Contract without Privity: Sovereign Offer and Investor Acceptance

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In the case of an investment dispute, Chapter 11 of the North American Free Trade Agreement ("NAFTA") permits investors from one NAFTA Party to submit to arbitration a claim against the sovereign government of another NAFTA Party. This type of arrangement in which a sovereign entity sets forth terms to which any potential claimant must accede in order for an agreement to be made is sometimes termed "arbitration without privity." Yet despite a lack of privity in negotiating the agreement, the parties to an arbitration still have an "arbitral contract." Chapter 11 is best viewed as a NAFTA Party's unilateral offer to arbitrate a specified set of claims (Section A) according to specified procedures (Section B). Arbitral tribunals will best serve NAFTA Parties and their investors by strictly adhering to the requirements set forth in Chapter 11.

Claimants frequently argue that enforcing the Chapter's terms literally is contrary to NAFTA's goal of investment expansion. Closer examination, however, reveals not only that such strict construction of the terms is required by international law, but also that such a construction would be more likely to achieve the goal of "increas[ing] substantially investment opportunities in the territories of the Parties." First, the NAFTA Parties waived their sovereign immunity from suit on the conditions set forth in Chapter 11. NAFTA was the product of extensive negotiation among the three Parties; arbitral tribunals lack the authority to rewrite that agreement by modifying the Chapter's terms. Effectively, investors may not counter-offer but must accept the terms set forth by the State Parties. Second, the Chapter's guidelines ease and facilitate investment by being clearly workable and predictable for all interested parties.

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Enhancing investors' ability to recover for breaches of Chapter 11 is often treated as the unwritten subtext of the goals set forth in Article 102 of Chapter One. For example, the tribunal in Metalclad Corp v United Mexican States cited Article 102 as the source for an “underlying” objective of NAFTA “to promote and increase cross-border investment opportunities and ensure the successful implementation of investment initiatives.” The italicized language is not in Article 102, and in fact, it is nowhere in NAFTA. Though it is possible to read the Preamble’s exhortation to “ensure a predictable commercial framework for business planning and investment,” in conjunction with the language that is in Article 102, to bolster what might be termed a “pro-investor” conclusion, this requires, as shown above, importing nonexistent language in the agreement. Accordingly, a more reasonable construction is that Chapter 11 is but one part of an overarching agreement that, as a whole, has helped to increase investment opportunities in the territories of the State Parties. Chapter 11’s mere existence may allay the fears of some investors wary of relying on whatever redress is available in a foreign land. Furthermore, the predictable framework referred to by the Preamble should benefit both State Parties and NAFTA investors.

An important additional consideration, however, is that the Parties did not agree to unfettered liability for investors’ setbacks. As the tribunal noted in Azinian v United Mexican States, “It is a fact of life everywhere that individuals may be disappointed in their dealings with public authorities... NAFTA was not intended to provide foreign investors with blanket protection from this kind of disappointment, and nothing in its terms so provides.”

Furthermore, each of the State Parties wore two hats when negotiating NAFTA. They negotiated the terms not only as potential defendants in Chapter 11 cases but also as representatives for their nationals who would be claimants in those cases against other State Parties. This construction reveals an inherent tension; investors may always want more access than State Parties are willing to provide in their notorious reluctance to give up their sovereign immunity. Nevertheless, when placed in historical context, Chapter 11 is a sizable step beyond the regimes to which State Parties have hitherto agreed. Recognizing this progress should help to reconcile investors and tribunals to the Chapter’s limitations. Construing it properly will help ensure its existence and may facilitate similar dispute settlement provisions in other free trade agreements. Construing Chapter 11 to reach beyond the Parties’ intentions, however, could dampen governments’ enthusiasm for investor-State dispute settlement.

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2. Metalclad Corp v United Mexican States, ICSID Case No ARB(AF)/97/1, Award (Aug 30, 2000) (on file with the Chicago Journal of International Law).
3. Id at para 75 (emphasis added).
5. Id at 549.
The historical context of NAFTA's investor-State dispute settlement chapter emphasizes the advances in the regime garnered by investors and supports tribunals' strictly adhering to Chapter 11's requirements. Critics often describe Chapter 11 as granting unprecedented rights to private investors vis-à-vis sovereign governments. This characterization is somewhat exaggerated—NAFTA Chapter 11 is arguably the latest step in a continuum that dates from at least the mixed claims commissions established in the latter 19th and early 20th centuries and extends through the bilateral investment treaties ("BITs") that came into favor in the 1980s. However, progress from agreements establishing mixed claims commissions has been slow at best and nearly stalled completely after World War II, when the vast majority of international claim dispute mechanisms were lump-sum settlement agreements.

The early claims commissions treaties differed from NAFTA Chapter 11 in important ways. First, these commissions were generally established to resolve a limited universe of claims arising from incidents that had already occurred. They therefore covered a finite, albeit possibly unidentified, set of potential claimants. While such definition does not preclude wrangling over certain claims or claimants at the margin that may or may not fall within an agreement's scope, the circumscription is nevertheless much more than in the Chapter 11 or BIT context. By contrast, Chapter 11 is forward-looking and by its terms does not apply to measures occurring before NAFTA's entry in force. Second, Chapter 11 applies to "investment disputes"—a more open-ended category than claims commissions established to settle all claims arising from certain incidents or sets of incidents, such as acts of piracy on the high seas. Third, most of these early claims commissions still required States to espouse investors' claims. This traditional screening mechanism, which required a government to present claims, remained to protect sovereigns from marginal or politically dicey claims. Chapter 11, on the other hand, permits investors to challenge State Parties directly, without diplomatic intervention. Fourth, the claims commissions generally used standing tribunals or permanent umpires, which might be thought to lead to greater consistency in decisionmaking and facility in comparing the merits of different claims. By contrast, Chapter 11 tribunals are ad hoc.

Nevertheless, despite these differences, cases decided by those claims commissions are important as primary sources developing the international law of claims. Without these decisions there would be a dearth of case-law authority as to the international law obligations of NAFTA State Parties under Chapter 11, which requires treatment "in accordance with international law." For that reason, those decisions are commonly referred to in NAFTA cases.

7. 32 ILM at 639 (cited in note 1).
More recent and more closely analogous precursors to Chapter 11 are BITs. Relatively few cases have been brought under the North American BITs, though ascertaining numbers is difficult given that some disputes are kept confidential. There is, therefore, little BIT precedent despite the similarity of some BIT provisions to the parallel NAFTA provisions. The greater number of cases brought under NAFTA to date, coupled with the relatively higher rate of cross-border investment among the three NAFTA parties than between most BIT partners, suggest that more cases will be decided in that context than in the BIT context.

Chapter 11, therefore, represents an important advance in the settlement of international claims. Its terms, however, are still limited. Chapter 11 permits an investor of one NAFTA Party with an investment in another NAFTA Party to bring a claim directly against that NAFTA Party on its own behalf or on behalf of its investment when measures adopted or maintained by that Party violate Section A of Chapter 11 and thereby cause injury. However, Chapter 11 need not, and should not, be read to mean that any NAFTA investor can recoup the losses it suffered in any investment deal gone awry by resorting to NAFTA dispute settlement.

On the issues raised in the cases brought to date, the State Parties have argued consistently for strict interpretation of Chapter 11’s terms. As of November 2000, eleven cases had been brought under Chapter 11, four each against Canada and Mexico, and three against the United States. The respondent State Party has raised jurisdictional objections of some kind in all of the ten cases that have progressed beyond initial stages. Those objections have fallen roughly into two categories: objections to procedure, for example, alleged failures to meet the requirements set out in Section B of Chapter 11; and objections to substance, for example, allegations that the claim itself falls outside the scope of the chapter.

Again as of November 2000, tribunals have issued full or partial decisions in six of those cases. These decisions are not binding precedent on other NAFTA tribunals, but may be viewed as persuasive authority by subsequent tribunals. It is too early to draw conclusions from this relative paucity of arbitral decisions. To date, however, only the tribunal in Waste Management, Inc v United Mexican States has dismissed a case on jurisdictional grounds while the other tribunals that have issued decisions have rejected jurisdictional challenges.

A sampling of jurisdictional arguments from five of the decided cases follows, as space constraints prohibit a thorough analysis of every jurisdictional argument raised

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8. This number includes only those cases in which tribunals have been constituted.
9. 32 ILM at 646 (cited in note 1).
in every case. Recurring themes include challenges to the waiver required by Article 1121, allegations that the challenged measure related to trade rather than investment, and allegations that claimants did not comply with the time periods set forth in Section B.

In Waste Management, Mexico challenged the validity of the waiver filed by the investor pursuant to Article 1121, which requires that claimants “waive their right to initiate or continue before any administrative tribunal or court under the law of any Party, or other dispute settlement procedures, any proceedings with respect to the measure of the disputing Party that is alleged to be a breach . . . “ Waste Management had filed a waiver reiterating the language in Article 1121 but adding language stating that the waiver did not apply to any dispute settlement proceedings alleging that Mexico had violated duties imposed under other sources of law, including the municipal law of Mexico. The company further noted that it intended to comply with Article 1121’s requirements. The panel majority found that Waste Management’s concurrent pursuit of redress in local courts evidenced an intent at odds with the waiver’s requirements. Accordingly, the tribunal held that the additional language “failed to translate as the effective abdication of rights mandated by the waiver.”

In Ethyl Corp v Canada, Canada raised several jurisdictional arguments, both substantive and procedural. Ethyl Corporation had claimed that it would be injured by Canadian legislative action that banned the interprovincial trade or import of the gasoline additive methylcyclopentadienyl manganese tricarbonyl (“MMT”). The case also featured a challenge to the waiver as Canada argued that Ethyl Canada’s waiver was insufficient because it was not filed with the Notice of Arbitration but later, with the Statement of Claim. Canada also contended that the claim fell outside the scope of Section A of Chapter 11, arguing that the measure at issue, a legislative bill, was not yet a measure adopted or maintained by a Party because it had not yet received royal assent at the time Ethyl filed its NAFTA claim. As a corollary, Canada argued that

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11. In the sixth case, Azinian v United Mexican States (cited in note 4), Mexico objected to the standing of two of the shareholders. Because there were other qualified shareholders, the objection would not have disposed of the case in its entirety and the Azinian tribunal chose not to address those questions preliminarily.
12. 32 ILM at 643 (cited in note 1).
15. Id at para 30.
16. Id at para 31. But see Waste Management, Inc v United Mexican States, ICSID Case no Arb(AF)/98/2, Dissenting Opinion June 2, 2000 (visited Mar 25, 2001) (finding waiver to be effective on date offered, and therefore sufficient to confer jurisdiction on the tribunal). Waste Management has refiled its case; ICSID registered the new case on Sept 27, 2000.
Ethyl's Statement of Claim, which was filed after the Act had received royal assent, was impermissible because the Act itself had not been referred to in the Notice of Arbitration and was not properly before the tribunal. Canada also claimed that Ethyl had failed to comply with the procedural requirement that an investor wait six months from the event giving rise to a breach before submitting a claim. Canada argued further that the measure related to trade in goods, rather than to investment, and was therefore not the type of measure that fell within the purview of Chapter 11.

The Ethyl tribunal dismissed these jurisdictional objections. It held that even if the MMT Act affected trade in goods and was covered under Chapter 3 of NAFTA, it could be covered under Chapter 11 as well. The tribunal gave short shrift to Canada's timeliness argument, noting that by the time the Claimant had submitted its Notice of Arbitration, the bill had passed the Senate and awaited only royal assent, which would be forthcoming as a matter of course. Finally, lumping together what it termed "procedural objections," the Ethyl tribunal concluded that NAFTA's goals of increasing investment opportunities and creating effective procedures for the resolution of disputes did not comport with overly strict readings of the procedural requirements and that the Parties did not intend that those conditions must be fulfilled in order for a tribunal's jurisdiction to attach.

Canada withdrew its ban on interprovincial trade after a panel convened under the Agreement on Internal Trade found the MMT Act to be inconsistent with that Agreement. Contrary to some popular media reports, the Ethyl tribunal did not cause Canada to reverse the ban. NAFTA Chapter 11 Tribunals may only give relief in the form of monetary damages and applicable interest; they may also order restitution of property so long as they provide that the disputing Party may pay damages and interest in lieu of restitution. Canada did settle the NAFTA case after the panel rendered its decision, though the fact that the ban violated the Agreement on Internal Trade does not necessarily mean it violated international law.

Canada made two similar jurisdictional arguments in Pope & Talbot, Inc v Canada, a case challenging Canada's implementation of the Softwood Lumber Agreement ("SLA"). First, Canada argued that the dispute in question was not an investment dispute because the SLA and its implementation are not measures relating to

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18. Id at 725.
19. Id at 725–6.
20. Id at 727–30.
22. 32 ILM at 646 (cited in note 1).
investment, but are rather measures relating to trade in goods that fall outside the scope of Chapter 11. Like the Ethyl tribunal, that tribunal determined that NAFTA contained “no provisions to the express effect that investment and trade in goods are to be treated as wholly divorced from each other,” and further found “the fact that a measure may primarily be concerned with trade in goods does not necessarily mean that it does not also relate to investment or investors.”

Second, Canada argued that Pope & Talbot had failed to file with its notice of arbitration a waiver from an investment on whose behalf it was submitting a claim, as required by Article 1121(b). By the time it did file the requisite waiver, Canada argued, the three-year period within which an investor may submit a claim under NAFTA had run. The tribunal rejected both arguments, noting the Ethyl award’s statement that a constructive waiver by the investor might be said to accompany the initiation of arbitral proceedings. It held that the waiver in Article 1121, which preserves an investor’s right to seek injunctive and similar relief, should be viewed as working to the benefit of the investor, and that failure to execute such a waiver would only disadvantage the investor. The tribunal concluded that “there would be no good reason to make the execution of the investor’s waiver a precondition of a valid claim for arbitration.”

In SD Myers, Inc v Canada, Canada again raised its argument that the measure in question, a ban on the export of PCB waste for disposal, was not a measure relating to investment because it dealt with trade in goods. The SD Myers tribunal dismissed that argument, citing the Pope & Talbot tribunal in accepting the view that “different chapters of the NAFTA can overlap and that the rights it provides can be cumulative except in cases of conflict.” Canada also argued that SD Myers lacked standing to bring a claim under Chapter 11 because Myers Canada, the Canadian enterprise in question, was not owned or controlled directly or indirectly by SD Myers, Inc, but was owned directly by the four shareholders of SD Myers, Inc. The SD Myers tribunal dismissed that argument, noting its reluctance to believe that “an otherwise meritorious claim should fail solely by reason of the corporate structure adopted by a claimant in order to organize the way in which it conducts its business affairs.”

24. Pope & Talbot, Inc v Canada, Award on Motion to Dismiss, para 26 (Feb 24, 2000) (on file with the Chicago Journal of International Law).
25. Id at para 33.
26. Pope & Talbot, Inc v Canada, Award in Relation to Preliminary Motion by Government of Canada to Strike Paragraphs 34 and 103 of the Statement of Claim from the Record (the “Harmac Motion”), para 16 (Feb 24, 2000) (on file with the Chicago Journal of International Law).
27. Id.
29. Id at para 294.
30. Id at para 229.
In *Metalclad*, Mexico argued that one of the measures at issue, an ecological decree preventing any development on land on which Metalclad had sought to develop a hazardous waste disposal facility, postdated the notice of arbitration. Mexico argued that Metalclad had not fulfilled the requirements of Section B of Chapter 11 because it had not provided a notice of intent to arbitrate with respect to that claim, and because six months had not elapsed between the events giving rise to the claim and its submission. The Tribunal rejected this argument, noting that the applicable arbitral rules permitted additional or incidental claims that fall within the scope of the arbitration agreement of the parties.

This article is not the place for a detailed analysis of the merit (or lack thereof) of the Chapter 11 tribunal decisions to date. On a global basis, it is too early to draw firm conclusions from these few decisions. It is, however, difficult to avoid a preliminary judgment that Chapter 11 tribunals have been, and may continue to be, loath to accept jurisdictional objections. Tribunals should reconsider their reluctance to credit what may seem like picayune insistence that compliance with the terms of Section B is required. The State Parties consented to the submission of claims to arbitration "in accordance with the procedures set out in this Agreement." Those procedural requirements are fairly easily identified and fairly easily met. Moreover, a tribunal's jurisdiction depends on compliance with those procedures, since those are the terms on which the State Parties consented to waive their immunity and submit to arbitration. Thus, requiring that investors meet those conditions ought to be viewed as essential to the lawful invocation of jurisdiction by Chapter 11 tribunals.

Determining whether a dispute falls within the scope of the Chapter 11 is more difficult. Certainly measures taken by a country may relate to more than just investment, and may also affect trade, or transportation, or any number of things. State Parties should not be able to avoid their Chapter 11 obligations on the basis of nomenclature alone. On the other hand, while virtually any government measure may be viewed as relating to investment within its borders in some sense by virtue of the ripple effect that most government measures have throughout an economy, it is untenable to suggest that the NAFTA State Parties intended to extend an unbounded offer to arbitrate disputes arising from any regulatory or other measure taken by the state.

32. Id.
33. Id at paras 66-69. Mexico has petitioned the Supreme Court of British Columbia to set aside the *Metalclad* award on the grounds, inter alia, that the *Metalclad* tribunal acted outside its jurisdiction by deciding matters of municipal law that should have been referred to Mexican courts. See Amended Petition to the Court at para 72(a), *United Mexican States v Metalclad Corporation*, Vancouver Reg No L002904 (B C Sup Ct) (filed Nov 14, 2000) (on file with the Chicago Journal of International Law).
34. 32 ILM at 643 (cited in note 1).
State Parties are likely to continue urging narrow construction of the Chapter, and are justified in so doing. Such an offer, whose terms were agreed to by three State Parties with the goal of protecting their own investors as well as protecting their fiscs, may only be accepted on its terms. There is little to no room for modification without renegotiating the agreement. Abiding by that restriction does not mean that the goals of Chapter 11 or of NAFTA more broadly will be frustrated. To the contrary, judicious construction of both the procedural and substantive requirements of Chapter 11 will ensure that it survives to inform the next generation of dispute settlement agreements.

35. 32 ILM at 645 (cited in note 1) (This allows the Free Trade Commission, comprising trade ministers of the three Parties, to issue a binding "interpretation" of provisions of Chapter 11. That article does not speak to how modifications might be effected.)