

NAFTA Investment Arbitration and the Growth of International Economic Law

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Investor-state arbitration under the North American Free Trade Agreement (NAFTA) has attracted a considerable amount of political attention over the past few years, primarily from labour unions, environmental organisations, nationalists, and anti-globalisation protestors. Oddly enough, all this attention has been generated over what amounts to 'less than a handful of cases,' only one of which has resulted in an order for a NAFTA government to pay compensation to an aggrieved investor.¹ So much attention has been paid to the phantoms and foibles of investor-state arbitration² that its very purpose appears to have been overlooked by both its opponents and the governments that originally agreed to its placement in the NAFTA.

The primary purpose of investor-state arbitration is to provide investors with a secure and predictable atmosphere for their foreign investments. This security is provided in addition to whatever comfort can be found in the investor's relationship with the host government, whatever system of laws is currently in place in the host country, and whatever experience the investor has had in that country. The availability of arbitration only provides a foreign investor with what often amounts to a last chance remedy (because it can be a costly³ and time-consuming process), but it is a remedy that can prove invaluable in time of need.

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All of the available awards and orders issued by every single NAFTA tribunal can be found at the following web site, <www.naftalaw.org>. While very few awards have been published to date, every case cited in the remainder of this paper can be found on the aforementioned web site.

however, two more tribunals have issued interim awards against Canada, for which damages hearings have been held, and final awards may be expected in the near future. These are *Re S.D. Myers, Inc. and the Government of Canada* (hereafter Myers) and *Pope & Talbot, Inc. and the Government of Canada* (hereafter Pope). No merits awards have been made in respect of claims against the United States, although one tribunal has issued an interim award on jurisdiction that did not go in the U.S.'s favour: *Re Raymond Loewen and Loewen Corp. and the Government of the United States of America* (hereafter Loewen).

These "phantoms" are primarily based upon the argument that the "sovereignty" of a government is greatly impaired by the very existence of investor-state arbitration, as well as WTO state-to-state arbitration. The former scenario is considered more offensive because the arbitration is brought, and managed, by a private party rather than a government actor. Of course, WTO arbitration is often brought at the behest of private interests but control of the litigation nonetheless rests in the hands of government lawyers. It is, of course, axiomatic that all international obligations represent an impingement upon state sovereignty. The real question is whether such sovereignty (or perhaps discretion) is being exercised in a beneficial or appropriate manner (where "beneficial" and "efficient" are adjectives that describe global-welfare-maximising activities), as opposed to an arbitrary or discriminatory manner (i.e. economically inefficient or suboptimal-regulatory activity).

¹In addition to having to pay its lawyers and the tribunal members, and the associated costs of litigation, the foreign investor must also evaluate the political cost of formally challenging a government over any particular dispute (considering the value of the overall investment, the likelihood of regulatory retaliation, and the potential for future investments in the host country).

While this remedy has been around for decades, its inclusion in an agreement that includes Canada and the United States (the world's two largest trading and investment partners) has transformed the potential for its use. Investment arbitration was once "bilateral" in name only, because while the obligations flowed both ways between treaty partners, investment generally only ever flowed from developed to developing countries. Accordingly, officials from developed countries really never needed to worry whether their own regulatory systems would meet the standards imposed by these obligations, because there were no investors to sue them. With investment obligations now in place between developed countries (in the NAFTA, and in the Energy Charter), and with investment flows increasing in all directions (i.e. from formerly less developed to relatively more developed countries), investment arbitration is beginning to take on more importance for businesses worldwide, as it provides them with a mechanism to address problems themselves, without a need for their home states to act as intermediaries in international disputes.

The purpose of this paper is to demonstrate how the five most important obligations contained within NAFTA Chapter 11 (and the hundreds of other bilateral investment treaties (BITS) existing in the world today) can be used to obtain compensation for harmful government conduct and thus provide greater security for foreign investment. First, it will briefly outline how the development of these obligations represents a form of global, jurisprudential phenomenon. Secondly, it will analyse how these obligations have been treated so far by NAFTA tribunals. Finally, it will explain how some of the officials who originally brought investment arbitration into existence in North America are now trying to curtail its growth, why they are doing so, and why they are unlikely to be successful in their efforts.

The Emerging Jurisprudence of International Economic Law

While it is too early in the life of the NAFTA to be making definitive statements about what its substantive investment obligations may mean, there have been enough cases to provide an indication of how the law appears to be developing. It may also be noted that the "law" itself is not as "new" as some would believe. The NAFTA's drafters liberally employed concepts such as "national treatment", "most favoured nation treatment", "international law" and "transparency" in their work. Each of these terms possesses a long tradition of consideration by international tribunals and usage in international economic treaties. As the concepts expressed in these terms are not new, their usage in the NAFTA and other BITS provides an opportunity for the articulation of a unified body of international economic law. To the extent that such a jurisprudential project can be undertaken, the result would be even greater security for foreign investors and their investments, as the use of such terms would attract a more universally understood meaning.

Although there is no formal rule of precedent in international investment arbitration, it is not unusual for one tribunal to find guidance or support in the award of another,⁵ particularly if the original tribunal was composed of jurists of notable repute, or if their reasoning was of such a high quality so as to deserve such recognition by later tribunals.⁶

See, e.g., Separate Concurring Opinion of Professor Brian Schwartz, Myers, supra, n. 2, at para 70 (hereafter Myers, Schwartz Opinion).

It should be noted that so far all NAFTA tribunals have been staffed by jurists of the highest, calibre, including eminent leaders in the fields of international law, diplomacy and international arbitration. Accordingly, the decisions being made by these early tribunals are bound to have at least some impact upon the deliberations of future tribunals.

It should therefore come as no surprise that NAFTA tribunals are being provided with more and more GATT 1947 and WTO jurisprudence from the disputing parties, and addressing the reasoning from these panel reports in their own awards. While there may be less chance of investment arbitration awards being cited by WTO panels (given the more closed character of the WTO legal system),¹ we may nonetheless be witnessing the nascent stages of a phenomenon that may be characterised as the jurisprudence of "international economic law"

To the extent that this common jurisprudence can be utilised more readily by more lawyers, the promise of security for foreign investment could be considerably enhanced. The promise of such a development would be improved through the implementation of additional investment agreements between developed countries, or a single multilateral investment agreement, but there are enough agreements already in place for a transnational corporation to contemplate arranging its affairs in a way that leaves arbitration as an option when it would be considered beneficial to do so. For the time being, North America will likely be seen as the petri dish for the emerging jurisprudential phenomenon.

The NAFTA

Modelled upon the United States Model BIT, NAFTA Chapter 11 contains the key obligations that can be found in virtually any BIT. The NAFTA delivers these five obligations in five separate provisions, although they can sometimes be found in combined form in various BITS. Four of these obligations have received consideration in the NAFTA awards that have been made thus far. Fortunately, the analysis used for the fifth obligation, most favoured nation (MFN) treatment, is theoretically identical to the national treatment obligation² and therefore lessons learned about the latter should be instructive in consideration of the former.

Not every North American investor is entitled to launch an arbitration against a NAFTA government. The only investors who are eligible to use the Chapter 11 process are those with investments in one of the other two NAFTA countries, and their claim can only be made for losses they experienced as a result of the breach of one of Chapter 11's investment obligations.³ Following the U.S. BIT Model, the definition of "investment" in NAFTA Chapter 11 is very broad, covering virtually any form of business activity in another NAFTA Party.⁴

For eligible NAFTA investors, the five most promising substantive obligations are (1) compensation for expropriation, (2) freedom from imposition of performance

¹ Article 3 of the WTO Dispute Settlement Understanding dictates how WTO Members are to resolve their disputes concerning interpretation of the covered agreements, stating that such interpretation should be limited only to the dispute at hand, and implying that such interpretation should be limited specifically to the covered texts.

² The only key difference is that with the MFN obligation, the treatment being received by the foreign investor is compared with that being received by another foreigner, whereas the national treatment obligation requires a comparison to be drawn between treatment received by the foreigner and the treatment being received by its domestic competitor.

³ See NAFTA Art. 1116, which entitles investors to make claims for loss or damage arising out of a breach of NAFTA Chapter 11 obligations with respect to treatment that they or their investment received at the hands of another NAFTA Party. NAFTA Art. 1117 is also available for investors who need to bring claims on behalf of their investment in another NAFTA party (for example, where an investment taking the form of a business enterprise was acquired after the breach had already occurred, meaning that the investor would not be entitled to recover any damages on its own behalf). See NAFTA Art. 1139.

requirements, (3) MFN treatment, (4) national treatment, and (5) treatment in accordance with international law. Each will be reviewed below (in reverse order of importance).

(1) NAFTA Article 1110: Compensation for Expropriation

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

NAFTA Article 1110 has been considered and commented upon by four tribunals thus far. This obligation has garnered the lion's share of attention from academics and critics alike, despite the fact that it is actually the least relevant for purposes of providing security for foreign investment. The reason that NAFTA Article 1110 has been given so much attention was the very notion that a foreign investor could obtain compensation for the imposition of regulation by a NAFTA government (owing, perhaps, to the fact that the domestic legal regimes of each NAFTA country differ markedly in terms of protection from expropriation). The reason that NAFTA Article 1110 is not particularly important for most investment disputes is that it is not common for the effects of a government measure to rise to the level of an expropriation under international law.

Of the four tribunals that have considered NAFTA Article 1110, only one made a finding of breach.⁵ In *Azinian*, the claimants attempted to argue that the abrogation of a contract between themselves and a Mexican municipality, by municipal officials, somehow constituted an expropriation of their "investment" in Mexico. The tribunal made such short order of the claim that its decision is of little theoretical jurisprudential value. The tribunal concluded that the municipal officials essentially had every right to abrogate the contract, which the claimants apparently were completely incapable of fulfilling. Accordingly, the tribunal never provided any useful analysis of NAFTA Article 1110. In fact, the one paragraph for which this award will probably be remembered is some obiter dicta that will likely be included (at least in part) in the written arguments of every government, regardless of the particulars of the claim:

"To put it another way, a foreign investor entitled in principle to protection under NAFTA may enter into contractual relations with a public authority, and may suffer breach by that authority, and still not be in a position to state a claim *under NAFTA*. It is a fact of life everywhere that individuals may be disappointed in their dealings with public authorities, and disappointed yet again when national courts reject their complaints. It may be safely assumed that many Mexican parties can be found who had business dealings with governmental entities which were not to their satisfaction. Mexico is unlikely to be different from other countries in this respect. NAFTA was not intended to provide foreign investors with blanket protection from this kind of disappointment, and nothing in its terms so provides."⁶

⁵ The four tribunals, in order of publication, were *Re Robert Azinian and the Government of the United Mexican States* (hereafter *Azinian*), *Pope*, supra, n. 2, *Re Metalclad Corp. and the Government of the United Mexican States* (hereafter *Metalclad*); and *Myers*, supra, n. 2. *Azinian Award*, *ibid*, at para. 83.

The next tribunal to consider an expropriation also dismissed the complaint, but not without tackling the most important elements of the NAFTA's expropriation obligation. First, the Pope tribunal concluded that the definition of expropriation in the NAFTA, which included reference to both direct and indirect expropriations, as well as something called acts "tantamount to expropriation", did not expand the scope of the obligation from that which is required under customary international law. The expropriation obligation includes direct confiscation as well as indirect, or "creeping," expropriations of investments. Unless the degree of government interference with an investment is sufficiently "substantial," a finding of expropriation will not be made. Substantial interference involves the kind of deprivation that would lead a tribunal to conclude that the investor has lost its ability to use, enjoy or dispose of an investment, whether it has been effectively confiscated or not. 1 3

The Pope tribunal's award should have provided considerable comfort to those who were concerned that the term "measure tantamount to expropriation" could be interpreted so as to include lesser forms of regulatory interference within the obligation to provide compensation." However, the award also contained a conclusion that appears to have foreclosed upon a popular argument for limiting application of the expropriation obligation: the so-called "police powers" exemption.

"Canada appears to claim that, because the measures under consideration are cast in the form of regulations, they constitute an exercise of "police powers," which, if non-discriminatory, are supposedly beyond the reach of NAFTA rules regarding expropriations. While the exercise of police powers must be exercised with special care, the Tribunal believes that Canada's formulation goes too far. Regulations can indeed be exercised in a way that would constitute creeping expropriation Indeed, much creeping expropriation could be conducted by regulation, and a blanket exception for regulatory measures would create a gaping loophole in international protections against expropriation. " 15

The police powers defence actually could have been rejected by the tribunal on a simple, textual basis. NAFTA Article 11 10(1) provides that expropriations are only allowed when they are (a) for a public purpose, (b) non-discriminatory, (c) in accordance with due process of law and NAFTA Article 1105 (discussed below), and include payment of compensation pursuant to the remainder of Article 1110. If the "and" in Article 110(1)(c) was an "or", the proponents of the police power defence would have a very strong basis for their arguments. But it does say "and", and so even if an expropriation is taken for a public purpose, is non-discriminatory and otherwise fair in all respects, compensation must nonetheless be paid.

The only questions that remain of particular interest for future cases are how to define the "investment" that is protected under NAFTA Article 1 110 and how the "substantial interference" test will be applied. While the *Metalclad* tribunal is the only one to have actually found a breach of NAFTA Article 1110, it dealt with what may be called a "garden variety" expropriation. The two measures in question were found clearly discriminatory and imposed in violation of NAFTA Article 1105. They rendered a newly built waste treatment facility, maintained by the wholly-owned subsidiary of a U.S. investor, totally and permanently inutile. For its part, the only guidance that the Myers

See Pope *Interim Merits Award*, *supra*, n. 2, at paras 101-02.
ibid., at paras 103-104.
ibid., at para. 99

tribunal definitely provided was that the substantial-interference test contains a temporal element. In that case, the measure was only in effect for sixteen months, and accordingly did not appear to have the degree of permanence necessary to constitute an expropriation.

On the issue of the kinds of investment covered under the NAFTA's expropriation obligation, the Pope tribunal initially appears to have provided a striking conclusion that "access to market is a property interest subject to protection under Article 1110".¹⁶ Does this mean that any individual from one country who enjoys "access" to the market of another country can make a claim for expropriation if that "access" is deprived? The Pope tribunal was certainly not dealing with such a claim. The investor had a wholly-owned subsidiary in Canada. The measure was a voluntary export restraint mechanism that hindered the subsidiary's ability to carry on its business, which was based upon exporting lumber to the United States. This was not a case of an American investor suing Canada because it could not export goods into Canada:

"Canada claims that the ability to sell lumber to the US market is an investment within the meaning of NAFTA. Article 1139(g) defines investment to include, among other things, "property, tangible or intangible, acquired in the expectation or used for the purpose of economic benefit or other business purposes." While Canada suggests that the ability to sell softwood lumber from British Columbia to the U.S. is an abstraction, it is, in fact, a very important part of the "business" of the investment. Interference with that business would necessarily have an adverse effect on the property that the Investor has acquired in Canada, which, of course, constitutes the investment. While Canada's focus on the "access to the U.S. market" may reflect only the Investor's own terminology, that terminology should not mask the fact that the true interests at stake are the investment's asset base, the value of which is largely dependent on its export business. "

This finding is of particular interest because it remains somewhat unclear whether the tribunal was suggesting that for the investment that must be the subject of an Article 1110 claim must be the entire business of an investor in the host country or merely an element of it. If it is the entire business that must be taken under the measure, the test of substantial interference will provide an insurmountable obstacle to larger transnational investors with significant investments in the host country. If the "investment" being expropriated can be defined more discreetly, it will be possible for investors with both large and small businesses in the host country to use Article 1 110 as required.' It is submitted that only the latter interpretation is acceptable, given the myriad kinds of "investment" contemplated under the NAFTA Article 1 139 definition, and the fact that the alternative interpretation would simply penalize investors who have decided to make a more serious commitment to investing in the host territory.¹⁹

ibid., at para 96.

ibid., at paras 97-98.

There are other ways to more narrowly delineate the sorts of "investment" that could be made subject to an expropriation. For example, if the expropriatory measure is imposed by a local government, it would only seem appropriate that the scope of the "investment" being affected by the measure would be limited by the territorial jurisdiction of the government that imposed the measure. This would mean that a local measure that banned access to that local market for a large, foreign-owned business could constitute an "expropriation" within the meaning of NAFTA Art. 1 110. And therefore contradict the NAFTA's art 102(1) objective of substantially increasing investment opportunities in the North American Free Trade Area.

(2) *NAFTA Article 1106: The Prohibition of Performance Requirements*

1. No Party may impose or enforce any of the following requirements, or enforce any commitment or undertaking, in connection with the establishment, acquisition, expansion, management, conduct or operation of an investment of an investor of a Party or of a non-Party in its territory:
 - (a) to export a given level or percentage of goods or services;
 - (b) to achieve a given level or percentage of domestic content;
 - (c) to purchase, use or accord a preference to goods produced or services provided in its territory, or to purchase goods or services from persons in its territory;
 - (d) to relate in any way the volume or value of imports to the volume or value of exports or to the amount of foreign exchange inflows associated with such investment;
 - (e) to restrict sales of goods or services in its territory that such investment produces or provides by relating such sales in any way to the volume or value of its exports or foreign exchange earnings.

3. No Party may condition the receipt or continued receipt of an advantage, in connection with an investment in its territory of an investor of a Party or of a non-Party, on compliance with any of the following requirements.
 - (a) to achieve a given level or percentage of domestic content;
 - (b) to purchase, use or accord a preference to goods produced in its territory, or to purchase goods from producers in its territory;
 - (c) to relate in any way the volume or value of imports to the volume or value of exports or to the amount of foreign exchange inflows associated with such investment; or
 - (d) to restrict sales of goods or services in its territory that such investment produces or provides by relating such sales in any way to the volume or value of its exports or foreign exchange earnings.

4. Nothing in paragraph 3 shall be construed to prevent a Party from conditioning the receipt or continued receipt of an advantage, in connection with an investment in its territory of an investor of a Party or of a non-Party, on compliance with a requirement to locate production, provide a service, train or employ workers, construct or expand particular facilities, or carry out research and development, in its territory.

5. Paragraphs 1 and 3 do not apply to any requirement other than the requirements set out in those paragraphs.

6. Provided that such measures are not applied in an arbitrary or unjustifiable manner, or do not constitute a disguised restriction on international trade or investment, nothing in paragraph 1(b) or (c) or 3(a) or (b) shall be construed to prevent any Party from adopting or maintaining measures, including environmental measures:
 - (a) necessary to secure compliance with laws and regulations that are not inconsistent with the provisions of this Agreement;
 - (b) necessary to protect human, animal or plant life or health; or

- (c) necessary for the conservation of living or non-living exhaustible natural resources.

Only two tribunals have considered NAFTA Article 1106, and only one of the six arbitrators who have been presented with this opportunity has concluded that the provision was actually breached. Article 1106 is a complicated provision, largely prohibiting the kinds of requirements that were once commonly imposed upon investments by national governments in developing countries.

Performance requirements have traditionally been included in U.S. BITS in order to prevent host governments from imposing requirements on the establishment or operation of investments that could dilute the value of the investment. Investment value would be weakened because these additional requirements, such as requirements to purchase or use local goods or services, impair an investor's ability to make the most efficient economic decisions in order to maximize its value.²⁰ Article 1106 prohibits two types of requirements: those that are imposed as a mandatory requirement on investments (Article 1106(1)) and those that are imposed in connection with the granting of a benefit. (Article 1106(3)).

It has been argued by Canada, in defence of the only two Article 1106 claims made so far, that its measures were never contemplated within the scope NAFTA Article 1106. Canada has argued that Article 1106 was only meant to encompass measures historically imposed by the governments of less-developed, capital-importing countries to maintain trade flows or promote local industrial development. Investors have countered that trade barriers are still trade barriers, regardless of whether they are being imposed by a government with an economically developed economy.

(a) Performance Requirement Example No. 1: Assigning Export Levels under Article 1106(1)(a)

When faced with the complex and arcane language of NAFTA Article 1106, however, tribunals have so far dismissed the investors' arguments. This is not to say that Canada has been successful in convincing these tribunals that the prohibition against performance requirements should be treated as an obsolete obligation. For example, the Pope tribunal has ruled that while historically the aim of Article 1106(1)(a) may have been to raise foreign exchange earnings by requiring a higher level of exports from the investment than the market might otherwise dictate, the provision could equally be used against the imposition of a voluntary export restraint mechanism (whose aim could be to limit exports rather than require them). In the Pope claim, the purpose of Canada's measure was to forestall the threatened use of U.S. trade remedy laws by U.S. lumber producers. The measure imposed a sliding scale of export taxes on lumber exports, ensuring that less Canadian lumber would be exported into the American market unless the price of lumber was so high that the U.S. competitors would nonetheless be satisfied.

Other examples include trade-balancing requirements (i.e. tying domestic sales levels to export levels) or requirements that stipulate a particular level at which the investment is obliged to export its products (traditionally, but not exclusively, used to set a minimum level for exports). Pope Interim Merits Award, *supra*, n 2, at para 74. See also Myers, Schwartz Opinion, *supra*, n. 5, at para. 192, noting that a NAFTA tribunal must look at both form and substance in concluding whether a performance requirement has been wrongly imposed upon an investment.

Voluntary export restraints are generally prohibited under multilateral trade agreements such as the NAFTA and WTO. "This prohibition stems from the basic economic fact that export restraints lead to sub-optimal economic outcomes for consumers in both the importing and the exporting country. They are difficult to discourage because they provide governments with an opportunity to settle messy trade disputes involving powerful domestic political interests by spreading the negative economic impacts of their compromise measures among the general population. Although export restraints are clearly deleterious for global economic welfare, the state-to-state nature of the WTO process militates against anyone being able to step forward and represent the interests of consumers by discouraging their use. The result is that certain members of a society profit from the economic rents generated under an export or import quota regime agreed upon by two governments at the expense of society at large, and with no practicable means of remedying the situation.²³

NAFTA Article 1 106(1)(a) stipulates that no NAFTA party may impose a requirement "to export a given level or percentage of goods or services" in connection "with the establishment, acquisition, expansion, management, conduct or operation of an investment of an investor of a Party or of a non-Party in its territory". Export quota regimes often assign levels specifically tailored to the output of individual firms. As such, these regimes clearly fall within the ambit of this provision, regardless of whether this type of measure was exactly what certain people had in mind when the text was drafted. If the measure assigns a level for exports by affected investments, causing investors and investments to alter their production and management decision making, and suffer significant losses, it should fall into NAFTA Article 1106(1)(a).²⁴

It may therefore appear surprising that the Pope tribunal did not make a finding of breach. The primary reason that the tribunal did not conclude that there was an Article 1 106 breach appears to be because it was dealing with a hybrid measure that did not actually set hard quota levels for each producer. Under Canada's export control measure, producers with historical export records were assigned an export level below which they could ship their lumber without paying any export taxes. They would only be forced to pay punitive taxes if they exceeded this quota in any given quota, but they could nonetheless continue to export their lumber (if the market price and economics of production dictated that they should do so). Accordingly, the tribunal concluded, and the investor agreed, that the measure bestowed a benefit on producers, such as the investment, who were assigned some share of the "fee free" export quota.

The Pope tribunal concluded that since Canada imposed its export performance requirement in connection with bestowing a benefit on the investment, there was no breach of Article 1 106(1)(a). If Article 1106(3) also listed the export performance

requirement as being prohibited in connection with the bestowing of a benefit, there could have been a breach.²⁵ The problem with this analysis is that it can hardly be considered a benefit for a firm to be forced to comply with an export restraint mechanism in the first place. While producers with historic patterns of U.S. export sales were comparatively better off under the regime than those who were given no "fee free" quota, the question of whether something constitutes a benefit should be seen from the perspective of a world where no such measure exists. The tribunal's analysis assumed the existence of the export restraint mechanism as a neutral, exogenous factor, thereby contaminating its "but for" world.

(b) Performance Requirement Example No. 2: Local Content: Articles 1106(1)(b) and (c)

The *Azinian* claim was not the first NAFTA complaint to be brought to arbitration. It was only the first to result in a final award. The first arbitration, the first substantive award, and the first settlement all belong to the case of *Re Ethyl Corp. and the Government of Canada*.²⁶ The first substantive award was the tribunal's decision on jurisdiction and other preliminary issues, which Canada lost. Canada settled with Ethyl in 1998, paying approximately CDN\$20,000,000 and withdrawing its measure.²⁷ While the Ethyl claim has always been regarded as an expropriation claim, it is just as likely that it would have been decided as an Article 1106 claim. With its measure, Canada banned the trade in a gasoline additive, MMT, across its border, and across the borders of each province. The world's sole producer of MMT, Ethyl, was still entitled under the measure to establish manufacturing facilities in each and every single province of Canada in order to sell its product. MMT was only barred from being traded across national or provincial borders. Ethyl had been doing business in Canada through a wholly-owned subsidiary that imported its MMT from the United States for sales and distribution in Canada.

Under NAFTA Article 11 06(1)(c), the NAFTA governments are obligated not to impose a requirement "to purchase, use or accord a preference to goods produced or services provided in its territory, or to purchase goods or services from persons in its territory". While it is true that Canada's measure, on its face, did not specifically require Ethyl to use or purchase anything in Canada, the fact remains that if Ethyl wanted to continue carrying on its business in Canada it would have to build manufacturing facilities in each of the provinces in which it desired to continue to do business (which, as a matter of necessity, would require the consumption of at least some amount of domestic goods and services). If it was not a de facto performance requirement, Canada's measure alternatively must have had the character of a measure tantamount to expropriation. Ethyl was essentially faced with a stark choice: either comply with the measure and start manufacturing MMT in each province of Canada, or stop importing and selling the product altogether.

Since Canada settled Ethyl's claim for compensation, we will never know whether an investor-state tribunal would have concluded that the measure constituted a performance requirement under NAFTA Article 1 106(1)(c). However, in a recent decision by a WTO

See, e.g., Art. 14 of the WTO Agreement on Subsidies and Countervailing Measures, Art. XI of the GATT and Arts 309 and 314 of the NAFTA.

See, generally, John H. Jackson, *The Jurisprudence of GATT & the WTO: Insights on Treaty Law and Economic Relations* (New York, Cambridge U. Press, 2000), pp. 69-86.

When governments impose measures that restrain the normal business decision making of an investment for the sake of some narrow domestic interest or other policy goal, should the investor not be entitled to be compensated for its loss? The NAFTA investor-state claim would appear to be the perfect antidote for investors who find themselves disadvantaged by the imposition of export restraints by governments in order to placate more powerful private interests in another country, despite the fact that their actions constitute a violation of various obligations under the WTO. While investor-state arbitration under such circumstances would not directly benefit affected consumers, it is nonetheless possible that after being made to pay compensation for imposing such measures in the past, governments may think twice about imposing them in the future.

²⁵ Pope Interim Merits Award, supra, n. 2, at paras 71-75; *Re Ethyl Corp. and Government of Canada*; Award on Jurisdiction (June 24, 1998), 38 LL.M 708 (1999) (hereafter *Ethyl*).

²⁶ The settlement came almost immediately after the Government of Canada lost a preliminary motion it brought concerning the tribunal's jurisdiction to entertain the claim. While government lawyers have publicly criticized the tribunal's award at various Canadian Bar Association seminars, it is submitted that the award speaks for itself as an eminently sensible and wholly justifiable decision.

panel concerned with a Canadian measure that also had the character of a trade-related investment measure, the panel determined (at least with respect to its analysis under GATT Article III) that the meaning of requirement was necessarily broad:

"The word requirements in its ordinary meaning and in light of its context in Article III:4 clearly implies government action involving a demand, request or the imposition of a condition, but in our view, this term does not carry a particular connection with respect to the legal form in which such government action is taken. In this respect, we consider that in applying the concept to "requirements" in Article III:4 to situations involving actions by private parties, it is necessary to take into account that there is a broad variety of forms of government of action that can be effective in influencing the conduct of private parties."

This interpretation of "requirement" is clearly in accord with the trade and investment liberalization objectives of the NAFTA and confirms the basic theory of NAFTA Article 1106 that measures which unnecessarily generate economic uncertainty for transnational investment and market distortion are generally to be eschewed by the parties to the NAFTA.²⁹ The focus of analysis under NAFTA Article 1106, accordingly, is on the economic decision making of individual firms. To the extent that the "establishment, acquisition, expansion, management, conduct or operation" of an investment is impeded by a measure that has the character or the effect of a requirement listed in NAFTA Article 1106, compensation must be paid to NAFTA investors for losses arising from its imposition.

The Myers tribunal was presented with a reasonably similar type of measure. Instead of banning the importation of MMT to interfere with the investment's business of importing MMT for distribution and sale in Canada, Canada imposed an export ban on PCB wastes to interfere with the investment's business of exporting those wastes for final destruction in the United States. In both cases, there was a pre-existing business that relied upon the freedom of cross-border trade in goods to execute its business model. In each case Canadian government officials claimed that their measures were not discriminatory because the investment was welcome to alter its business model so as to undertake all steps of production in Canada.

Dr. Schwartz, Myers' appointee to the tribunal, concluded that "the practical effect" of Canada's PCB export ban was to effectively require Myers' Canadian subsidiary to achieve a certain level of Canadian content in its business activity, i.e. to ensure that the physical disposal of all wastes took place in Canada. He concluded that this de facto regulatory requirement violated Article 1106(1)(b).³⁰ He further postulated that because the export ban would have required Myers' investment to build a facility in Canada, local goods and services would have likely been required in violation of Article 1106(1)(c), but did not make the finding in the interests of judicial economy and because of a lack of specific evidence on that point.³¹

Canada-Measures Affecting the Automotive Industry WT/DS139, 142/R, 11 February 2000, para. 10.107.

²⁹ The Pope tribunal did not address these GATT panel decisions in its Award, when it concluded that Canada's hybrid export restraint mechanism did not impose a "requirement" within the terms of NAFTA Art. 1106(1)(a).

³⁰ Myers, Schwartz Opinion, supra, n 5, paras 192-94.

³¹ Myers, Schwartz Opinion, ibid., para. 197.

The majority of the Myers tribunal, however, did not agree with Dr. Schwartz's analysis. They concluded that even though a tribunal must consider matters of both form and substance, they could not be satisfied with finding an Article 1106 breach where the measure did not specifically stipulate any one of the seven requirements prohibited by Article 1106.32 Accordingly, the usefulness of NAFTA Article 1106 as a means of providing security for foreign investors in the modern regulatory context remains somewhat in doubt.

(3) NAFTA Articles 1102 and 1103: National Treatment and MFN Treatment

Article 1102: National Treatment

1. Each Party shall accord to investors of another Party treatment no less favorable than that it accords, in like circumstances, to its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.
2. Each Party shall accord to investments of investors of another Party treatment no less favorable than that it accords, in like circumstances, to investments of its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.
3. The treatment accorded by a Party under paragraphs 1 and 2 means, with respect to a state or province, treatment no less favorable than the most favorable treatment accorded, in like circumstances, by that state or province to investors, and to investments of investors, of the Party of which it forms a part.

Article 1103 : Most-Favored-Nation Treatment

1. Each Party shall accord to investors of another Party treatment no less favorable than that it accords, in like circumstances, to investors of any other Party or of a non-Party with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.
2. Each Party shall accord to investments of investors of another Party treatment no less favorable than that it accords, in like circumstances, to investments of investors of any other Party or of a non-Party with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.

The national treatment and MFN treatment standards have each had a long history in international economic law. They can be found in most trade and investment agreements and have received the lion's share of international judicial consideration. NAFTA Article 1102(1) even indicates that these two standards shall be used by treaty interpreters as rules through which the objectives of the NAFTA should be considered and applied in interpreting the NAFTA text. The NAFTA version of the MFN and national treatment standards requires their application to measures affecting either investors or their investments, whether at the national or local level.

³² Myers Merits Award, supra, n 2, paras 275-77

NAFTA Article 1 104 also requires that the better of the national treatment or MFN treatment standards be granted when available. This means that investors and their investments are entitled to the best level of treatment provided to either their domestic competitor(s) under Article 1102, or to any foreign competitor(s), under Article 1103.

The meaning of the terms "national treatment" and "MFN treatment" has been canvassed in a number of GATT and VVTO Panel reports, as well as in WTO Appellate Body decisions. The most frequently considered concept reflected in these standards is contained within the GATT, in Article III. Article 111:4 provides an expression of the national treatment standard that most closely applies to NAFTA Article 1102:

"The products of the territory of any contracting party imported into the territory of any other contracting party shall be accorded treatment no less favourable than that accorded to like products of national origin in respect of all laws, regulations and requirements affecting their internal sale, offering for sale, purchase, transportation, distribution or use."

While the GATT is limited to regulating measures affecting trade in goods, the principles it expresses are capable of wider application. In this regard, there are now provisions recalling both the national treatment and MFN treatment standards in the General Agreement on Trade in Services, the WTO Agreement on the Trade-Related Aspects of Intellectual Property and the VVTO Agreement on Technical Barriers to Trade. The basic standards remain unchanged in each of these applications, and therefore the interpretation given to these provisions by WTO panels should be applicable within the NAFTA context.

In a nutshell, the national treatment and MFN treatment standards guarantee that an equality of competitive opportunities should exist between similarly situated commercial competitors. Accordingly, when a good, service provider or investment is treated less favorably than a competitor without a legitimate reason, the principle will have been violated. The analysis of these comparative treatment standards can thus be segregated into two primary elements: the determination of "likeness" (involving definition of the relevant market and applicable legal regime) and a comparative evaluation of "treatment".

(a) Like Circumstances

Two NAFTA tribunals have given awards under NAFTA Article 1 102 that appear to have acknowledged that the primary question of "likeness" involves identification of the relevant competitors and the relevant market. The Myers tribunal began its analysis by identifying the competitors of the investor and its investment in the Canadian market, noting that these domestic industry players must have been operating in like circumstances with the investor/investment because they were so frightened of competition that they lobbied intensely to ensure that the measure would be imposed.³³ The Pope tribunal also stated that "the first step" in determining like circumstances is to ascertain with whom the investor or its investment must be compared based upon participation in the same economic or business sector .³⁴

³³ *ibid.*, at para. 251.

³⁴ Pope Final Merits Award, *supra*, n 2, at para. 78

However, both tribunals also made it clear that they would retain considerable discretion to consider what other political and legal aspects of "circumstances" within which these investors/investments competed, and within which the measure would be relevant to determining whether a breach of NAFTA Article 1 102 had in fact occurred.³⁵ This decision can be equated somewhat with the approach adopted by the WTO Appellate Body in Japan - Taxes on Alcoholic *Beverages*, where it stated:

"The concept of "likeness" is a relative one that evokes the image of an accordion. The accordion of "likeness" stretches and squeezes in different places as different provisions of the WTO Agreement are applied. The width of the accordion in any one of those places must be determined by the particular provision in which the term "like" is encountered as well as by the context and the circumstances that prevail in any given case to which that provision may apply." 36

The Myers tribunal determined that the international legal context within which NAFTA Article 1 102 operated required it to consider the "like circumstances" issue as a potential exemption for measures that might provide investors/investments with less favourable treatment. In other words, the tribunal wanted to confirm that "there were no 'unlike circumstances' that warranted differential and adverse treatment," particularly those related to the web of international environmental agreements to which Canada was a party.³⁷ The Myers tribunal decided that, since Canada's environmental policy excuses for imposing its measure upon the investor and investment were wholly unwarranted, a breach of Article 1 102 had indeed occurred.³⁸

For its part, however, the Pope tribunal used the "like circumstances exemption" to deny the investor and investment recovery under NAFTA Article 1102. The tribunal determined that if a NAFTA Party could provide sufficient justification for how a measure provided unequal treatment to an investor or investment, *vis-a-vis* their domestic competitors, such treatment could be excused with a finding of differential circumstances. Rather than focussing strictly on whether or not a NAFTA party intended to discriminate with its measure, the tribunal would ask whether the unequal treatment could be:

"justified by showing that it bears a reasonable relationship to rational policies not motivated by preference of domestic or foreign owned investments. That is, once a difference in treatment between a domestic and a foreign-owned investment is discerned, the question becomes, are they in like circumstances? It is in answering that question that the issue of discrimination may arise.""

In other words, the Pope tribunal essentially adopted a three-part test for national treatment:

define the relevant market;
determine whether there has been "treatment less favourable"; and, if so,
require the NAFTA Party to provide proof that its measure was justified on some reasonable policy grounds.

Pope Final Merits Award, *ibid.*, at paras. 75-76, Myers Merits Award, *supra*, n. 2, at para. 245.

³⁶ Japan-Taxes on Alcoholic Beverages, WT/DS8/AB/R, WT/DS10/AB/R, WT/DS 11/AB/R, October 4, 1996, p 21

³⁷ Myers, Schwartz Opinion, *supra*, n. 5, at para. 162.

³⁸ **Pope Final Merits Award**, *supra*, n. 2, at para. 66. Once the Myers tribunal concluded that there was no environmental policy excuse for its conduct, the question of discriminatory treatment was a "foregone conclusion."

Pope Final Merits Award, *ibid.*, at para. 79

The first and third parts of the test reflect the question of like circumstances, where likeness is considered in definition of the relevant market (i.e. identifying the investor/investment's competition) and "circumstances" refers to the policy environment in which the measure operates. This test differs somewhat from the GATT likeness analysis, which has historically been limited rather strictly to a list of factors employed for the identification of competing goods,⁴⁰ but has more recently been expanded to include consideration of the relative risks inherent in their use."

This difference has been justified by at least one NAFTA tribunal as being necessary to address the lack of a general exception provision applicable to NAFTA Articles 1103 and 1102. By contrast, GATT Articles I and III are subject to the general GATT exemption clause, Article XX (which provides that even though a measure may violate a substantive obligation, it may be justified under certain specified policy grounds so long as it is not applied in an arbitrary or discriminatory manner).

There are some future obstacles to the success of this judicially crafted "like circumstances". For example, tribunals may be confronted with policy justifications that would not be acceptable under a general exception provision such as GATT Article XX. In such cases, a tribunal's acceptance of a government's policy justification becomes little more than acceptance of proof of the government's lack of discriminatory intent—converting Articles 1102 and 1103 into prohibitions against only *de jure* discrimination, rather than prohibitions against any measure that is only discriminatory in result.⁴²

(b) Treatment No Less Favourable

The phrase "treatment no less favourable" is a common GATT/WTO concept which has been interpreted to require countries to allow equal competition between goods in a country. As stated in United States in section 337 of the Tariff Act of 1930:

"The words treatment no less favourable in paragraph 4 call for effective equality of opportunities for imported products in respect of the application of laws, regulations and requirements affecting the internal sale, offering for sale, purchase, transportation, distribution or use of products. This clearly sets a minimum permissible standard as a basis... The purpose of the Article III:2, dealing with internal taxes and other internal charges, is to protect "expectation on the competitive relationship between imported and domestic products"."

In order to prevent discrimination, the WTO approach to the national treatment and MFN standards has focused upon obtaining the kind of circumstances in which no discrimination can exist, rather than attempting to seek out discriminatory intent. If foreign products or businesses are provided with an effective equality of competitive

The seminal case, in this regard, is: Report of the Working Party on Border Tax Adjustments, GATT Panel Report, adopted December 2, 1970, BISD I BS/97, which enunciated four factors to be used to identify like goods: (i) the properties, nature and quality of the products, (ii) the end-uses of the products; (iii) consumers' tastes and habits; and, (iv) the tariff classification of the products. *European Communities- Measures Affecting Asbestos*, WTO Appellate Body Report, March 12 2001, WT/DS135/AB/R, at para. 115. The Appellate Body also provided a wide-ranging discussion of the likeness analysis at paras 88-108 of its report.

For its part, the Myers tribunal appeared to consider the issue of intent to be of great significance, at paras 252-254, although it was not clear exactly how the issue should be addressed in cases where there was no overwhelming evidence that discriminatory intent existed.
Section 337 of the Tariff Act of 1930, (1989), 365/386-387, paras 5.11-5.13.

opportunities, it will be unnecessary to second guess the actual motives of governments and their officials (which can be a difficult undertaking at the best of times). As noted by the Pope tribunal in its *Final Merits Award*, the obligation to provide "treatment no less favourable" means providing the best treatment available to any other competing investor or investment, regardless of whether a balance of foreign or domestically-owned investors or investments are receiving the same lesser level of treatment.

"Accordingly, the Tribunal interprets the treatment required by Articles 1102(1) and 1102(2) on the one hand, and 1102(3) on the other, to be identical, save for the limitations to states and provinces. The Tribunal also interprets both standards to mean the right to treatment equivalent to the "best" treatment accorded to domestic investors or investments in like circumstances. The tribunal thus concludes that "no less favourable" means equivalent to, not better or worse than, the best treatment accorded to the comparator."

In the absence of the recently fashioned "like circumstances exemption", arguments over the meaning of providing "treatment less favourable" would be of much more importance to the disputing parties. This is because investors would be able to obtain compensation for losses suffered as a result of receiving less favourable treatment so long as they could demonstrate that they were operating in like circumstances with whomever else was receiving more favourable treatment. If tribunals continue to assert their right to determine whether there are legitimate excuses for the differences in treatment claimed between competitors, it will be less crucial to argue that no differences in treatment exist."

Looking forward, questions will remain as to whether the discretion that at least two NAFTA tribunals have appropriated for themselves—to determine whether a justification exists for discrepancies in treatment—will dilute the quality of the NAFTA's national treatment and MFN treatment obligations. Instead of ensuring that foreign investors are provided with the equality of competitive opportunities that would ensure freedom from discrimination, injudicious use of this discretion could subject investors and investments to less favourable treatment whenever a NAFTA government can provide evidence that it did not intend to discriminate, whatever its reasons may have actually been or the impacts actually caused.

(4) NAFTA Article 1105: Treatment in Accordance with International Law

Article 1105: Minimum Standard of Treatment

1. Each Party shall accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security.

Such arguments usually focus upon whether the analysis of difference should be based upon an evaluation of the treatment being received, or the effects of such treatment—commonly treated in terms of *de jure* versus *de facto* treatment.

⁴⁵ Rudolph Dolzer and Margrete Stevens, *Bilateral Investment Treaties* (The Hague, Martinus Nijhoff, 1995), p. 58

NAFTA Article 1105 requires NAFTA governments to "accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security". Read in conjunction with NAFTA Article 1116, this provision provides NAFTA investors with a right to seek damages before an independent, international tribunal whenever a NAFTA government's treatment of its investment violates "international law." "Fair and equitable treatment" and "full protection and security" are but two non-exhaustive examples of the kind of treatment that "international law" requires.

It is generally accepted that the purpose of a provision such as NAFTA Article 1105 is "to provide a basic and general standard which is detached from the host State's domestic law"⁴⁵ This was the conclusion arrived at by the Mexican Claims Commission in *Hopkins (United States of America) v United Mexican States*, in which it was stated that measures affecting foreigners and their investments will be held to international law standards as a minimum standard of treatment, even if their application results in better treatment being provided to the foreigner than is available under domestic law.⁴⁶

So how does a government provide an investment with treatment that is in accordance with "international law?" Article 38 of the Statute of the International Court of Justice is often regarded as the definitive statement about the substance of "international law". It provides:

The Court, whose function it is to decide in accordance with international law such disputes as are submitted to it, shall apply:

- (a) international conventions, whether general or particular, establishing rules expressly recognized by the contesting States;
- (b) international custom, as evidence of a general practice accepted as law;
- (c) the general principles of law recognized by civilised nations;
- (d) subject to provisions of Article 59, judicial decisions and the teachings of the most highly qualified publicists of various nations, as subsidiary means for the determination of rules of law."

Customary international law is but one element of "international law". These norms are evidenced in state practice as being those obligations for which states consider themselves and each other to be bound. State practice can be observed from diplomatic correspondence and in treaty making. It can also be evidenced in the secondary sources of judicial decision-making and international treaties (i.e. when international law experts say it exists). From a practical perspective, the same is true for international law principles, which can also be demonstrated through a more exhaustive, comparative law study of a significant cross-section of domestic legal systems⁴¹

Accordingly, while NAFTA Article 1105 provides two standards within its text that could be used to obtain relief for an injured investment ("fair and equitable treatment" and "full protection and security"), one can also look to customary international law and the principles of international law for sources of content for the minimum standard of

treatment.⁴⁹ Nonetheless, of the three tribunals that have been asked to consider the application of Article 1105, two have largely restricted themselves to findings based upon the "fair and equitable treatment" standard.

The Pope tribunal concluded that the "fair and equitable treatment" standard was an "additive" concept that was not actually "included" in the treatment that Article 1105 indicated must be provided under international law. It came to this conclusion based upon an analysis of the various *BIT'S*, which often require "fair and equitable treatment" in addition to whatever treatment is required under international law. The tribunal's reasoning was that the NAFTA parties could not have possibly intended to agree to a "minimum" standard provision that would provide other investors with potentially better treatment under all of the *BIT'S* to which one of the NAFTA parties was a member."

However, if one ignores minor controversy implied in the Pope tribunal's "additive" analysis and concentrates upon its application of the fair and equitable treatment standard, it appears that the tribunal was fairly conservative in its approach. It clearly rejected the minimalist approach advocated by the NAFTA parties as "doing violence" to the fair and equitable treatment standard that appears in hundreds of international investment treaties.⁵¹ but it did not outline a wide-ranging analysis of just how high a standard NAFTA governments could be expected to meet.

The tribunal did not draw any conclusions that would suggest that "substantive fairness" is an element of the "fair and equitable treatment" standard. It did not do so even though its award included a finding that explicitly acknowledged the inequitable manner in which the investment was treated under Canada's regime, and in spite of the fact that the standard explicitly includes "equitable" treatment.⁵² It is accordingly apparent that at least for this tribunal-the "fair and equitable treatment" standard was limited in this case to issues of procedural fairness only. On this ground, the tribunal described a course of conduct managed by a Canadian official that it did consider to constitute a violation of the standard by Canada. In fact, the tribunal appeared to surmise that this official's conduct possibly constituted a form of retaliation or punishment for the investor having brought its case (although it avoided drawing any explicit conclusion on the matter of intent).

Almost immediately after Pope filed its arbitration claim, this official commenced an audit process for which he was unsure he had the necessary authority, but asserted that he did. He made arbitrary demands upon the investor and investment to submit to his process on his terms, and rejected offers of compromise. He repeatedly threatened to advise his minister to revoke all or part of the investment's entitlement to export quotas (which largely formed the basis of its viability as a going concern). Finally, even though a hearing was held by the NAFTA tribunal in which it was concluded that the audit process was "seriously flawed" and "not a reliable basis for further action", the official quietly recommended to his minister that the investment's quota should be reduced. This was based upon misleading information about the investor and its investment (including an unsubstantiated implication of possible fraud).⁵³ It is apparent that this kind of conduct, likened by the tribunal to "regulatory combat" rather than "cooperation," would violate

⁴⁵ The *United States of America On Behalf of George W Hopkins v The United Mexican States* (Docket No 39) (1926) 21 Am. 1. Int'l. Law 160, at 166-67. The Myers tribunal came to the same conclusion at paras 225-28 of its award.

⁴⁷ [1945] C.T.S. 7, in force October 24, 1945.

⁴⁸ That leaves only treaty law (as one of the three primary sources of international law) which will be discussed in further detail below.

The kind of content that [can be](#) found in international custom and principles include prohibitions on arbitrary and discriminatory conduct, and the principle of good faith-which can be seen in such international law concepts as the doctrine of abuse of rights and the *pacta sunt servanda* rule.

⁵⁰ Pope *Final Merits Award*, supra, n. 2, at paras 110-11 and 115-18.

⁵¹ *ibid.*, at para. 113.

⁵² *ibid.*, at paras 154-155.

⁵³ *ibid.*, at paras 156-81

the standard of fair and equitable treatment regardless of whether it was considered additive or not, or based on custom or treaty.

For its part, the *Metalclad* tribunal was presented with an equally egregious set of facts, which it considered under the fair and equitable standard (which it appeared to consider as *included* in the treatment required under international law).⁵⁴ In coming to this conclusion, the tribunal observed the customary international law rules of treaty interpretation recalled in Articles 26 and 31 of the Vienna Convention on the Law of Treaties.⁵⁵ In observing these rules of interpretation, the tribunal acknowledged that it needed to interpret NAFTA Articles 1105 and 1110 in good faith, in accordance with the ordinary meaning of their terms in their proper context, and in light of the NAFTA's objects and purposes.⁵⁶

The *Metalclad* tribunal first noted that one of the objectives of NAFTA Article 102(1) was to "increase substantially investment opportunities in the territories of the Parties". Its consideration of this objective appears to have been elaborated specifically in consideration of the transparency principle, as required under NAFTA Article 102(1).⁵⁷ The tribunal had been called upon to determine whether a U.S. investment in Mexico had been treated in a fair and equitable manner concerning the considerable number of years that it had endured sparring with state and local officials who prevented *Metalclad* from being able to operate its investment notwithstanding the fact that it had received all the necessary federal and state permits to proceed, in addition to repeated assurances from federal Mexican officials.

The tribunal made a number of findings concerning how Mexico breached the fair and equitable treatment standard, starting with the simple fact that there appeared to be "no clear rule" as to whether a municipal permit was ever required under Mexican law. It further determined that there was no established practice or procedure governing permit applications at any rate. These omissions, the tribunal concluded, amounted "to a failure on the part of Mexico to ensure the transparency required by NAFTA."⁵⁸

⁵⁴ *Metalclad Award*, supra, n. 11, at para. 74.

⁵⁵ Vienna Convention on the Law of Treaties (1969) 1155 U.N.T.S. 331, in force 1980 (hereafter "Vienna Convention").

⁵⁶ NAFTA Art. 102(1) provides:

The objectives of this Agreement, as elaborated more specifically through its principles and rules, including national treatment, most-favored-nation treatment and transparency, are to:

- a) eliminate barriers to trade in, and facilitate the cross-border movement of, goods and services between the territories of the Parties;
- b) promote conditions of fair competition in the free trade area;
- c) increase substantially investment opportunities in the territories of the Parties;
- d) provide adequate and effective protection and enforcement of intellectual property rights in each Party's territory;
- e) create effective procedures for the implementation and application of this Agreement, for its joint administration and for the resolution of disputes; and
- f) establish a framework for further trilateral, regional and multilateral cooperation to expand and enhance the benefits of this Agreement.

⁵⁷ *Metalclad Award*, supra, n. 11, at paras 75-76.

⁵⁸ *ibid.* at para. 88 In making these findings, however, the tribunal did not repeat its interpretative analysis—that because "transparency" is a fundamental principle of the NAFTA, which must inform the objectives that must be employed in interpreting its provisions, gross failures to regulate in a transparent manner could be seen as failure to accord "fair and equitable treatment" in accordance with "international law," as required under NAFTA Art 1105.

In fact, the tribunal never fully explained whether it saw the "fair and equitable treatment" standard as: (1) being additional to whatever treatment is required under "international law", (2) being an example of the kind of standard that must be followed in international law, or (3) whether the words "fair and equitable treatment" are essentially superfluous terms that recall no more than the customary international law governing the treatment of aliens. Given the wording of the tribunal's primary finding,

The tribunal also appears to have concluded that when the NAFTA parties wrote in NAFTA Article 102(2) that the Agreement's objectives were to be elaborated by principles and rules such as transparency, and that those objectives were to be used to enlighten the tribunal's interpretation of NAFTA provisions such as Article 1105, it only made sense to determine that a lack of transparency could be considered within the context of what "fair and equitable treatment" means. The tribunal did not completely explain itself in this regard, however. Perhaps it believed that because it had recalled the customary international law rules of treaty interpretation, and outlined the relevant objectives and principles contained within NAFTA Article 102(1), it was obvious that a failure to regulate transparently could be considered relevant for evaluation of the "fair and equitable treatment" standard in NAFTA Article 1105.

Regardless of what the tribunal was thinking, what it did next was lay out a series of examples of government conduct that it concluded breached the international law standard of fair and equitable treatment that it determined was contained within NAFTA Article 1105. First, the tribunal concluded that *Metalclad* was led by federal officials to believe that it did not require the municipal construction permit first required, and later refused without a hearing, by local officials. It further concluded that *Metalclad* relied upon the advice it received from federal officials, to its detriment. Regardless of whether the advice that *Metalclad* received was correct, the tribunal appears to have concluded that a failure to address such detrimental reliance constituted a breach of fair and equitable treatment under international law." The tribunal further appeared to conclude that the near total lack of transparency that characterised the long, confusing and painful process that *Metalclad* was forced to endure in order to run its business made *Metalclad's* detrimental reliance particularly critical and damaging.⁶⁰

Third, the tribunal found that local officials were not even convinced that they had the authority to effectively override the permits issued by state and federal officials, although they issued a "stop work" order anyway." In addition, the tribunal concluded that the municipality failed to provide *Metalclad* with any notice or opportunity to be heard at the meeting during which its thirteen-month-old construction permit was considered and refused.⁶² The tribunal further concluded that the municipality's decision to deny *Metalclad's* permit was based upon irrelevant and/or improper considerations, and that it was denied without the provision of satisfactory reasons for decision." As a result, the tribunal wrote:

"The actions of the Municipality following its denial of the municipal construction permit, coupled with the procedural and substantive deficiencies of the denial,

however, it would appear that it chose the second of these formulations that fair and equitable treatment is one of the international law standards that must be respected under NAFTA Art. 1105. See *Metalclad Award*, *ibid.*, at para. 74.

⁵⁹ *ibid.*, at para. 89, the tribunal states that "*Metalclad* was entitled to rely on the representations of federal officials and believe that it was entitled to continue construction of its landfill."

⁶⁰ *ibid.* at paras 88 and 99.

ibid., at paras 94-95. The tribunal noted that if municipal officials were sure of their position, they would not have needed to proceed with their application before Mexico's Federal Court, in an attempt to prevent *Metalclad's* facility from being opened—resulting in an additional two years during which *Metalclad* was prevented from running its business, based upon a "temporary" injunction that was eventually dismissed with the Municipality's application.

ibid., at para. 91.

ibid., at paras 92-93, the tribunal noted that "the construction permit was denied without any consideration of, or specific reference to, construction aspects or flaws of the physical facility."

support the Tribunal's finding, for the reasons stated above, that the Municipality's insistence upon and denial of the construction permit was improper.⁶⁵

It is not clear from this finding whether the tribunal was concluding that any one of these deficiencies could conceivably constitute a breach of the fair and equitable treatment standard or whether it was necessary for many (or all) of them to be present for a breach to occur. It would appear that in this case the tribunal concluded that the cumulative effect of these deficiencies certainly constituted a denial of fair and equitable treatment. Nonetheless, it also appears that the tribunal considered this "cumulative" finding to be separate and apart from its finding that Mexico's failure "to ensure a transparent and predictable framework for Metalclad's business planning and investment" also constituted a breach of NAFTA Article 1105.⁶⁵

(a) "International Law"

By far the most interesting finding made by a NAFTA tribunal concerning Article 1105 came from the Myers tribunal. It was the first to receive arguments that "treatment in accordance with international law," as a matter of logic, must include treatment in accordance with treaty obligations as well. NAFTA governments are obligated to honour their treaty obligations under the *pacta sunt servanda* rule of international law, an expression of the fundamental international law principle of good faith. Many treaty obligations, such as those contained within the various WTO Agreements, were designed particularly with the treatment of private sector actors (such as foreign investors) in mind. This was a conclusion reached by the WTO panel in United States in sections 301 to 310 of the Trade Act of 1974:⁶⁶

"7.77 Trade is conducted most often and increasingly by private operators. It is through improved conditions for these private operators that Members benefit from WTO disciplines. The denial of benefits to a Member which flows from a breach is often indirect and results from the impact of the breach on the market place and the activities of individuals within it...

7.81 ... In treaties which concern only the relations between States, State responsibility is incurred only when an actual violation takes place. By contrast, in a treaty the benefits of which depend in part on the activity of individual operators the legislation itself may be construed as a breach, since the mere existence of legislation could have an appreciable "chilling effect" on the economic activities of individuals.

7.85 In this sense, Article III:2 is not only a promise not to discriminate in a specific case, but is also designed to give certain guarantees to the market place and the operators within it that discriminatory taxes will not be imposed. For the reasons given above, any ambivalence in GATT panel jurisprudence as to whether a risk of discrimination can constitute a violation should, in our view, be resolved in favour of our reading.

⁶⁰ *ibid.*, at para. 97.

⁶⁵ otherwise, the tribunal would not have begun its discussion of the cumulative deficiencies in the municipal permitting process with "moreover". Accordingly there were at least two, and possibly three or more, reasons as to why Mexico breached NAFTA Art 1105 in its treatment of Metalclad's investment in its territory.

⁶⁶ WTO Panel Report, WT/DS152/R, December 22, 1999.

The international obligations contained in the various WTO Agreements are fundamentally related to the interests of private actors who depend upon the stability and security that these rules are designed to offer. While they may be entered into by states, they are designed for the benefit of these private actors, including foreign investors. Accordingly, it should come as no surprise that a NAFTA investor might be entitled to seek compensation for government behavior that violates one of these treaty obligations and harms its investment as a result. NAFTA Article 1105 requires treatment in accordance with "international law". International law is generally acknowledged to include treaty, custom and principles. If a NAFTA government's measure violates a particular WTO obligation, it has not only violated its treaty obligation in relation to the harmed foreign investment; it has also violated the international law principle of good faith by not honoring its WTO obligation.

A majority of the Myers tribunal appears to have recognized this logic, stating:

"The Tribunal considers that a breach of Article 1105 occurs only when it is shown that an investor has been treated in such an unjust or arbitrary manner that the treatment rises to the level that is unacceptable from the international perspective. That determination must be made in the light of the high measure of deference that international law generally extends to the right of domestic authorities to regulate matters within their own borders. The determination must also take into account any specific rules of international law that are applicable to the case.

In some cases, the breach of a rule of international law by a host Party may not be decisive in determining that a foreign investor has been denied "fair and equitable treatment", but the fact that a host Party has breached a rule of international law that is specifically designed to protect investors will tend to weigh heavily in favour of finding a breach of Article 1105."⁶⁷

With these obiter dicta, the Myers tribunal may not have actually been saying that any breach of a WTO obligation constitutes a breach of Article 1105. Instead, it may have only been suggesting that a finding of a WTO breach could be considered very persuasive by a tribunal called upon to consider whether Article 1105 has been breached by the same course of conduct that constituted the WTO breach. The majority's reasoning is not particularly clear on this point, and its finding that Canada's treatment of the investment was so discriminatory that it not only constituted a violation of NAFTA Article 1102, but NAFTA Article 1105 as well,⁶⁸ does not shed any further light on the matter.

Accordingly, it will remain for future tribunals to determine exactly the extent to which investor security will be enhanced by the ability to raise an alleged breach of WTO obligations in a claim under NAFTA Article 1105.⁶⁹

⁶⁷ Myers, Schwartz Opinion, *supra*, n. 5, at para's 263-64.

⁶⁸ *ibid.*, at para. 266

⁶⁹ It should be noted that some investment protection agreements, such as the, contain more specific language about treaty obligations. For example, Article 10(1) of the Energy Charter Treaty requires "treatment [no] less favourable than that required by international law, including treaty obligations

(5) *The Free Trade Commission*

NAFTA Article 2001 provides for the creation of a body called the Free Trade Commission, composed of one representative from each NAFTA government (usually the cabinet member responsible for trade and investment, or a designate). This paper body provides the auspices under which the NAFTA parties officially meet. NAFTA Article 1132(2) provides that the Commission may issue interpretations of the NAFTA text that shall be binding upon a tribunal hearing an investment claim.⁷⁰ On July 31, 2001, the Commission purported to issue such a statement in respect of the interpretation of NAFTA Article 1105.

It is rumoured that the Commission took this unprecedented step-of officially reinterpreting the NAFTA text-for two reasons. The first factor, which motivated Canadian officials to begin seeking such changes as early as 1998, was that NAFTA tribunals were not agreeing with the arguments being made by NAFTA governments about the "proper" meaning of NAFTA provisions such as Article 1105. This concern crystallised when the *Metalclad* tribunal issued its final award, followed closely by final merits awards by the Pope and *Myers* tribunals. The second factor, which finally brought the U.S. Government to the Commission table by the spring of 2001, was a growing concern among State Department lawyers that as many as three more tribunals might soon be issuing awards that would include breaches of NAFTA Article 1105 by the United States.

(a) Why Did the Commission Act?

Of course, the idea to effectively amend NAFTA Article 1105 did not arise one day while the three ministers were having coffee. Invoking the Commission process had been suggested by various NAFTA government officials, particularly from Canada, since 1998. Sometimes policy decisions originate in the minds of politicians and their staff. More often, however, they originate in the minds of managing bureaucrats. Use of the Commission to change the meaning of NAFTA Article 1105 bears all of the hallmarks of the latter scenario. Consistently urged by their officials, and not sensing the likelihood of any backlash from private sector supporters for making changes to a provision whose promise was not yet fully realised by most lawyers or business people, the three trade ministers finally heeded the advice that they had been receiving and issued their interpretative statement.

This advice was being provided by officials who have insisted that Chapter 11 is a Pandora's Box that has been fashioned out of some innocuous treaty provisions by a small number of "creative" lawyers and a few rogue tribunals. These officials—who are currently leading the charge to both limit application of the NAFTA and prevent its provisions from being included in new multilateral agreements (such as the Free Trade Agreement of the Americas)—can be grouped into two camps. The first is composed of frontline regulators whose discretion has been subjected to question under various international economic obligations. In the past, these officials could expect arguments

against them to be blunted by the fact that their enemies were always wary that whatever arguments they made could someday be used against their own regulators in another case. In the case of investment arbitration, however, these regulators could not expect aggrieved investors to pull any of their punches.

The second camp of government opponents to investment arbitration is composed of those government lawyers who have been on the front lines of combat with NAFTA investors over the first few years. For these lawyers, victories have been few and far between." These lawyers have also frequently expressed their concern that investors' counsel may make arguments that they would recoil from making (in the future interests of safeguarding their government clients' discretion to regulate). Accordingly, these public sector lawyers can be seen as being in a permanent conflict of political interest-between arguing for an interpretation of international obligations that most maximises global welfare and ensuring that whatever arguments they make circumscribe as little as possible their government colleagues' discretion to impose economically inefficient measures in the future.

Moreover, as this second camp of government NAFTA opponent can most often be found working within the diplomatic corps of the government in question (e.g. the State Department for the United States, or the Trade Law Division of the Canadian Department of Foreign Affairs), it is understandable that they also share a common experience of having exclusive control over all matters of international economic law making. This exclusive role has been encroached upon by the private sector interlopers who work for NAFTA investors, making arguments they would never make and articulating a vision of international economic policy they would prefer to see safely reflected only in the speeches of their political masters. While private sector lawyers have been involved in international economic disputes for many years (working behind the scenes at WTO negotiations or arbitration), control has heretofore remained safely in the hands of the diplomats and government lawyers who believed that they always "knew what was best".

The easiest way to "fix" the problem of investment arbitration would be to amend the NAFTA to either eliminate it altogether, or at least to include a screening mechanism that would return control of the law-making process⁷² to government lawyers. Unfortunately for this second camp of government NAFTA opponents, these approaches can neither be adopted nor advocated, because to do so would directly contradict decades of trade policy making. These diplomats and lawyers have been (correctly) advocating that global economic welfare can best be maximised through the creation of a binding web of international trade and investment rules. Accordingly, advocating a frontal assault on investment arbitration would signify a complete retreat that would not only be extremely detrimental for the world economy, but would also constitute a political nightmare for their political masters.

Instead, the approach that has been adopted and employed, through the Commission's interpretative authority, is to attempt to neuter specific NAFTA obligations one by one.

⁷⁰ NAFTA Art. 1131 provides as follows:

7. A Tribunal established under this Section shall decide the issues in dispute in accordance with this Agreement and applicable rules of international law.
2. An interpretation by the Commission of a provision of this Agreement shall be binding on a Tribunal established under this Section.

Although one must always remember that the zero-sum game of law is not a particularly useful paradigm for understanding the relative success of any international economic dispute. In economic terms, it may be that every single "loss" for a government's trade lawyers (acting in defence of a challenged measure) is actually a victory for its consumers.

⁷² By "law-making process," I mean to refer to the opportunity to convince a tribunal to make findings in an award that may have the affect of generating jurisprudence that could be adopted by future tribunals.

The first obligation to undergo such treatment is the one that appears to present the most danger to unfettered government decision making: Article 1105. If the process works, Articles 1102/1103, 1106 and 1110 would likely be next.

Before now, when individuals did not use their access to investment arbitration in order to hold governments to their international economic bargains, exclusive control of the dispute settlement process permitted these lawyers and diplomats to simultaneously pursue two contradictory policies. They could publicly maintain their allegiance to the fundamental objectives of free trade and comparative advantage, while still defending their colleagues' discretion to act in an arbitrary or discriminatory (i.e. sub-optimal) manner, because they were in control of the dispute settlement process and virtually all of the information involved. If they were eventually unable to cut some sort of deal with their opponents from the other country, they could force whatever changes would be necessary on their colleagues using the weight of a WTO panel result against them.

State-to-state dispute settlement could thus be seen as part political theatre and part safety valve, providing the impetus for incremental regulatory change while never permitting control to slip into the hands of those who might not be willing to accept an economically inefficient, face-saving compromise. Because investment arbitration under the NAFTA threatens to transform this intricately choreographed diplomatic dance into something much more effective (in terms of realising the economic goals found in international economic agreements), it threatens both the discretion of the first camp of government opponents to regulate as they see fit, and the authority of the second camp to maintain the political process that they have established. While neither camp would admit that they therefore share common cause with what has come to be known as the "anti-globalisation movement," because it would contradict the overarching policy goal favouring free trade, the only difference between governmental and non-governmental opponents of NAFTA investment arbitration is that the latter are being more intellectually honest about their motives.⁷³

(b) What did the Commission Actually Attempt to Do?

What changes to NAFTA Article 1105 did these officials actually attempt to have their ministers, sitting as the NAFTA Commission, make? There were three:

Article 1105(1) prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to investments of investors of another Party.

The concepts of "fair and equitable treatment" and "full protection and security" do not require treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens.

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).⁷⁴

This is why non-governmental opponents advocate far more significant changes than do the governmental opponents of investment arbitration, starting with elimination of investment arbitration and continuing with the dismantling of the multilateral trading system. They possess the courage of their convictions (however misplaced), and are unfettered by the need to at least appear to remain generally in favour of the international movement towards liberalised trade and investment. A copy of the Commission's statement, issued July 31, 2001, can be found at <www.naftalaw.org>.

The Commission's goal was to "correct" these three alleged "mistakes" which their officials told them were being made by NAFTA tribunals. The first "mistake" (which was made by each of the *Metalclad*, *Myers* and *Pope* tribunals) was a conclusion that because NAFTA Article 1105 required "treatment in accordance with international law" it probably required more of government officials that obeying a very low threshold of treatment that government lawyers argue exists in "customary international law minimum standard of treatment of aliens". Before each tribunal, lawyers for the NAFTA parties have unsuccessfully argued that this minimalist standard of treatment is all that is required under NAFTA Article 1105, requiring no more than a bare minimum of protection for foreign investments against "egregious," "shocking" or "outrageous" government conduct.⁷⁵

The second so-called "mistake," which was explained by the *Pope* tribunal in considerable detail in its final award on the merits, was that the "fair and equitable treatment" standard in Article 1105 may actually be "additive" to whatever treatment might be required under international law, rather than subsumed in it." It is possible that the trade ministers believed that the *Metalclad* tribunal essentially made the same so-called mistake because it appeared to base its findings exclusively on the "fair and equitable treatment standard" as well. However, a careful reading would suggest that the *Metalclad* tribunal actually believed "fair and equitable treatment" to be treatment that was required under "international law" (customary or otherwise).

The final so-called "mistake" that the Commission attempted to address with its statement is closely related to the first. The ministers' concern appears to have been that in interpreting the Article 1105 requirement of "treatment in accordance with international law," some tribunals might be led to believe that Article 1105 actually requires NAFTA governments to treat investments in accordance with "international law" (as described above). This appears to be exactly the conclusion arrived at by a majority of the *Myers* tribunal."

Whether the trade ministers' statement of interpretation will actually have the desired effect is, of course, a matter of considerable question. In the case of the *Metalclad*, *Pope* and *Myers* claims, the question is surely moot. In fact; it is doubtful that the ministers' statement will have any immediate impact at all, given the customary international law presumption against retroactivity in treaty interpretation and the international law maxim that no person may be judge in his or her own cause. The prohibition against retroactivity is actually enshrined as Article 28 of the Vienna Convention.⁷⁸

The case most often cited for such a proposition is *Neer v United Mexican States* (1926), 4 R.I. A.A. 60 (Mexico-United States Claims Commission), which-unlike other chambers of the same body-proposed a very high threshold for finding state responsibility: "an outrage, bad faith, willful neglect of duty or insufficiency of governmental action so far short of international standards that every reasonable and impartial person would recognize its insufficiency."

⁷⁶ *Pope* Final Merits Award, at paras 105-18

⁷⁷ *Myers*, Schwartz Opinion, supra, n 5, at paras 263-64

⁷⁸ Supra, n. **. Under Article 28, treaty provisions cannot bind a party "in relation to any act or fact that took place or situation which ceased to exist" before that provision entered into force. It has similarly been found that a party to a treaty cannot make use of a reservation provision in order to retroactively exempt governmental conduct that has become the subject of a dispute under that treaty. See *Alcoa Minerals of Jamaica, Inc. and Government of Jamaica* (1979) IV Yearb. Comm. Arb. 206 (Preliminary Award Made in 1975).

The presumption against retroactivity is also considered to be a general principle of law, as recognized by the International Law Commission.⁷⁹ Accordingly, it would be very difficult for a NAFTA Party to argue that the Commission's statement was intended to have retroactive effect without explicit evidence of such. The Commission's statement provides absolutely no indication that it is intended to have a retroactive effect and NAFTA Article 1131(2) also provides no indication that the Commission's interpretation could possibly have a retroactive effect.

When the Commission's statement eventually does start to affect new cases, two other arguments will remain against its application. First, it is questionable that the Commission's statement can be used to guide tribunals because its terms are not supportable under NAFTA Articles 102(2) or 1131(1), requiring interpretation of NAFTA provisions to be in accordance with the customary international law of treaty interpretation.⁸⁰ Secondly, the impact of the Commission's statement is likely to be blunted by the application of the most-favoured-nation treatment principle - both in interpretation and in application.⁸¹

(c) Interpretation or Amendment?

The NAFTA contains considerable, built-in guidance for interpretation by arbitration tribunals. NAFTA Article 102(2) provides that the NAFTA Parties "shall interpret and apply" its provisions "in the light of its objectives set out in paragraph 1 and in accordance with applicable rules of International law." NAFTA Article 102(1) lists six objectives, only two of which obviously apply to interpretation of NAFTA Article 1105:

- (b) promote conditions of fair competition in the free trade area;
- (c) increase substantially investment opportunities in the territories of the Parties,

NAFTA Article 102(1) also provides that these objectives are to be "elaborated more specifically through [the NAFTA's] principles and rules, including national treatment, most-favoured-nation treatment and transparency". To date, virtually every NAFTA tribunal has adopted the same customary international law approach to treaty interpretation that has become the norm in WTO dispute settlement, and that is reflected in Article 31 of the Vienna Convention.⁸² This approach requires the terms of a treaty to be interpreted in good faith in accordance with the ordinary meaning to be given to them in their context and in the light of the treaty's objective and purpose.

Using this approach, three NAFTA tribunals have rejected the interpretation of NAFTA Article 1105 that is now memorialized in the Commission's statement. That when the NAFTA parties required each other to treat NAFTA investments "in accordance with

international law" they really only meant to require treatment in accordance with customary international law (and in particular, the ancient "minimum standard of treatment of aliens"). In other words, eight out of a possible nine arbitrators have thus far concluded that the Commission's interpretation of "international law" as only meaning "customary international law" is simply not supported in the plain meaning of the NAFTA text.⁸³ This plain meaning is only enhanced with reference to the aforementioned NAFTA's trade-liberalising objectives.⁸⁴

NAFTA Article 1131(1) directs that tribunals "shall" decide issues before them in accordance with the NAFTA and "the applicable rules of international law". Tribunals cannot ignore the customary international law of treaty interpretation unless expressly commanded to do so by the NAFTA and the NAFTA parties have not claimed that they amended the NAFTA text with the Commission's statement. Accordingly, tribunals will likely be forced to reject the NAFTA Commission's interpretation because its intended impact has the character of an "amendment" to the NAFTA, rather than an "interpretation". The NAFTA parties have also indicated that the Commission's statement does not constitute an amendment, and accordingly it cannot be treated as such.⁸⁵

Moreover, since Article 102(2) requires the NAFTA governments to interpret the NAFTA in accordance with the applicable rules of international law, they are actually prohibited from using the Commission's interpretative authority under Article 1131(2) to impose changes to the meaning of NAFTA Article 1105 that cannot be supported under the customary international law rules of treaty interpretation. They are prohibited from doing so under the principle of good faith, expressed in the *pacta sunt servanda* rule (which itself has been recalled in Article 26 of the Vienna Convention).

(d) The MFN Rule

In the event that a NAFTA tribunal cannot see its way clear to disregard the Commission's interpretation, there may be another avenue through which to seek better treatment. That other avenue is NAFTA Chapter 11's MFN obligations, enshrined in Article 102(1) and Article 1103.

NAFTA Article 1103 was not touched by the NAFTA Commission's statement. Accordingly, it still holds the power of the typical MFN provision, providing its subject with a prospective guarantee of the best level of treatment made available to any other foreign competitor. Moreover, under NAFTA Article 101(c), NAFTA tribunals must employ the MFN principle to elaborate their interpretation of the NAFTA's objectives.

As Professor Schwarzenberger noted many years ago, the main function of the MFN principle:

"consists in forming an agency of equality. It prevents discrimination and establishes equality of opportunity on the highest possible plane: the minimum of discrimination and the maximum of favours conceded to any third State... It is clear that m.f.n. clauses serve as insurance against incompetent draftsmanship and lack of

⁷⁹ It did so in 1997 and 1999 reports on the issue of Nationality in Relation to Succession of States. See URLs <http://www.un.org/law/ilc/reports/1997/cha_p4.htm>, at para. (1) of its commentary and <<http://www.un.org/law/ilc/reports/1999/english/chap4.htm>> at para. (1) of its commentary.

Thanks go to Professor Rob Howse of the University of Michigan for assisting me in thinking about this line of argument.

Finally, it is not clear that the "customary international law" standard that the ministers seek to enshrine does not include expressions of "fair and equitable treatment" that go far beyond the very minimal protections advanced by government lawyers. This argument, which will be saved for another day, would be based upon the simple fact that customary international law, by definition, is not static, and that therefore the burgeoning field of international economic law, particularly as expressed in multilateral trade and bilateral investment treaties, has helped shape the customary international law requirements of protection for foreign investment in different ways that reflect the rise of post-industrial economies and the regulatory welfare state.

See e.g. *Ethyl*, supra, n. 26, at paras. 50-57, Myers, Schwartz Opinion, supra, n 5, at paras 196-204

⁸³ See discussion above.

⁸⁴ In contrast, the more narrow approach being advanced by the Commission cannot possibly be seen as "promoting conditions of competition" or "increasing substantially investment opportunities." It is designed to provide NAFTA officials with the ability to act in a manner that three tribunals have concluded would otherwise breach NAFTA Art. 1105.

⁸⁵ The NAFTA contains provisions for amendment of its text in Art. 2202. The Commission did not purport to act under this authority to make its changes to Art. 1105.

imagination on the part of those who are responsible for the conclusion of international treaties. While it is thus that the standard of m.f.n. treatment has the effect of putting the services of the shrewdest negotiator of a third country gratuitously at the disposal of one's own country, another aspect of the matter is more significant... As long as a country is content to enjoy treatment equal to that of the most-favoured third country, and the subject-matter of the treaty lends itself to such treatment, the use of the m.f.n. standard leads to the constant self-adaptation of such treaties and greatly contributes to the rationalization of international affairs."⁸⁷

This concept of the shrewdest drafters being put at the disposal of another country via the MFN obligation received very favourable treatment in a recent ICSID case, *Maffezini v Spain*.⁸⁷ In *Maffezini*, the tribunal determined that an Argentinean claimant was entitled to rely upon a provision from an investment treaty between Chile and Spain because this provision accorded more favourable treatment to the claimant than he would have received under the treaty between Argentina and Spain. He was permitted to do so because the Spain-Argentina BIT contained a MFN provision that entitled him to the best treatment made available to foreign investors in Spain. The less favourable provision, contained within the Spain-Argentina BIT, required the claimant to submit his dispute to a domestic court and wait as long as eighteen months before proceeding to arbitration. The more favourable provision, contained within the Spain-Chile BIT, permitted the claimant to immediately launch his arbitration. Accordingly, the tribunal held:

"if a third-party treaty contains provisions for the settlement of disputes that are more favorable to the protection of the investor's rights and interests than those in the basic treaty, such provisions may be extended to the beneficiary of the most favored nation clause as they are fully compatible with the *ejusdem* generis principle. Of course, the third-party treaty has to relate to the same subject matter as the basic treaty, be it the protection of foreign investments or the promotion of trade, since the dispute settlement provisions will operate in the context of these matters, otherwise there would be a contravention of that principle."⁸⁸

The result in the *Maffezini* case suggests that application of the MFN principle to NAFTA Article 1105, as modified by the NAFTA Commission's interpretation, may provide some very interesting results. Because each NAFTA party has entered into a free trade agreement or bilateral investment agreement since the NAFTA was brought into force, each has potentially offered better treatment to other investors than which is currently available in the Commission's modified version of NAFTA Article 1105.¹⁰

George Schwarzenberger, "The Most-Favoured-Nation Standard in British State Practice" (1945) 22 Br Y.B. Int'l L. 96 at 99-100.

⁸⁷ Emilio Agustín *Maffezini and The Kingdom of Spain*, Case No. A1 January 25, 2000, Decision of the Tribunal on Objections to Jurisdiction, see <www.worldbank.com/icsid/cases/emilio_DecisiononJurisdiction.pdf> (hereafter *Maffezini*)

⁸⁸ *ibid.*, at para 56.

⁸⁹ In NAFTA Annex IV, each of the NAFTA Parties have taken reservations for obligations entered into under international agreements in force or signed prior to the date of entry into force of the NAFTA (January 1, 1994) They have also taken identical, sector-specific reservations concerning future international treaty obligations. Accordingly, in relation to all other international economic treaties not limited to, or pertaining exclusively to, those sectors, the NAFTA Parties will be required to provide MFN treatment (i.e. extend terms as favourable to the investors and investments of the other NAFTA Parties as they have extended to any other investor or investment since the NAFTA came into force. This scenario was actually alluded to by the Pope tribunal in its consideration of how the "fair and equitable treatment" standard should be considered "additive" to whatever level of treatment must be

For example, in cases where United States measures are the subject of a NAFTA claim, an investor may turn to provisions such as Article 11:3 of the United States-Albania BIT (which came into force on January 4, 1998), requiring that:

- (a) Each Party shall at all times accord to covered investments fair and equitable treatment and full protection and security, and shall in no case accord treatment less favorable than that required by international law;
- (b) Neither Party shall in any way impair by unreasonable and discriminatory measures the management, conduct, operation and sale or other disposition of covered investments;

In cases against Mexico, the investor can refer to provisions such as Article 9-06 of the Mexico-Chile Free Trade Agreement, which came into force on August 1, 1999 and is identical to the text of NAFTA Article 1105. In cases against Canada, the investor can refer to provisions such as Article 2:2(a) of the Canada-Costa Rica BIT, which came into force on March 18, 1998 and requires "fair and equitable treatment in accordance with principles of international law".

Using Article 1103, investors with a claim against the United States could therefore argue for "fair and equitable treatment" as a stand alone concept, in addition to whatever treatment might be found to exist under "international law". Under Article 1103, investors with a claim against Mexico could receive exactly the same treatment that they would have been able to receive under NAFTA Article 1105 had the Commission never issued its statement. Finally, while investors with a claim against Canada would not be able to receive the status quo ante that existed in Article 1105, nor "fair and equitable treatment" as a stand alone concept, the investor would at least be able to put forward arguments based upon both custom *and* international legal principle to prove a breach of Article 1105.⁹¹

Accordingly, if the NAFTA Commission's interpretation of NAFTA Article 1105 was to be adopted by tribunals, such adoption would lead to the distinctly peculiar result that Mexican and American investors in Canada could receive somewhat less favourable treatment than would be afforded to Canadian investors in either the United States or Mexico. Canadian investors in Mexico or the United States would be able to make Article 1105 arguments that the breach of an international economic treaty obligation (Such as the WTO TRIPS Agreement) harmed their investment. For their part, Mexican investors in the United States would at least be able to take advantage of the "additive" character of the U.S. BIT's "fair and equitable treatment" standard.⁹² The least favourable treatment under this new regime would accordingly fall upon U.S. investors in Canada or Mexico.⁹³

required under international law (which it did not address). The tribunal apparently considered that if it did not adopt the interpretation of NAFTA Art. 1105 that it chose, it was likely that Art. 1103 could be used to bring about such a result anyway Pope Final Merits Award, at paras 117-118. One of the apparent results of application of the MFN obligation is that the Canadian Government would not be required to treat investments in accordance with international law where to do so would mean refraining from breaching an international treaty obligation that caused harm to an investor (such as an intellectual property obligation under the WTO TRIPS Agreement). By contrast, both the United States and Mexico would still need to provide such treatment, as it is countenanced in the basic concept of "treatment in accordance with international law," from which only Canada will have succeeded in exempting itself in the Commission's statement and the BITs it has concluded since ratifying the NAFTA. Keeping in mind that the NAFTA parties are not required, under the NAFTA, to provide the investments to their own nationals with treatment in accordance with Art. 1105, whatever that might be. This result is perhaps the most ironic, as rumour has it that it was the United States that finally agreed to make these changes to Art. 1105 in order to protect against claims that (because of the anti-retroactivity bias in customary international law) will likely be decided against the United States anyway.

These rather perverse results can only be avoided in two ways. Either tribunals will need to ignore the obvious application of the MFN rule, as applied in *Maffezini*; or they will need to conclude that either the Commission's statement cannot govern their interpretation of NAFTA Article 1105 because its purported interpretation cannot be supported under the customary international law rules of treaty interpretation. Otherwise, tribunals will need to prepare to hear arguments about the nature and content of customary international law, and how within the context of international economic law it has changed throughout the years.

(e) What is the Customary International Law Minimum Standard Anyway?

Of course, even if a tribunal were to accept the Commission's statement of interpretation as binding, but rejected the foregoing MFN analysis, it is not at all clear that the NAFTA governments would obtain the low level of treatment to which they hope to be held liable in future cases. This is because the standard of "fair and equitable treatment" may have entered into customary international law at any rate, aided by a slowly growing body of arbitral jurisprudence about what is, and is not, fair.

As Professor F.A. Mann once noted, the importance of including these kinds of provisions in BITS "lies in the contribution they make to the development of customary international law, in their being a source of law." In Mann's opinion:

"The paramount duty of States imposed by international law is to observe and act in accordance with the requirements of good faith. From this point of view it follows that, where these treaties express a duty which customary international law imposes or is widely believed to impose, they give very strong support to the existence of such a duty and preclude the Contracting States from denying its existence.

These remarks apply, in particular, to the overriding effect of the standard of fair and equitable treatment, to the duty not to expropriate except on certain terms and to the duty to 'observe any obligation arising from a particular commitment it may have entered into with regard to a specific investment'. The cold print of these [BITS] is a more reliable source of law than the rhetorics in the United Nations.,⁹⁴

The inclusion of provisions such as Article 1105 in virtually all BITS may accordingly be viewed as contributing to a lengthy process of development of customary international law. Accordingly, even if "fair and equitable treatment" and "full protection and security" were either omitted from a particular BIT, or were attributed the same interpretation accorded to them under the NAFTA Commission's statement, these standards might nonetheless be applicable as independent requirements whenever "treatment in accordance with international law" was required. As the case law from adjudication of provisions such as NAFTA Article 1105 (and the "fair and equitable treatment" standard in particular) continues to be made, it will become increasingly more difficult for governments to escape the burden of this minimum standard."

⁹⁴ F.A. Mann, "British Treaties for the promotion and protection of Investments" (1981), 52 *Brit Y.B. Int'l L.* 241 at 249-50.

jurisprudence, there will be more and more cases where the standard to which governments are held will be much higher

Conclusion: Realising Security for Foreign Investment

The NAFTA experience provides a tantalising image of how investment arbitration can be used to obtain security for foreign investors. The security it offers is not limited to the last chance remedy that it offers investors to obtain compensation for individual losses. Its primary function will be in providing an opportunity for development of a more unified jurisprudence of international economic law that can be used for the benefit of foreign investors worldwide. There are over 1800 bilateral investment agreements currently in place between approximately 170 countries. The efforts of a limited number of influential North American bureaucrats to limit access to this emerging body of law are not likely to be successful. There are too many BITS in place, offering too many investors the opportunity to pursue their own legal interests. The potential welfare gains are simply too great for us to turn back now.