toxic Substance Control Act, but also allowing them in a 1996 regulation called the Import for Disposal Rule.⁸¹ The latter regulation permitted S.D. Myers and a few other companies to import PCBs into the United States for processing and disposal.⁸² Immediately following the ruling allowing the importation of PCBs into the United States, the Canadian government issued an "Interim Order" banning the export of PCBs so that it could study the contradictory U.S. laws and "review its international obligations concerning PCB trade."⁸³ At the time, Canada was a member of the Basel Convention, a multilateral environmental agreement that governed trade in toxic waste; the United States, however, was not a member of the convention.⁸⁴ Obligations under the Basel Convention included: "(1) not to engage in trade in toxic waste with non-parties; (2) to ensure PCBs are disposed [of] in an environmentally sound manner; and (3) to develop a viable, long-term strategy to dispose of such waste at home."⁸⁵ Canada ultimately decided to develop permanent regulations permitting the export of PCBs to the United States.⁸⁶ Although the regulations were implemented in February, 1997, the U.S.-Canada border was officially closed to PCB trade later that year when a U.S. court concluded that the toxic waste trade violated the Toxic Substance Control Act.⁸⁷

In 1998, S.D. Myers sued Canada for \$20 million in profits it claimed to have lost during the sixteen-month period Canada had spent evaluating the divergent American PCB regulations.⁸⁸ S.D. Myers claimed that the "Canadian ban constituted 'disguised discrimination' aimed specifically at S.D. Myers in violation of NAFTA's national treatment rules [of] (Article 1102)" and the fair

80. *Id.* at 15.

81. *Id.*

82. *Id.*

83. *Id.*

84. *Id.*

85. *Id.*

86. *Id.* at 16.

87. *Id.*

88. *Id.*

and equitable treatment rules of Article 1105.⁸⁹ S.D. Myers also claimed violations under Articles 1106 and 1110.⁹⁰ On November 13, 2000, a tribunal ruled in favor of S.D. Myers, upholding the claims under Articles 1102 and 1105, but dismissing the Articles 1106 and 1110 claims. The tribunal found that S.D. Myers' share of the Canadian market constituted an investment under Article 1139.⁹¹ The tribunal has yet to decide on an award amount, but S.D. Myers is now claiming \$50 million in damages. Canada has appealed the case to a domestic court in British Columbia, the site of the original arbitration.⁹²

IV. CHAPTER 11 POINTS OF CONTENTION

As with almost any international trilateral treaty, it would be possible to spend a considerable amount of time evaluating myriad criticisms. Therefore, in the interests of brevity, this discussion will be limited to the most contentious and important issues surrounding Chapter 11: (1) sovereignty issues; (2) constitutional issues; (3) definitional issues; and (4) environmental issues. Included in this section are several recommendations to assist in remedying the above-mentioned points of contention.

Certain critics of Chapter 11 lament that most of the cases that have been arbitrated thus far resemble "regulatory taking" cases, rather than the seizure of private property cases NAFTA proponents claimed they sought to protect investors from when the Agreement was signed in 1992.⁹³ The cases in the preceding section clearly show how willing tribunals have been to hold that statutes and judicial decisions may constitute expropriations or violations of fair and equal treatment under Chapter 11. When NAFTA was signed, most observers anticipated that Chapter 11 would be used solely to prevent the Mexican government from unfairly expropriating U.S. and Canadian companies.⁹⁴ History has proven otherwise, as the majority of Chapter 11 arbitrations to date have involved the U.S. and Canadian governments. Furthermore, critics point out that investors, such as

89. *Id.*

90. *Id.*

91. *Id.* at 16-17.

92. *Id.* at 17.

93. *Id.* at 37.

94. *See* Weiler, *supra* note 4, at 192.

the one involved in the *S.D. Myers* case, are routinely using Chapter 11 to gain an increased market share in a foreign country, thus transforming Chapter 11 from the “shield” it was meant to be into a “sword.”⁹⁵ These examples illustrate that Chapter 11 may have become the antithesis of its original purpose of being a protection for foreign investors.

On the other hand, proponents of Chapter 11 maintain that it is “a bold creative step by which the [lofty] goals of economic fairness are most likely to be achieved.”⁹⁶ Examining and considering the merits of these points of contention and any possible recommendations necessary to remedy the contentious issues will help answer the question of whether Chapter 11 is a “sword” to be feared or a “shield” to be embraced.

A. Sovereignty Issues

A common criticism of Chapter 11 is that a host nation’s sovereignty is diminished by affording foreign investors added power in asserting investment claims in binding arbitrations. However, Justin Byrne argues that by allowing private parties direct access to dispute resolution, Chapter 11 acts as a good example of rule-based diplomacy.⁹⁷ By adhering to the rules established in Chapter 11, “equal treatment” among the parties can be assured and the negative aspects of “power-based diplomacy,” such as that found in Chapter 20 of the NAFTA, can be avoided.⁹⁸ The *Ethyl* case is cited as an example of a private party’s ability to rely on the rules established under Chapter 11 to pursue a claim, rather than having to rely on its home country.⁹⁹ However, it is more important to focus on the fact that in the *Ethyl* case the Canadian government may have repealed the ban on MMT imports due to the large amounts of money it had already spent on the litigation. Arguably, the government was simply seeking to prevent protracted and expensive litigation. Byrne concedes “there exists a possibility of vexatious litigation when direct access to

95. See BANKRUPTING DEMOCRACY, *supra* note 37, at 37 (quoting Howard Mann of the International Institute for Sustainable Development).

96. Haigh, *supra* note 1, at 132.

97. Justin Byrne, Comment, *NAFTA Dispute Resolution: Implementing True Rule-Based Diplomacy Through Direct Access*, 35 TEX. INT’L L.J. 415, 416 (2000).

98. *Id.* at 422–23.

99. *Id.* at 425–27.

the dispute resolution process is granted.”¹⁰⁰ The potential for vexatious litigation creates a sovereignty issue.¹⁰¹ If a party such as Ethyl can pressure the Canadian government into repealing legislation in order to avoid costly litigation, what does that say for Canada’s policy-making ability? Canada, or another NAFTA country for that matter, might have to think twice before instituting unpopular legislation for fear of the financial repercussions of defending expensive litigation against private foreign investors.

Scholar Ian Laird asserts that it is “misguided reasoning to think that holding governments accountable is a threat to democracy.”¹⁰² He argues that even a government with good intentions to protect its citizenry will probably violate international trade provisions from time to time. According investors a reliable forum for redress and the resultant litigation is a small price to pay for the “numerous benefits

100. *Id.* at 427.

101. In speaking about the proposed Multilateral Agreement on Investment (MAI), which had been fashioned after the GATT and NAFTA’s Chapter 11 dispute settlement regimes, and how it could affect the sovereignty of nations involved in investor-to-state arbitrations, Lawrence Herman concluded that “the notion that allowing private parties the right to sue governments will create ‘super citizens’ seems over-drawn.” Lawrence L. Herman, *Sovereignty Revisited: Settlement of International Trade Disputes—Challenges to Sovereignty—A Canadian Perspective*, 24 CAN.-U.S. L.J. 121, 136 (1998). While Herman maintained that hysteria exhibited by some anti-investor-to-state commentators was unnecessarily alarmist, he acknowledged that the issues surrounding investor-to-state dispute settlement could not be easily dismissed and suggested that one possible solution would be to establish safeguard provisions, like those in the 1994 GATT agreement. Although Herman was speaking in regards to the proposed MAI, his suggestions can easily be applied to Chapter 11 proceedings. That is, to set down interpretive notes making it clear that “investment measures that can be challenged must involve an element of ‘taking’ or of confiscation and that mere changes to laws, regulations, or policies that have a direct or indirect effect on the value of an asset are not sufficient.” *Id.* In creating such guidelines, a nation would be able to implement fair legislation and change its laws as it saw fit without fear of facing multiple and expensive litigations from disgruntled private investors. As long as the legislation satisfied the anti-discrimination provisions in Chapter 11 such as national treatment, both the country and the investor would be adequately protected, and the potential for numerous claims would be diminished. Herman also proposed that another possible solution to the sovereignty issue is to end investor-to-state arbitrations all together and return to more traditional modes of dispute settlement where only nations have standing to bring claims. *Id.* The problem with this solution is that it ignores the plight of the foreign investor who has conducted himself properly but faces economic discrimination from his host country. History has shown that private investors need access to dispute resolution processes to adequately protect their economic interests. The best solution seems to be to maintain the current dispute resolution process, which was clearly needed, and improve upon it by adding interpretive notes.

102. Ian A. Laird, *NAFTA Chapter 11: NAFTA Chapter 11 Meets Chicken Little*, 2 CHI. J. INT’L L. 223, 229 (2001).

of international trade and investment.”¹⁰³ Laird maintains that the “real risk is that rational debate about free trade and investment will be stifled under the weight of anti-free trade hysteria.”¹⁰⁴

While advocates see Chapter 11 as the perfect “equalizer,” some critics see it as promoting gross disparity among the NAFTA countries. Jose Alvarez, a professor at the University of Michigan School of Law, writing from a Mexican perspective, has vividly described Chapter 11 as “a U.S. bilateral investment treaty on steroids—a dream come true for the U.S. foreign investor.”¹⁰⁵ Alvarez considers Chapter 11’s rhetoric of neutrality and equal protection as ringing hollow because, at least in the foreseeable future, “few Mexican investors are likely to be in the position to penetrate the U.S. market.”¹⁰⁶ Therefore, it is only U.S. investors who will likely benefit from Chapter 11’s provisions. The result of this “investment liberalization,” Alvarez argues, will be a Mexican economy increasingly dominated by multinationals from the United States.¹⁰⁷

Mexico undertook an economic revolution when it accepted Chapter 11 and departed from the long-established Calvo doctrine, and it has done so “without the resources needed to alleviate the inevitable adjustment pains.”¹⁰⁸ It should be remembered that the Calvo doctrine was a “cornerstone of Mexican legal tradition” and an integral part of the Mexican National Constitution, and that a departure from the doctrine will necessarily be difficult.¹⁰⁹ The social, cultural, and political costs of “investment liberalization” were not

103. *Id.*

104. *Id.* Some commentators do not share Laird’s views regarding international investment agreement law trends. James Brown sees NAFTA and Chapter 11 as “substantially” reducing city and county governments’ sovereignty and legislative powers. James J. Brown, *A Heads Up on Recent Development: Entering 2000 with Fewer Sovereign Powers and Expanded Compensable Property Rights: Dilemmas for Local Government*, 29 STETSON L. REV. 733, 734 (2000). He believes that the United States Trade Representative and the Department of Commerce’s Trade Compliance Center, which oversee compliance and enforcement of the NAFTA and are committed to opening international markets, do so at the expense of the domestic sector and local governments. *Id.*

105. Jose E. Alvarez, *Critical Theory and the North American Free Trade Agreement’s Chapter Eleven*, 28 U. MIAMI. INTER-AM. L. REV. 303, 304 (1996-97).

106. *Id.*

107. *Id.* at 306.

108. *Id.* at 305.

109. Diego César Bunge, *Southern Cone Perspective on the North American Free Trade Agreement-NAFTA*, in *NAFTA AND BEYOND: A NEW FRAMEWORK FOR DOING BUSINESS IN THE AMERICAS* 556 (Joseph J. Norton & Thomas L. Bloodworth eds., 1995).

considered when the NAFTA was drafted.¹¹⁰ Alvarez warns that economic liberalization in the past that favored “ugly anglos” resulted in cycles of violent backlashes by the Mexican people.¹¹¹ He remains unconvinced that Chapter 11 marks the end of Mexico’s economic history and foresees potential backlashes in the future.¹¹² Alvarez warns that if a volatile situation were to develop again, the repercussions would be felt not only in Mexico but also among the other NAFTA countries. Finally, Alvarez points out that Chapter 11 says next to nothing about the duty that multinationals owe to host states under international law; there is no requirement to respect the national sovereignty of the state in which multinationals operate.¹¹³ Instead of being truly balanced, Professor Alvarez sees Chapter 11 as “merely a short-sighted, one-way ratchet to reward and attract U.S. capital.”¹¹⁴

These criticisms illustrate the potential sovereignty issues associated with Chapter 11 arbitrations. Powerful foreign investors may have the opportunity to hold governments hostage by threatening or bringing litigation with the intention of influencing the government’s policy-making process. And in the case of Mexico, the current support for Chapter 11 will quickly wane if its benefits are not enjoyed by Mexican citizens as well as Americans.

One of the strongest criticisms of Chapter 11 is that by allowing investors direct access to dispute resolution, the Agreement runs the risk of promoting vexatious legislation by foreign investors and creating a threat against the national sovereignty of the NAFTA countries. Because NAFTA requires disputants to evaluate a case on the merits, it becomes very expensive for governments to adjudicate all cases, frivolous or not. Justin Byrne contends that “expensive, meritless litigation may deter governments from passing otherwise desirable and valid legislation.”¹¹⁵ This may have a chilling effect on the ability of governments to address pressing social or environmental issues and thereby diminish the sovereignty of the NAFTA countries.

110. See Alvarez, *supra* note 105, at 305.

111. *Id.* at 306.

112. *Id.*

113. *Id.* at 309.

114. *Id.* at 310.

115. See Byrne, *supra* note 97, at 434 (citing Samrat Ganguly, Note, *The Investor-State Dispute Mechanism (ISMD) and a Sovereign’s Power to Protect Public Health*, 38 COLUM. J. TRANSNAT’L L. 113, 114 (1999)).

The most effective way to remedy this situation is to modify some of Chapter 11's procedural provisions. By instituting a preliminary examination or some kind of screening mechanism that includes the threat of sanctions or litigation in a domestic court against a party who brings a meritless, frivolous, or needlessly expensive suit, many Chapter 11 arbitrations could be avoided.¹¹⁶ Such a preliminary process would not need to cost a lot of money, and it would certainly cost less than following through with a full-blown arbitration in every case. If the arbitral body were then to govern the proceeding using other Chapter 11 provisions, both parties to a dispute could rest assured that their interests would be adequately protected. This type of procedural modification could provide needed confidence in Chapter 11, prevent the promulgation of vexatious litigation and prevent a threat to the national sovereignty of the NAFTA countries. This improved procedural protection would also diminish the ability of powerful U.S. companies to take advantage of a weaker Mexican government and would provide a level playing field for private investors from all three NAFTA countries.

B. Constitutional Issues

Another criticism of Chapter 11 is that it lacks the procedural safeguards to protect common constitutional guarantees. Chapter 11's opponents point to the *Loewen* case and claim that by allowing Loewen to appeal the decision and award that was rendered by the Mississippi court, the tribunal minimized the constitutionally protected right to a jury trial.¹¹⁷ The right to a jury trial is rendered meaningless if every domestic trial can be appealed to a binding international arbitral tribunal. In *Loewen*, the tribunal claimed that it had the authority to hear the case even though the Mississippi Supreme Court had already decided the matter. The implications of this ruling suggest that further review of court rulings by arbitral tribunals is possible, even those issued by the United States Supreme Court.¹¹⁸

In the *Metalclad* case, the tribunal ruled that Mexico had violated the Article 1105 provisions of fair and equitable treatment. The

116. *Id.*

117. *See* BANKRUPTING DEMOCRACY, *supra* note 37, at 20.

118. *Id.* Arbitral tribunals seem to ignore the settled doctrines of res judicata and collateral estoppel.

tribunal made reference to Article 1102 and the “transparency principle,” which it interpreted as the “idea that all relevant legal requirements for the purpose of initiating, completing and successfully operating investments made, or intended to be made, under the Agreement should be capable of being readily known to all affected investors of another Party.”¹¹⁹ The tribunal also ruled that:

[o]nce the authorities of the central government of . . . [Mexico] become aware of any scope for misunderstanding or confusion in . . . connection [with the transparency principle], it is their duty to ensure that the correct position is promptly determined and clearly stated so that investors can proceed with all appropriate expedition in the confident belief that they are acting in accordance with all relevant laws.¹²⁰

Based on this interpretation, the tribunal ruled that when the Mexican federal government issued the permits to Metalclad but the municipality did not, the federal government had an affirmative duty to enforce the “correct position” regarding the matter.¹²¹ The problem with this ruling is that it ignores the municipality’s right to create local laws that govern the people and areas located within its jurisdiction. By missing this point, the tribunal assigned more obligations to the Mexican government under Chapter 11 than those negotiated by the NAFTA parties.¹²² In his essay, *Considerations of NAFTA Chapter 11*, Maximo Romero Jimenez asserts that “[a] tribunal should not rule on domestic legislation,” but that such a dispute should be resolved in the “appropriate domestic administrative and judicial fora.”¹²³

Another potential constitutional issue stems from the *Ethyl* case. Although the Ethyl Corporation “jumped the gun” by initiating a Chapter 11 arbitration prior to the completion of the six-month period following the date the Canadian law was enacted, the tribunal nevertheless held that the incorrect “[t]iming did not rise to jurisdictional significance.”¹²⁴ That is, the tribunal accepted jurisdiction de-

119. Maximo Romero Jimenez, *Considerations of NAFTA Chapter 11*, 2 CHI. J. INT’L L. 243, 247 (2001) (citing *Metalclad*, *supra* note 54, para. 76).

120. *Id.* at 247 (citing *Metalclad*, *supra* note 54, para. 76).

121. *Id.*

122. *Id.* at 248.

123. *Id.*

124. Alan C. Swan, *International Decision: Ethyl Corporation v. Canada, Award on Jurisdiction Under NAFTA/UNCITRAL*, 94 AM. J. INT’L L. 159, 165 (2000).

spite the fact that Ethyl did not follow the Article 1120 provisions correctly. If tribunals persist in accepting jurisdiction in disputes despite obvious violations of procedural due process, like the tribunal did in the *Ethyl* case, then the parties of NAFTA are likely to feel like they have no assurances of receiving adequate constitutional protection under Chapter 11.

The simplest way to remedy constitutional procedural due process concerns is for future arbitral tribunals to adhere strictly to the guidelines established in Chapter 11's Section B. If a party fails in any respect to meet the procedural guidelines, as the claimant did in the *Ethyl* case, then the tribunal should summarily dismiss the case or postpone it until that party achieves full compliance with such procedural guidelines. If a claimant in a domestic case lacked standing, he could not expect the court to ignore that fact and hear the case anyway, even if the claimant were to acquire standing at sometime in the future. Likewise, arbitral tribunals should be held to the procedural guidelines found in Chapter 11 and refuse to accept a case before its time and in violation of procedural due process.¹²⁵

Advocacy groups opposed to Chapter 11 have sued in Canadian courts to question the constitutionality of the secrecy of Chapter 11 proceedings, stating that it violates the guarantees of free press and free expression.¹²⁶ Presently, arbitrations need not be publicized and are closed to the public. Consequently, it is impossible to know

125. Andrea Bjorklund argues in her article, *NAFTA Chapter 11: Contract Without Priv-ity: Sovereign Offer and Investor Acceptance*, that the parties of NAFTA "did not agree to unfettered liability for investors' setbacks." Andrea K. Bjorklund, *NAFTA Chapter 11: Contract Without Priv-ity: Sovereign Offer and Investor Acceptance*, 2 CHI. J. INT'L L. 183, 184 (2001). Furthermore, she states that "[i]t is a fact of life everywhere that individuals may be disappointed in their dealings with public authorities. . . . NAFTA was not intended to provide foreign investors with blanket protection from this kind of disappointment, and nothing in its terms so provides." *Id.* (citing *Azinian v. United Mexican States*, 39 I.L.M. 537 (2000)). She claims that the terms of Chapter 11 are limited and that tribunals should hold disputants to those express substantive and procedural terms. *Id.* at 186. Thus, "requiring that investors meet those conditions ought to be viewed as essential to the lawful invocation of jurisdiction by Chapter 11 tribunals." *Id.* at 190. While this author agrees with Bjorklund's contention, several tribunals have been willing to ignore procedural flaws in cases and have accepted jurisdiction nonetheless. Therefore, the NAFTA parties must do more than just admonish tribunals to expressly adhere to Chapter 11's provisions to remedy the system's flaws. The NAFTA parties should acknowledge the deficiencies in the present statute and enact further procedural safeguards to prevent future arbitral tribunals from violating vital constitutional guarantees.

126. *Treaty: Democratic Principles Should Not Be Sacrificed to Free Trade: NAFTA Panels Need More Openness*, FORT WORTH STAR-TELEGRAM, Aug. 12, 2001, at 2 [hereinafter *Democratic Principles*].

about the problems giving rise to Chapter 11 disputes, which prevents interested groups from being able to impact the process and help address the underlying problems. Anti-Chapter 11 groups claim that an open arbitration process is essential “to inform the public about how its money is being spent; to safeguard the fairness of the decision-making process; and to reveal whether the government is functioning properly.”¹²⁷ Developing a dispute resolution regime that fosters openness will assist NAFTA tribunals in quelling the dissent among a critical public concerned about potential violations of constitutional guarantees.

A more transparent reporting system is needed so that when a dispute arises, interested parties will be able to gain information concerning the dispute and take part.¹²⁸ Currently, there is no way for such parties to know that an arbitration is in progress. As one observer stated, “[a]lthough Chapter Eleven of the NAFTA establishes a mechanism for the settlement of investment disputes through arbitration tribunals, this process probably will be challenged and the operating framework will need substantial refinement.”¹²⁹ This prediction is coming true in light of the difficulties experienced in the Chapter 11 arbitrations that have taken place to date. Eliminating the secrecy of the entire Chapter 11 dispute resolution process will go a long way toward promoting trust and confidence in the system.¹³⁰

127. *Id.*

128. See Haigh, *supra* note 1, at 133.

129. Rodolpho Sandoval, *Chapter Eleven: Investments Under the North American Free Trade Agreement*, 25 ST. MARY'S L.J. 1195, 1212 (1994).

130. One commentator has argued that the tradition of maintaining confidentiality in international arbitrations “should have no application in the context of NAFTA Chapter 11 arbitral proceedings.” Fulvio Fracassi, *NAFTA Chapter 11: Confidentiality and NAFTA Chapter 11 Arbitrations*, 2 CHI. J. INT'L L. 213, 213 (2001). Fracassi contends that Chapter 11 proceedings are inherently different than typical international arbitrations that occur between two private parties who have contracted to adjudicate their dispute via the arbitral process, often for the express purpose of keeping the proceeding confidential. He points out that “NAFTA is not a private commercial arbitration contract but an international treaty between three sovereign states.” *Id.* at 217. Because Chapter 11 proceedings are between one of the NAFTA parties and a private investor, Chapter 11 “cannot implicitly give rise to an obligation of confidentiality owing to non-parties of the treaty.” *Id.* In fact, the tribunal in the *Metalclad* case ruled that the UNCITRAL or ICSID rules that govern a Chapter 11 proceeding do not expressly restrict one party of an arbitration from making information concerning the arbitration publicly available. *Id.* Despite the fact that some Chapter 11 tribunals have recognized these rules, other tribunals have maintained that confidentiality applies. *Id.* at 218–19. Chapter 11 arbitrations involve challenges to sovereign acts, they have far-reaching public policy ramifi-

In July of 2001, trade ministers from the NAFTA countries met to discuss the NAFTA and issued “clarifications,” thus making claim documents available to the public.¹³¹ While the trade ministers did not make tribunal proceedings themselves open to the public, this new trend toward greater openness is encouraging.¹³² The more open and transparent arbitral tribunals make disclosure of Chapter 11 proceeding, taking into account the need for “confidentiality of proprietary business information,” the easier it will be to meet the concerns of Chapter 11’s critics.¹³³ A system that is open will be considered democratic, and a system that provides all interested parties with a voice will be deemed constitutional and unthreatening to national sovereignty.

C. Definitional Issues

A further point of contention surrounding Chapter 11 concerns the definitions provided within the statute. Critics often turn to the language of Chapter 11 to show how unclear definitions in the Article’s text affect the manner in which it is applied in investment disputes. For the purposes of this discussion, the definitions of “expropriation” in Article 1110 and “national treatment” in Article 1102 will be discussed to illustrate how different interpretations of their meanings can affect the outcome of Chapter 11 cases.

The basic premise of expropriation is that countries may undertake measures in “good faith” and in a “non-discriminatory manner,” but if the result is a loss or diminution in value of an investor’s investment, the country is obligated to pay fair compensation.¹³⁴ This

cations and they have serious implications for the public purse for which governments are accountable to its citizens. For the above mentioned reasons, the NAFTA parties need to consider public policy and issues of public interest when evaluating the level of confidentiality Chapter 11 tribunals should employ. It should be noted, “[c]onfidentiality is not a prerequisite to resolving disputes under NAFTA Chapter 11.” *Id.* at 221. Parties involved in Chapter 11 disputes should have to trade a measure of confidentiality, while still ensuring that proprietary business information is protected, for a more open proceeding simply because of the “far-reaching public policy and monetary implications.” *Id.* This trade-off of openness for the opportunity to have a forum for private investors in which to sue the NAFTA countries seems fair in light of the potential for expensive and debilitating litigation and the ethical and constitutional duty that nations have to keep their citizens informed.

131. See *Democratic Principles*, *supra* note 126, at 2.

132. *Id.*

133. See Sandoval, *supra* note 129, at 1212.

134. See Price, *supra* note 9, at 424–25.

concept is not new in the United States and is embodied by the concept of eminent domain. However, the hard question with expropriation is where to draw the line. Because of its long history in domestic law, the concept of expropriation itself is not controversial, but establishing its outer boundaries has proven to be a very controversial proposition indeed.

In most Chapter 11 arbitrations to date, the claimant has relied on Article 1110, contending that any “measure” undertaken in the host country amounted to an expropriation.¹³⁵ For example, in the *Loewen* case, the claimant maintained that the \$500 million jury award and the \$150 million “coerced” settlement “had the effect of severely infringing and interfering with Loewen’s property rights, and thus were tantamount to expropriation.”¹³⁶ The language, “a measure tantamount to expropriation,” has come under some criticism for lacking an established definition and for expanding the expropriation net far beyond traditional domestic norms. Article 201(1) defines a “measure” as including “any law, regulation, procedure, requirement or practice.”¹³⁷ The tribunal in the *Metalclad* case interpreted this language to include:

[n]ot only open, deliberate and acknowledged takings of property, such as outright seizure or formal or obligatory transfer of title in favour of the host State, but also covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, or the use or reasonably-to-be-expected economic benefit of property even if not necessarily to the obvious benefit of the host state.¹³⁸

This definition allowed the tribunal to find that an expropriation took place when the Mexican government’s actions—or inaction—effectively prevented Metalclad from using the waste disposal facility it built.

David Haigh claims that the drafters of NAFTA intended to create broader expropriation provisions than those normally applied in cases involving compulsory takings. He notes that the language of Article 201(1) suggests that even measures not equivalent to “emi-

135. See Haigh, *supra* note 1, at 126.

136. *Id.* (quoting *Loewen Group Inc. v. United States*, Notice of Claim Under Ch. 11 of the NAFTA, ICSID, Oct. 30, 1998, para. 167).

137. See NAFTA, *supra* note 5, art. 201.

138. *Metalclad*, *supra* note 54, ¶ 103.

ment domain” takings but merely “measure[s] tantamount to expropriations” should come under Chapter 11.¹³⁹ Haigh believes that this added breadth is justified because foreign investors are in a naturally vulnerable position in relation to their host governments and therefore need added protection.¹⁴⁰

The *S.D. Myers* case illustrates how far the expansion of the traditional definition of expropriation can and will be taken, given the unclear definition provided in Chapter 11. In that case, even though the PCB processing and disposal services provided by the claimant were performed in the United States and no evidence supported the claim that Myers’s Canadian affiliate suffered any direct damage from the “measure”—a necessary element to show Ethyl had an “investment” in Canada—the tribunal still found that an expropriation occurred.¹⁴¹ Therefore, without the additional necessary connections to Canada, the U.S. company’s effort to obtain a share of the market in Canada was deemed to be an expropriation.¹⁴²

Ian Laird would read Article 1110(1) literally and interpret it as a no-fault provision.¹⁴³ That is, he would argue that *any* government measure enacted under the guise of its “police powers” should still be compensated regardless of how vital the measure is for national security, health and safety, or any other legitimate government purpose. However, Laird concedes that if the government’s measure affected an investment that posed a serious health and environmental hazard, then “it is unlikely the investor could or would bring a claim, nor would it likely be able to collect any damages.”¹⁴⁴ However, given the broad reading of expropriation, there seems to be little preventing investors from bringing numerous lawsuits based on Article 1110, which could result in a significant strain on the resources of the NAFTA countries forced to defend them.

In the *Loewen* case, the claimant argued that it was not afforded national treatment as mandated by Article 1102. It claimed that the jury trial was biased because the prosecution referred to Loewen as a Canadian company several times during the trial and that, due to this bias, the damages award was excessive. However, one of the jurors in

139. See Haigh, *supra* note 1, at 127–28.

140. *Id.*

141. See BANKRUPTING DEMOCRACY, *supra* note 37, at 17.

142. *Id.*

143. See Laird, *supra* note 102, at 226.

144. *Id.* at 227.

the case stated, “[t]he Loewen group . . . clearly violated every contract it ever had with O’Keefe [the plaintiff] If there was ever an indefensible case, I believe this was it.”¹⁴⁵ In fact, Loewen’s actions were so egregious that it is reasonable to argue that the damages award was based on Loewen’s actions rather than its status. Therefore, the treatment Loewen received was no worse than any other company would have received for committing blatant anti-competitive acts against another American company. Thus, the jury’s actions were arguably in harmony with the standards of national treatment in Article 1102. By holding otherwise, the tribunal in the *Loewen* case broadened the definition of national treatment under Chapter 11, which would prevent domestic courts from making legitimate rulings based on clear evidence.

Articles 1102, 1110, and 201(1) stand as prime examples of the difficulties created by ambiguous and broad language in NAFTA. No one is exactly sure what a “measure tantamount to nationalization or expropriation” really means, and, after the *Loewen* case, no one can be sure what the limits to “national treatment” will be. Unclear definitions open the door for decisions that the drafters of NAFTA never could have envisioned. Most likely the drafters of NAFTA did not intend to allow companies seeking to protect a market share in a foreign country, as was the case in *S.D. Myers*, to be able to invoke Chapter 11’s provisions.

When the NAFTA countries’ trade ministers meet in the future they should take the opportunity to clarify the exact meanings of Articles 1102, 1110, and 201(1) and to issue comments with respect to their definitional limits. By more clearly articulating the definitions of “expropriation” and “national treatment,” and by establishing narrower parameters, the NAFTA’s trade ministers can assist the NAFTA countries in preserving their valuable resources by avoiding vexatious litigation. Narrower definitions will also help minimize the overall number of cases by reducing the risk of meritless cases being brought.¹⁴⁶

145. See *BANKRUPTING DEMOCRACY*, *supra* note 37, at 19.

146. In the fall of 1998, the NAFTA parties agreed that the need existed for an interpretive clause of Chapter 11 limiting the interpretation of “measures tantamount to expropriation” to avoid the difficulties created by cases such as *Loewen* and *S.D. Myers*. See Ana Tschen, *Chapter 11: The Efforts to Define Expropriation*, 8 CURRENTS INT’L TRADE L.J., 50, 51 (1999). The problem with Chapter 11’s definition of expropriation is that a viable definition of what constitutes a “taking” does not exist anywhere in international law. Obviously, determin-

D. Environmental Issues

One of the most contentious Chapter 11 issues concerns the impact of the dispute resolution regime on the environment. Chapter 11's most vociferous opponents are environmental advocacy groups who claim that the investor-to-state dispute resolution provisions allow private corporations to penalize governments for attempting to protect the environment.

Chapter 11 includes certain specific exemptions for health and

ing the definition of a "taking" is simple when a country physically takes over a foreign investor's property. The difficulty comes when a country regulates and the legislation creates an adverse effect on the investor. Thus, distinguishing between valid, noncompensable regulations and inappropriate, compensable takings becomes the key issue. Ana Tschen argues that making such a determination requires consulting the guidelines for interpreting international treaties in Article 31 of the Vienna Convention. *Id.* at 54. The Vienna Convention states that an international treaty should be interpreted by its plain language first and then the ordinary meaning of the language should be adopted. *Id.* Next, the Vienna Convention states in Article 32 that the recollection of negotiation discussions for a treaty may be viewed in order to gain extrinsic interpretations of the language of the statute. *Id.* Tschen believes the working group that is faced with the task of drafting an interpretive note for Chapter 11 should consider the guidelines contained in the Vienna Convention. *Id.* at 55. While Tschen sees no easy solution to the definitional problems in Chapter 11, she argues that an alternative to an amendment of the chapter would be to shift the burden of proof to private investors who would need to demonstrate that the host "government has abused its power with a certain regulation or that the measure is truly expropriative." *Id.* at 56. This procedural change would relieve the governments from having to prove their actions did not amount to an expropriation at the beginning of a claim.

The problem with this solution is that it diminishes the ability of private investors to bring suits against governments, the whole point behind Chapter 11. However, given the difficulties illuminated by many Chapter 11 arbitrations it seems justifiable to scale back the power of private investors to file claims against governments. At the very least, Tschen believes that a case-by-case review of arbitrations should be implemented until arbitrations gain added transparency and a larger body of case law develops to guide future tribunals. *Id.* at 58.

Charles Brower makes the same argument for developing a body of Chapter 11 law in his article, *Investor-State Disputes Under NAFTA: The Empire Strikes Back*. See generally Charles H. Brower II, *Investor-State Disputes Under NAFTA: The Empire Strikes Back*, 40 COLUM. J. TRANSNAT'L L. 43 (2001). In rejecting the view that domestic courts should have the power to exercise what some see as de novo review of arbitral rulings, Brower argues that this level of review will deter the development of international law. Other commentators also maintain that the solution to Chapter 11's problems is to allow parties to arbitrate and to fight to form the law as they see fit. Charles N. Brower & Lee A. Steven, *NAFTA Chapter 11: Who Then Should Judge?: Developing the International Rule of Law Under NAFTA Chapter 11*, 2 CHI. J. INT'L L., 193, 201 (2001). Brower and Steven see the indefiniteness of the law as an opportunity for interested parties to shape the law. *Id.* What this argument and the previous ones fail to consider is the enormous cost associated with creating a body of Chapter 11 law. Private investors are seeking hundreds of millions of dollars in damages, and governments are being forced to spend huge amounts of taxpayers' dollars to defend such suits. While developing a body of law may be helpful in the long term, doing so may not be economically feasible and is certainly not a practical solution.

childcare but does not provide specific exemptions for environmental or safety measures.¹⁴⁷ Article 1110, which deals with expropriation, allows for measures based on a country's police powers that negatively affect investments but still requires the NAFTA country to compensate the affected investors. Article 1114, which relates to environmental measures, states, "[n]othing in this Chapter shall be construed to prevent a Party from adopting, maintaining or enforcing any measure *otherwise consistent with this Chapter* that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental concerns."¹⁴⁸ At first reading, it appears that the drafters gave serious consideration to environmental issues, but on further review, the language of Article 1114 indicates that an environmental measure must first pass the not-amounting-to-an-expropriation standard under Article 1110 before it will be deemed legitimate under Article 1114.¹⁴⁹ Therefore, the language of Article 1114, when considered in conjunction with the broader language of Article 1110, is "largely meaningless," because governments will still be required to compensate investors for any and all environmental legislation that creates a negative effect, regardless of how important the legislation is for the protection of the environment.¹⁵⁰

The *Metalclad*, *Ethyl*, and *S.D. Myers* cases illustrate the potential danger to the environment that flows from allowing private parties to sue governments that attempt to pass environmental legislation. The tribunal in *Ethyl* appeared poised to rule in *Ethyl's* favor despite conflicting evidence regarding the effects of MMT. Because MMT contained a known neurotoxin, it was reasonable for the Canadian government to have been concerned about permitting its use. The danger in such situations lies in waiting for science to catch up with trade before making a determination regarding the safety of a product. If the product proves to be harmful, the government is then justified in curtailing its use through legislation and the investor should be precluded from suing and gaining any monetary damages if its market is suddenly foreclosed.

147. See Paterson, *supra* note 22, at 104.

148. *Id.* at 105 (emphasis added).

149. *Id.*

150. *Id.*

The more difficult issue is in deciding when a government should curtail the use of a *potentially* dangerous product. A government could forbid the use of the product as soon as it learns of its potential danger, but it would then face litigation by negatively affected foreign investors. Alternatively, the government could wait to amass more scientific evidence while hoping that the product is not later found to be dangerous. If the product were found to be harmful, the government would likely be criticized for not acting sooner to curtail use of the product and could then face litigation from its own injured citizens. Under either scenario the government risks substantial liability.¹⁵¹

In *Metalclad*, studies showed that the waste disposal site in question was geographically adequate for waste disposal.¹⁵² However, considering the volatility of the waste and the past record of contamination at the site, it is understandable, if not commendable, that the municipality used caution to protect its citizens. Obviously, there must be a balancing of interests in protecting the environment—on one side, the interests of investors and on the other side, the interests of the government. What environmental advocacy groups claim, however, is that Chapter 11 tips the balance too much in favor of investors and exposes countries and their citizenry to potentially serious health and safety impacts.

151. The *Methanex* case, in which a Canadian company that produces the gasoline additive methyl tertiary butyl ether (MTBE) filed a Chapter 11 claim against the United States because the Governor of California declared a ban on the substance, stands as a prime example of the problems surrounding potentially dangerous products. See Lucien J. Dhooge, *The Revenge of the Trail Smelter: Environmental Regulation as Expropriation Pursuant to the North American Free Trade Agreement*, 38 AM. BUS. L.J. 475, 507 (2001) (citing *Methanex Corp. v. United States*, Notice of Arbitration and Statement of Claim Under Ch. 11 of the NAFTA and the UNCITRAL Arbitration Rules, 2000). In that case, the tribunal found that the research conducted to measure the toxic effects of MTBE on humans was inconclusive. One problem with the lack of discernible results is that the federal government of the United States has done minimal research on the subject. Only MTBE levels several thousand times those found currently in limited California water sources caused “chronic neurologic” effects in humans. *Id.* at 506. However, high levels of the substance caused cancer in laboratory testing of rats and mice. While the tribunal found the executive order to be an overreaction to incomplete evidence, the State of California still finds itself in the unenviable position of hoping that further MTBE research does not reveal more serious effects in humans. This case illustrates how difficult it can be for local and state governments to pursue the appropriate course of action in dealing with potentially dangerous products. If governments regulate too much, they face expensive litigation from foreign investors. If governments regulate too little, they face enormous potential liability and even more serious litigation in the future from injured citizens.

152. See *Metalclad*, *supra* note 54, ¶ 44.

Article 1114 stands as a provision that seems meaningless when read in conjunction with Article 1110. It is likely that the drafters did not foresee the debilitating effects of the language they chose, and they should therefore amend the provision to give it some “teeth” in protecting the environment.

The majority of commentators addressing the issue of the environment have concluded that something more must be done to protect it.¹⁵³ Coming to a consensus on what exactly must be done is not easy. As the preceding sections also indicated, many commentators mention drafting an interpretive note to clarify the meaning of Articles 1114 and 1110 as a possible remedy to environmental problems.¹⁵⁴ However, given the environmental issues involved, any clarifications that the NAFTA parties successfully draft may not necessarily remedy the problem. Because enormous amounts of money are at stake in disputes involving the environment, any clarifications of the agreement will be subject to strict scrutiny by disgruntled investors and unexpected loopholes may be found. However, given the controversy surrounding Articles 1110 and 1114, issuing an interpretive note may be the quickest way to find some kind of preliminary solution.

One author suggests that if investors were better able to forecast environmental measures, they could factor in the added environmental costs to their investment decision.¹⁵⁵ Therefore, national and

153. See Dhooge, *supra* note 151, at 475; Lucien J. Dhooge, *The North American Free Trade Agreement and the Environment: The Lessons of Metalclad Corporation v. United Mexican States*, 10 MINN. J. GLOBAL TRADE 209, 209 (2001); Mark Vallianatos, Comment, *Exceptions and Conditions: De-Fanging the MAI*, 31 CORNELL INT'L L.J. 713 (1998); Daniel R. Loritz, *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, 533 (2000); 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 (1999); Julia Ferguson, Note & Comment, *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, 499 (2000); David A. Ganz, *Global Trade Issues in the New Millennium: Potential Conflicts Between Investors Rights and Environmental Regulation Under NAFTA's Chapter 11*, 33 GEO. WASH. INT'L L. REV. 651 (2001); Gaetan Verhoosel, *Foreign Direct Investment and Legal Constraints on Domestic Environmental Policies: Striking a "Reasonable" Balance between Stability and Change*, 29 LAW & POL'Y INT'L BUS. 451, 451 (1998); J. Martin Wagner, *Nature Beyond the Nation State Symposium: International Investment, Expropriation and Environmental Protection*, 29 GOLDEN GATE U. L. REV. 465, 465 (1999).

154. See Ferguson, *supra* note 153, at 517; Dhooge, *The North American Free Trade Agreement*, *supra* note 153, at 285–88; Dhooge, *supra* note 151, at 554.

155. See Verhoosel, *supra* note 153, at 478.

local governments should develop “environmental policy plans” covering a period of perhaps five or more years that investors could rely on in making their investment decisions.¹⁵⁶ The problem with this solution is that government administrations often change and such “environmental policy plans” could become subject to political maneuvering. In addition, environmental conditions might change during the course of an agreement and create compliance problems for the government.

A further proposed solution to environmental protection problems is to impose certain preliminary procedures—called “gatekeeper” provisions—that an investor must satisfy before continuing with a full arbitration.¹⁵⁷ Again, this solution undermines Chapter 11’s provisions as they stand presently. But as with the other issues presented in this discussion, there may be no other way to effectively deal with environmental protection issues other than to scale-back private investors’ power with specific preliminary or “gatekeeper” provisions.

V. CONCLUSION

Notwithstanding its defects, NAFTA’s Chapter 11 stands as a bold step to meet the lofty goals articulated in Article 102 and the preamble of the NAFTA Agreement.¹⁵⁸ While Chapter 11 has the potential to be used by investors as a “sword,” rather than the “shield” it was intended to be, recent efforts to open up the dispute resolution process signal a favorable trend. Chapter 11 critics should continue to press for more openness in and accessibility to the system in order to protect against potential problems affecting national sovereignty, constitutional guarantees, and environmental protection. In this manner, governments can feel secure that their ability to govern effectively will not be hindered by foreign investors bent on bringing costly and unwarranted litigation.

On the other hand, by relying on well-established international norms for investment, investors can depend on Chapter 11 to provide a viable forum in which to redress their grievances without having to rely on their home governments. A clarification of definitions

156. *See id.*

157. *See* Byrne, *supra* note 97, at 433; Dhooge, *The North American Free Trade Agreement*, *supra* note 153, at 284.

158. *See supra* note 5.

to troublesome articles in Chapter 11 would solve many of the ambiguities that have arisen regarding the appropriate scope of these provisions. Furthermore, procedural safeguards added to the Chapter 11 arbitration process would aid in the prevention of vexatious litigations and meritless claims. The drafters of NAFTA would do well to address the problems that the arbitral tribunals of the *Metalclad*, *Ethyl*, *Loewen*, and *S.D. Myers* cases have both uncovered and created and to amend the provisions where improvement and clarification is needed. By doing so, NAFTA countries will be less likely to feel a threat towards their sovereignty or constitutions, foreign investors will have well-defined norms to guide valid claims against host governments, and environmental groups will be assured of a higher level of protection for the environment.

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