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Considerations of NAFTA Chapter 11
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I. INTRODUCTION

The North American Free Trade Agreement ("NAFTA")1 entered into force in January 1994. For Mexico, this was an important step. Before NAFTA, all foreign investor disputes were resolved in domestic administrative tribunals and judicial courts because Mexico did not recognize international claims by foreign investors. Since NAFTA, however, Mexico has changed its policy and now allows investors of the other NAFTA Party to submit a claim against it before an international tribunal for breach of its obligations under NAFTA Chapter 11.

NAFTA Chapter Eleven is divided in two sections: Section A contains the substantive rules such as National Treatment, Minimum Standards of Treatment, Performance Requirements, Transfers and Expropriation, and Compensation.2 Section B contains the dispute settlement rules for investor-State arbitrations. The disputing party is able to choose among three different arbitration rules: the Convention on the Settlement of Investment Disputes between States and Nationals of Other States ("ICSID Convention"), the International Centre for Settlement of Investment Disputes ("ICSID") Additional Facility Arbitration Rules, or the United Nations Commission on International Trade Law ("UNCITRAL") arbitration rules.3

NAFTA Chapter 11 is similar to the Bilateral Investment Treaties ("BITs") signed by the United States. The investor-State mechanism has been used by investors to claim damages for alleged breach of their investments. This mechanism

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2. Id at 639–649.
allows the investor of one Party to bring a claim against another Party for alleged breaches of Section A of NAFTA Chapter 11.

Given the importance of this chapter for both investments and investors in the North American region, I will proceed to make a general overview of some issues regarding Minimum Standards of Treatment and Expropriation principles. I will also comment on the recent decision in the *Metalclad* case and on the acceptance of amicus curiae briefs in investor-State arbitrations.

II. MINIMUM STANDARDS OF TREATMENT

NAFTA Article 1105(1) has been the subject of multiple interpretations. This Article provides that:

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.

This article states the rules of treatment that a host Party is obligated to accord to investments of investors of another Party. The obligations of the NAFTA Parties are to provide treatment in accordance with international law. The phrases "fair and equitable treatment" and "full protection and security" are standards that were incorporated into Article 1105(1) from customary international law.

In customary international law, "fair and equitable treatment" is the international standard for a Minimum Standard of Treatment. The phrase "fair and equitable treatment" was used for the first time in the Organization for Economic Cooperation and Development ("OECD") Draft Convention on the Protection of Foreign Property in 1963. The Notes and Comments to Article 1 of the Draft Convention states that "the phrase fair and equitable treatment ... indicates the standard set by international law for the treatment due by each State with regard to the property of foreign nations. ... The Standard required that conforms in effect to the minimum standard which forms part of customary international law". For this reason, fair and equitable treatment is viewed as linked to the customary international minimum standard.

However, the Minimum Standards of Treatment are only granted to the investments of another Party and not to the investor itself. That is, in order to claim that the State failed to provide the appropriate standard of treatment, the company, not the individual investor, must be able to prove its assertion of damages.

5. 32 ILM at 639.
7. Id at 244.
III. EXPROPRIATION AND COMPENSATION

Article 1110(1) has also been the subject of multiple interpretations. NAFTA Article 1110(1) states that:

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.

The text refers to three concepts: direct and indirect nationalization or expropriation, and a measure tantamount to nationalization or expropriation. However, it is not clear that the text is making reference to three different kinds of nationalization or expropriation. In my opinion, a measure tantamount to expropriation falls within the scope and coverage of an indirect expropriation for the reasons stated below.

It is well recognized in international law that there are only two kinds of expropriation: direct expropriation, where there is a taking by the government for a public purpose, and indirect expropriation, which is the result of a measure that amounts to an expropriation. A direct expropriation implies a transfer of the title of the property in question to the host State. When a State Party plans to expropriate directly, it must do so on a non-discriminatory basis and through the payment of compensation at the fair market value of the property. An indirect expropriation, on the other hand, is more difficult to identify because there is no actual transfer of the investor's property to the host Party. Rather, it may be the result of interference with property that is equivalent to a taking of the investor's property.

With respect to a measure tantamount to expropriation, NAFTA arbitral tribunals have clarified this issue in the recent decisions of Pope & Talbot and SD Myers. In SD Myers, the arbitral tribunal made reference to the primary meaning of the word "tantamount." According to the Oxford English Dictionary, the word tantamount means equivalent. In Pope & Talbot, the tribunal concluded that "something that is 'equivalent' to something else cannot logically encompass more." The same position was supported by the tribunal in SD Myers which concluded that the intention of the drafters of the NAFTA was to use the word "tantamount" to embrace the concept of so-called "creeping expropriation," rather than to expand the internationally accepted scope of the term "expropriation." If this conclusion is
accepted, a measure tantamount to expropriation cannot be considered as a new category of expropriation.

Moreover, NAFTA Article 1110 does not provide the standards for determining the applicability of what is a measure tantamount to expropriation, nor can it be determined by international law. It is unlikely that the Parties had sought to expose themselves to possible liability by creating a new category of expropriation without providing guidance regarding what constituted a measure tantamount to expropriation.

IV. THE METALCLAD AWARD

In addition to the comments above regarding NAFTA Articles 1105 and 1110, it is also important to bear in mind the Metalclad award issued on August 30, 2000. In this case, the tribunal found that Mexico was responsible for the inability of Metalclad, a small US company, in successfully operating a hazardous waste landfill built on a previously contaminated site at La Pedrera in the Mexican State of San Luis Potosí. However, it is important to note that Mexico has commenced proceedings to set aside the award.

In this arbitration, the company acquired a hazardous waste landfill site in the state of San Luis Potosí from Mexican owners. The La Pedrera site was previously contaminated with 20,000 tons of toxic waste that were stored without any treatment. The previous owners had obtained some of the necessary permits for the landfill, but never obtained the construction or operating licenses from the municipality of Gualdalcázar. Despite not having a construction permit, Metalclad began construction. The municipality had denied the permit because it wanted the toxic waste already at the site to be treated before any new waste was brought in. Area residents and environmental non-governmental organizations raised this issue in opposing the reopening of the landfill, creating a social and political problem for the government of San Luis Potosí.

The tribunal concluded that the municipality was not entitled to deny the Municipal Construction License based on environmental matters, because hazardous waste is regulated by the Federation. In the arbitral tribunal's opinion, the municipality's jurisdiction is limited to construction and building security matters and therefore it was not empowered to support its decision on environmental grounds. That is, the municipality was obligated to grant the permit because Metalclad had

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15. Metalclad, ICSID Case No ARB(AF)/97/1, Award of Aug 30, 2000.
17. These proceedings were filed in the Supreme Court of British Columbia in Vancouver. British Columbia was selected by the tribunal as the place of arbitration. Mexico submitted to the court its petition to set aside the award on November 2000. The hearing is scheduled to commence on February 19, 2001.
previously obtained the federal permit. Thus, the municipality's denial was illegal. Consequently, the tribunal found Mexico liable for breach of NAFTA's minimum standard of treatment and expropriation provisions in Articles 1105 and 1110.**

Regarding Article 1105, the tribunal concluded that, "Metalclad's investment was not accorded fair and equitable treatment in accordance with international law."** In order to find a violation of "fair and equitable treatment" under Article 1105(1), the tribunal made reference to NAFTA Article 102(1), which states that one of the objectives of the treaty is the "transparency" principle.** The tribunal interpreted "transparency" in its award as the "idea that all relevant legal requirements for the purpose of initiating, completing and successfully operating investments made, or intended to be made, under the Agreement should be capable of being readily known to all affected investors of another Party."** The tribunal also stated that, according to the transparency principle under NAFTA Article 102(1), "once the authorities of the central government of any Party... become aware of any scope for misunderstanding or confusion in this connection, it is their duty to ensure that the correct position is promptly determined and clearly stated so that investors can proceed with all appropriate expedition in the confident belief that they are acting in accordance with all relevant laws."**

Based on the above, the tribunal considered that given the "absence of a clear rule as to the requirement or not of a municipal construction permit, as well as the absence of any established practice of procedures as to the manner of handling applications for a municipal construction permit, amounts to a failure on the part of Mexico to ensure the transparency required by NAFTA."** According to the tribunal, the lack of transparency in the legal framework resulted in a breach by Mexico of its obligation to provide Metalclad with "fair and equitable treatment" as required by NAFTA Article 1105(1).**

The bases upon which the tribunal found a breach by Mexico of NAFTA Article 1105(1) are questionable. NAFTA Article 102(1) states as follows:

1. The objectives of this Agreement, as elaborated more specifically through its principle and rule, 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;

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18. Metalclad at paras 73–112.
19. Id at para 74.
20. Id at para 76.
21. Id.
22. Id (emphasis added).
23. Id at para 88 (emphasis added).
(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 applications of this Agreement, for its joint administration and for the resolution of disputes; and
(f) establish a framework for further trilateral, regional and multilateral co-operation to expand and enhance the benefits of this Agreement.

From the simple reading of these provisions, there is no basis to find a breach of NAFTA Chapter 11 for lack of transparency in the rules and procedures for handling applications for a municipal construction permit in a State Party. It is highly questionable to read NAFTA Article 102(1) as requiring the NAFTA Parties to ensure that the correct position in its administrative and judicial rules and procedures be promptly determined, and to clarify the rules and procedures when there is a misrepresentation on behalf of an investor. In other words, a tribunal is not empowered to create more obligations than those negotiated by the NAFTA Parties in Chapter 11.

Regarding Article 1110, the tribunal concluded that in denying Metalclad fair and equitable treatment by preventing it from operating the landfill, notwithstanding that the project was approved and supported by the federal government, and thereby violating Article 1105, Mexico also took a measure tantamount to expropriation in violation of Article 1110(1).

The tribunal's considerations in finding a breach of NAFTA Article 1110(1) based on a violation of Article 1105(1) are suspect for the reasons stated above in reference to transparency. That is, if the tribunal has no basis to support its finding of breach of the minimum standard of treatment for lack of transparency, it also has no grounds to conclude that a measure tantamount to expropriation can be found by the fact of lack of transparency in the legislation and rules of a Party.

In addition, the tribunal equated a simple alleged breach of domestic law, such as the Municipal Construction License denial, with a breach of Mexico's international law obligations under NAFTA. In my opinion, the tribunal failed to consider that these kinds of acts have to be challenged in the appropriate domestic administrative and judicial fora. A tribunal should not rule upon domestic legislation. The tribunal exceeded its jurisdiction in linking transparency issues with domestic legislation.

Another relevant issue is that the tribunal issued an award without clearly setting out all of the arguments and evidence of both parties. It is an international standard that an award must clearly set out the reasons and bases of its evaluation of the arguments and evidence. However, in this award, there are no reasons stated by the tribunal as to why the arguments and evidence presented by one of the disputing

25. 32 ILM 296 at 297.
Considerations of NAFTA Chapter 11

parties was not taken into consideration. This obviously leaves a disputing party in a position to challenge the decision. In my opinion, before rendering its decision, a tribunal should be cautious to consider and include all the reasons for its decision, including an evaluation of the evidence, testimony, and expert reports, in order to avoid a challenge to its decision before the national courts of the place of arbitration.

V. AMICUS CURIAE IN INVESTOR-STATE ARBITRATIONS

Another important issue is the participation of third parties in arbitrations initiated under Chapter 11. Amicus curiae participation in NAFTA Chapter 11 should not be considered a procedural matter that can be resolved by tribunals. Rather, amicus curiae participation is a policy matter that should be decided by the NAFTA Parties because the provisions of Chapter 11 do not contemplate such intervention.

Although some cases involve environmental issues, NAFTA Chapter 11 does not contemplate environmental disputes per se. A tribunal is only entitled to resolve a claim in relation to the principles and obligations under Section A of Chapter 11. Environmental measures disputes are not a basis for an investor to bring a claim to arbitration. In fact, NAFTA Article 1114 provides that a Party is able to impose regulations to protect the environment and that it is not permitted to decrease the environmental protection regulations in order to promote foreign investment. Despite the latter, several environmental agencies are interested in participating in cases brought under Chapter 11 through the submission of pleadings known as amicus curiae. These briefs are made by persons or agencies that do not have standing to participate in a proceeding. Allowing these submissions would affect NAFTA Chapter 11 because it could make these proceedings public, and it could empower tribunals to take those briefs as expert opinions in a specific matter.

NAFTA does not contemplate the submission of amicus curiae in cases brought under Chapter 11. The parties in an investor-State arbitration are the disputing party (the Claimant) and the State Party (the Respondent). In addition, NAFTA Chapter 11 allows for limited participation from the other NAFTA Parties in the form of submissions regarding matters of interpretation of the treaty. It is important to point out that the other NAFTA Parties’ right to participate is limited to what Article 1128 encompasses. Therefore, we should conclude that Chapter 11 does not provide for third party participation. This conclusion is reinforced by the fact that when a

27. Although any application to set aside an award in an arbitral proceeding under the ICSID Convention (as opposed to Additional Facility’s proceedings such as in Metalkola) must occur by way of the internal ICSID annulment proceedings.

28. 32 ILM at 639-649.

29. Id at 642.

30. Id at 645.
NAFTA Party receives information related to evidence and written arguments, in order to make a submission, the Party is obligated to treat that information as if it were a disputing party.31

Thus, it is clear that the negotiators of NAFTA intended to limit access to the investor-State arbitration to the Claimant, the Respondent and the other NAFTA Parties. However, the NAFTA negotiators did not clarify whether it was the intention of the Parties to make these proceedings confidential. Thus, the tribunal should respect the agreements reached by the disputing parties. If there is no such agreement, the tribunal should follow what Chapter 11 or the procedural rules provide. For example, Article 25(4) of the UNCITRAL arbitration rules provides that in the absence of an agreement between the parties, the hearings should be held in camera.32 Therefore, in my opinion, in the absence of clear rules of confidentiality regarding the proceedings and information, arbitrations should not be open to the public until the NAFTA Parties establish rules that would resolve these problems. It is an international principle that only the parties in a treaty are entitled to modify the content of a treaty. Therefore, the NAFTA Parties should be entitled to state their positions confidentially, and the tribunal should not give access to the public or accept third party participation because of the impact this could have on Chapter 11.

On the other hand, NAFTA Article 1133 provides that “a tribunal, at the request of a disputing party or, unless the disputing parties disapprove, on its own initiative, may appoint one or more experts to report to it in writing on any factual issues concerning environmental, health, safety or other scientific matters raised by a disputing party in a proceeding.”33 That is, the tribunal is entitled to appoint experts in order to obtain opinions on specific matters. It is important to mention that the tribunal is obligated to obtain the consent of the disputing parties before it appoints such experts. Therefore, in my opinion, a tribunal is not entitled to receive expert opinions through amicus briefs without the consent of the disputing parties. Amicus curiae are not independent opinions. They are always interested in supporting one specific position. The acceptance of these pleadings could be unfair to the other party, which would have to spend time and money in order to respond to such additional argument. Until the NAFTA Parties decide whether to agree to such submissions, a tribunal should not authorize the participation of third persons and should not accept opinions that have not been requested and accepted by the disputing parties.

31. Id at 645.
32. UNCITRAL Arbitration Rule 25(4).
33. 32 ILM at 646.
VI. CONCLUSION

There are several other considerations to make on Chapter 11. However, I will limit my conclusion to the issues raised above.

Regarding NAFTA Article 1105, it is right to conclude that "fair and equitable treatment" as well as "full protections and security" are minimum standards of treatment from the customary international law and that Minimum Standard of Treatment applies only to investments and not to investors.

Regarding NAFTA Article 1110, international law has only recognized two kinds of expropriations—direct and indirect. A measure tantamount to expropriation is a subcategory of an indirect expropriation. Chapter 11 does not create a new category of expropriation.

Regarding the Metalclad award, I believe that the tribunal does not have jurisdiction to create new obligations for NAFTA Parties beyond those already negotiated. That is, transparency does not include regulations and legislation of a Party.

Regarding amicus curiae, this is a policy problem that should be resolved by the NAFTA Parties and not by the tribunals. Moreover, Chapter 11 does not provide for third party participation. A tribunal is limited to accepting expert opinions only if the disputing parties consent.