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## NAFTA Chapter 11 Dispute Resolution and Mexico: A Healthy Mix of International Law Economics, and Politics

### Keywords

Dispute Resolution, Economics, International Law: History, Politics, Investment, International Trade, States, Treaties

# NAFTA CHAPTER 11 DISPUTE RESOLUTION AND MEXICO: A HEALTHY MIX OF INTERNATIONAL LAW, ECONOMICS AND POLITICS

Scott R. Jablonski\*

## I. INTRODUCTION

Trade and investment agreements provide the political, economic and legal framework for economic integration in the modern international political economy, and underscore the importance of international law in the integration process. The proliferation of such agreements among nation-states since the mid-twentieth century has been a major factor contributing to the increasing volume of business transactions across borders.<sup>1</sup> The Americas are certainly not an exception to these trends. There are roughly fifty regional, sub-regional and bilateral trade and

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1. Since the inception of the General Agreement on Tariffs and Trade (“GATT”) in 1948, now the World Trade Organization (“WTO”), there has been continued increase in the number of trade agreements in the world. “At present, about 97% of total global trade involves countries that are members of at least one PTA, compared with 72% in 1990. Asian Development Bank, *Trends in Trade and the Expansion of PTAs*, at <http://www.adb.org/Documents/Books/ADO/2002/pta0200.asp> (last visited Feb. 23, 2003) [hereinafter “*Trends in Trade*”]. Notably, there was 22-fold increase in world trade in merchandise from 1948 to 2000. World Bank, *Doha WTO Ministerial 2001* at [http://www.wto.org/english/thewto\\_e/minist\\_e/min01\\_e/brief\\_e/brief21\\_e.htm](http://www.wto.org/english/thewto_e/minist_e/min01_e/brief_e/brief21_e.htm) (last visited Feb. 23, 2003) [hereinafter “*Doha WTO*”]. Aggregate world trade in goods in services in 1948 was \$58 billion, compared to \$7.6 trillion in 2000. *Id.* In 2000, total world foreign direct investment flows reached \$1261 billion, which was 53-fold increase from 1973 when such investment totaled \$24 billion. *Id.* Between 1990 and 2000, the number of bilateral investment treaties (“BITs”) between countries increased from 470 to nearly 2000, and some regional trade groupings such as NAFTA and the EU have incorporated investment agreements into their broader trade agreements. Mary Hallward-Driemeier, *Do Bilateral Investment Treaties Attract FDI? Only bit .and they could bite*, (June 2003), at [http://econ.worldbank.org/files/29143\\_wps3121.pdf](http://econ.worldbank.org/files/29143_wps3121.pdf) (last visited Mar. 15, 2004).

integration agreements in the Americas,<sup>2</sup> with negotiations underway for other agreements, including a Free Trade Area of the Americas ("FTAA").<sup>3</sup> In 2000, total trade among FTAA negotiating countries had reached roughly \$784 billion, growing at 11% annually.<sup>4</sup>

Within the context of multilateral governance of trade and investment and increasing transnational business transactions lies the following reality: more transnational transactions mean an increasing need to seek effective, uniform principles of dispute resolution for disputes between private parties and governments arising out of a government's obligations under a trade agreement.<sup>5</sup> This is particularly true in the context of trade-related investment agreements, through which private parties play a direct role in economic integration.<sup>6</sup> The role of law in the modern international political economy is therefore paramount.

Several obstacles, however, often hinder or severely detract from efforts to achieve uniformity of dispute resolution among foreign legal systems. The greatest obstacle is the phenomenon of differing legal traditions. Alternative Dispute Resolution ("ADR"), namely arbitration, has emerged as the preferred method of dispute resolution among nation-states belonging to trade agreements, as well as among private parties engaged in international transactions.<sup>8</sup> Indeed, in the context of international investment, private parties have long preferred international arbitration for resolving investment disputes with foreign governments.<sup>9</sup>

Chapter 11 of the North American Free Trade Agreement ("NAFTA")<sup>10</sup> is unique among trade agreements in that it contains an entire chapter dealing with foreign investment and the protection of such investment.<sup>11</sup> Chapter 11 broadly defines who an investor is and what an investment is in North America, and gives

2. See SICE, *Inventory of Dispute Settlement Mechanisms, Procedures and Legal Texts Established in Existing Trade and Integration Agreements, Treaties and Arrangements in the Hemisphere and the WTO*, at [http://www.sice.oas.org/cp\\_disp/English/dsm\\_toc.asp](http://www.sice.oas.org/cp_disp/English/dsm_toc.asp) (last visited Feb. 23, 2003) [hereinafter "SICE, *Inventory*"].

3. See *infra* note 43.

4. Council of the Americas, *Free Trade Area of the Americas*, at <http://www.americas-society.org/coal/publications/testimony.AmbFrechette-9-9-02.html> (last visited Feb. 23, 2003) [hereinafter "*Free Trade Area*"].

5. See Hope H. Camp, Jr., *Dispute Resolution and United States-Mexico Business Transactions*, 5 U.S.-MEX. L.J. 85 (1997); see Noemi Gal-Or, *Private Party Direct Access: A Comparison of the NAFTA and the EU Disciplines*, 21 B.C. INT'L & COMP. L. REV. 1, 3, 11-12 (1998).

6. See Camp, *supra* note 5; see Gal-Or, *supra* note 5.

7. *Id.*

8. *Id.*

9. See *infra* Part II.C.2.b (discussing various aspects of international alternative dispute resolution).

10. North American Free Trade Agreement, Dec. 17, 1992, part 5, chapter 11, U.S.-Can.-Mex. (effective Jan. 1, 1994), reprinted in 32 I.L.M. 289, 296 (1993) [hereinafter "NAFTA"]. The Contracting Parties to NAFTA are Canada, the United Mexican States ("Mexico") and the United States of America ("United States").

11. Donald S. Macdonald, *Chapter 11 of NAFTA: What are the Implications for Sovereignty*, 24 CAN.-U.S. L.J. 281 (1998) (pointing out that NAFTA is "the first comprehensive international trade treaty to provide to private Parties direct access to dispute settlement as of right.")

private investors in NAFTA Parties<sup>12</sup> direct access to binding international arbitration for claims against NAFTA Parties arising out of investment disputes. NAFTA thus seeks to bridge the gap between private individuals and governments in the resolution of cross border commercial disputes. And, it does so by creating an opportunity for a private investor to resolve an investment dispute without litigating in foreign courts or pressuring the investor's home government to resolve the dispute through diplomatic bargaining.<sup>13</sup> The arbitration alternative is also a pragmatic approach to the pressing need for effective international investment dispute resolution without engaging in the monumentally difficult task of harmonizing three different legal systems.<sup>14</sup> Chapter 11 dispute resolution is indeed representative of the evolving link between international law, economics and politics in the modern global political economy

Despite its pragmatism and progressive nature, however, Chapter 11 dispute resolution has not escaped criticism. In recent years it has come under attack by various groups and commentators in NAFTA Parties whose arguments are generally based upon two main assertions: Chapter 11 dispute resolution is a threat to national sovereignty and an abrogation of democracy<sup>15</sup> These critics base their assertions on what they believe are fundamental flaws in the Chapter 11 dispute resolution framework. The most often-cited arguments are that Chapter 11 promotes frivolous litigation and permits disproportionate compensation, lacks an adequate award review process, uses "secret" tribunals to reduce transparency prevents legitimate governmental regulation, and derogates from notions of equality and sustainable development.<sup>16</sup> In recent years, the literature on Chapter 11 has increased as the general debate on its dispute resolution framework has intensified.

The debate has centered primarily on whether Chapter 11 is detrimental to all NAFTA Parties. A focus on Mexico, however, is particularly intriguing given Mexico's history toward foreign investment and its economic status relative to Canada and the United States.<sup>17</sup> Interestingly Chapter 11, for all intents and purposes, runs counter to the traditional Mexican approach to international law and foreign investment. That traditional approach emanates from conceptions of international law and economic integration that are quite opposite from the

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12. The text of NAFTA refers to Canada, Mexico and the United States as "Parties, therefore for purposes of consistency I refer to NAFTA countries as NAFTA Parties and a NAFTA country individually as NAFTA Party.

13. See Charles H. Brower II, *Investor-State Disputes Under NAFTA: The Empire Strikes Back*, 40 COLUM. J. TRANSNAT'L L. 43, 44 (2001) [hereinafter "Brower II"].

14. *Id.*

15. See *infra* Part IV. Brower II, *supra* note 13, at 44 (noting that Chapter 11 "has become a lightning rod for opponents of globalization and the intrusion of international law into domestic affairs.")

16. See *infra* Part IV This is not an exhaustive list of the criticisms of Chapter 11; however, it does include the most often-cited arguments and thus the arguments that deserve most attention for purposes of this article.

17 This is not to de-emphasize the implications of Chapter 11 on the United States and Canada. That discussion is simply outside the scope of this article.

philosophy behind NAFTA.<sup>18</sup> Indeed, the traditional Mexican approach to investment dispute resolution has customarily characterized a major line of demarcation between developed and developing countries in an age of globalization.

The inclusion of Chapter 11 in NAFTA, therefore, represents a major reversal in policy for Mexico, and thus begs the question: is Chapter 11 direct access dispute resolution beneficial to Mexico? After all, of the NAFTA Parties it is Mexico which has made the most dramatic changes in accepting Chapter 11 and which is economically disadvantaged compared to its North American counterparts.<sup>19</sup> Any detrimental aspects of Chapter 11 arguably would affect Mexico the most. The purpose of this article, therefore, is to provide an informed discussion of the criticisms of Chapter 11 dispute resolution and to evaluate the implications of Chapter 11 for Mexico, focusing on the NAFTA text and the Chapter 11 arbitrations against Mexico so far. First, however, this paper presents important historical and policy foundations behind NAFTA in order to pave the way for a discussion of Chapter 11 and Mexico.

Part II first provides a brief background on the history of economic integration in the Americas. This part highlights the interrelationship of historical political and economic policy interests pursued by the United States and Latin America. Part II also includes an overview of the traditional Mexican approach to foreign investment and international law. Indeed, history tells why things are the way they are now, and thus serves as an important backdrop for discussing the purposes of NAFTA Chapter 11 and its implications for Mexico. Part II ends with a detailed discussion of the background of NAFTA and its dispute resolution framework, commenting briefly on the differing legal traditions of NAFTA Parties and ADR in general. This discussion completes the task of providing the necessary background information for proceeding to a more narrow discussion of Chapter 11 and Mexico.

Part III discusses in detail Chapter 11. It first highlights the major substantive provisions of Chapter 11, and then details its dispute resolution framework. This is followed by summaries of the first four final arbitral awards involving Mexico.<sup>20</sup> This discussion sheds light on how the process has been handled in real-life situations in Mexico and serves as a critical reference point for purposes of this article.

Part IV moves to an informed discussion of the implications of Chapter 11 for Mexico. It does so by taking into account the major criticisms of Chapter 11, and then by responding to them using the Chapter 11 text and the first four final arbitral awards against Mexico as the bases for testing those criticisms. The criticisms discussed herein are by no means exhaustive. Rather, this article

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18. See *infra* Part II.B.1.

19. See *infra* Part II.B.1.

20. At the time of this writing, private investors have invoked the Chapter 11 dispute resolution mechanism against Mexico on nine occasions, and on roughly twenty occasions overall. This comment is confined to discussion of the first four final arbitral awards issued involving Mexico.

summarizes the most often-cited concerns with Chapter 11. This discussion attempts to accomplish several things. It provides further clarity as to how and why NAFTA Parties structured Chapter 11 as they did. It demonstrates why the broader concerns with Chapter 11 are unfounded—why Chapter 11 is not a threat to Mexico's sovereignty or democratic governance.

Further, and perhaps most importantly Part IV also sheds light on how Chapter 11 is a unique example of how international law is a necessary and positive force for Mexico in the governance of economic integration in North America. As an extension of well-established principles of international law to business activities between private individuals and governments, and as a novelty in the ongoing trend of economic integration in the Americas, Chapter 11 direct access dispute resolution is exemplary of what is necessary for Mexico's successful participation in the international political economy

## II. A NOTE ON THE HISTORY OF ECONOMIC INTEGRATION IN THE AMERICAS

Globalization is the buzz word for describing the modern international political economy. Although specifically defining the phenomena of globalization and when it precisely began tends to generate debate, it certainly implies "a stretching of social, political and economic activities across frontiers."<sup>21</sup> In this sense, economic integration—predominantly accomplished through trade and investment agreements—is a key ingredient, a critical tool, of globalization.<sup>22</sup> The proliferation of trade agreements in the Americas over the last half century demonstrates an unprecedented push by nation-states of varying wealth and size to integrate their economies.<sup>23</sup> This is perhaps nowhere more apparent than in NAFTA, where two countries with highly advanced economies, the United States and Canada, entered into a free trade agreement with Mexico, a developing country.<sup>24</sup> The history behind NAFTA goes back much further than the early 1990s, however. Historical, political, and economic policy interests of both the United States and Latin America as a whole set the background for understanding

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21. DAVID HELD ET AL., *GLOBAL TRANSFORMATIONS: POLITICS, ECONOMICS AND CULTURE* 15 (1999).

22. There are four basic levels of economic integration, which include (1) free trade area, (2) customs union, (3) a common market, and (4) an economic union. *See generally* MICHAEL R. CZINKOTA ET AL., *INTERNATIONAL BUSINESS* 256-57 (5<sup>th</sup> ed. 1999). A free trade area is the least integrative model, with focus on eliminating taxes, quotas, tariffs and other trade barriers among member countries without forming collective policy for relations with nonmembers. *See id.* In a customs union, on the other hand, members not only agree to eliminate trade barriers, they also agree to common trade policy regarding nonmembers. *Id.* A common market goes step further, as it incorporates the tenets of a customs union but seeks to integrate further the factors of production—labor, capital and technology—thus eliminating restrictions mainly in the areas of immigration and investment. *Id.* Lastly, "the creation of true economic union requires integration of economic policies in addition to the free movement of goods, services, and factors of production across borders. *Id.* A common monetary and tax policy as well as a common currency among members further characterize an economic union. *Id.*

23. *See supra* notes 1-3.

24. Gwynne & Kay, *supra* note 18.

## NAFTA and the intended purposes and implications of its provisions.

### *A. U.S. Policy and the Economics of Latin America*

As Latin America and the Caribbean gained their independence from European colonial powers in the first part of the nineteenth century, the United States faced a critical foreign policy decision: what would be U.S. foreign policy in a Western Hemisphere of independent countries?<sup>25</sup> The answer to this question, along with economic trends in Latin America over the last two centuries, helps explain the policy behind modern economic integration. In 1822, the United States was the first country officially to recognize Argentina (then La Plata), Chile, Peru, Colombia and Mexico as new countries.<sup>26</sup> In 1823, President Monroe and Secretary of State John Quincy Adams fashioned the historic Monroe Doctrine, which has served as the crux of United States foreign policy in the region ever since.<sup>27</sup>

In 1901, President Theodore Roosevelt referred to the Monroe Doctrine as "a guarantee of the commercial independence of the Americas."<sup>28</sup> At the time, there was brewing tension between European countries and Latin American countries, particularly Venezuela and the Dominican Republic, arising out of the failure to repay public debts to European lenders.<sup>29</sup> In 1904, President Roosevelt, anticipating possible military action by European countries, officially reaffirmed U.S. commitment to intervene against any foreign power that attacked any Latin American nation, regardless of any general reluctance of the United States to become engaged in such a military entanglement.<sup>30</sup> This became known as the Roosevelt Corollary.<sup>31</sup> Subsequent U.S. presidents acted to strengthen the precepts of the Monroe Doctrine and the Roosevelt Corollary. For example, President Taft championed Dollar Diplomacy in Latin America,<sup>32</sup> and President Wilson used

25. See SAMUEL F. BEMIS, *JOHN QUINCY ADAMS AND THE FOUNDATIONS OF AMERICAN FOREIGN POLICY* (1940); see ARTHUR P. WHITAKER, *THE UNITED STATES AND THE INDEPENDENCE OF LATIN AMERICA, 1800-1830* (1941).

26. ALAN BRINKLEY, *AMERICAN HISTORY: A SURVEY* 282 (10th ed. 1999).

27. *Id.* The Monroe Doctrine "established the idea of American hegemony in the Western Hemisphere that later U.S. governments would invoke at will to justify policies in Latin America. *Id.* The Monroe Doctrine had two major themes: (1) the United States would not tolerate any future European colonization in the Western Hemisphere, and (2) the United States would regard any attack on an American nation as an attack upon the United States, and would respond with force against any country or countries initiating such an attack. The Monroe Doctrine was primarily political doctrine; however, it also furthered United States economic interests in Latin America by stopping European colonization and the imperial, protectionist economic policies that accompanied such colonization. *Id.*

28. THOMAS G. PATERSON ET AL., *1 AMERICAN FOREIGN RELATIONS: A HISTORY TO 1920* 243 (5<sup>th</sup> ed. 2000).

29. *Id.* at 244.

30. *Id.*

31. *Id.*

32. *Id.* at 243. Dollar Diplomacy included "using private financiers and business leaders to promote foreign policy, and using diplomacy to promote American commerce and investment abroad. *Id.* at 240. Indeed, "[e]xports to Latin America increased markedly from \$132 million at the turn of the century to \$309 million in 1914. *Id.* at 240.



military force to quiet internal conflicts in the region and safeguard U.S. commercial interests.<sup>33</sup>

World Wars and the Great Depression in the first part of the twentieth century curtailed U.S. involvement in Latin American affairs.<sup>34</sup> In fact, the economic effects of these events shocked Latin American economies and set the stage for major economic policy changes in the region.<sup>35</sup> Prior to the mid-twentieth century, Latin American countries had followed an export-oriented economic model based mostly on primary product exports.<sup>36</sup> This served U.S. needs and commercial interests, but left Latin American economies at the mercy of international demand fluctuations.<sup>37</sup> As industrialized countries erected trade barriers to recover from the Depression, Latin American countries experienced serious decreases in export income which caused severe economic setbacks.<sup>38</sup>

During World War II, Latin American countries experienced increased export income from the increased demand for food stuffs, but wartime industrial production and consumption limited the availability of much needed industrial imports to Latin American countries.<sup>39</sup> These events stirred nationalistic rhetoric in many large Latin American countries, and led to the emergence of political populism, which called for protectionist economic policies geared toward boosting internal development.<sup>40</sup> By the 1940s, policymakers in Latin America, deriving theoretical support from the tenets of dependency theory and economic structuralism, implemented inward-looking, protectionist policies that lasted through the 1970s, known mainly as import substitution industrialization ("ISI").<sup>41</sup>

33. *Id.* at 245.

34. FREDERICK S. WEAVER, *LATIN AMERICA IN THE WORLD ECONOMY* 121 (2000).

35. *Id.* at 117-121.

36. *Id.*

37. *Id.*, PATRICE FRANKO, *THE PUZZLE OF LATIN AMERICAN ECONOMIC DEVELOPMENT* 46-47 (1999); Gwynne & Kay, *supra* note 18 at 129-30.

38. FRANKO, *supra* note 38, at 46-47.

39. WEAVER, *supra* note 35, at 121.

40. *Id.* at 121-25, 137.

41. FRANKO, *supra* note 38, at 52-55. With regard to dependency theory, Franko comments: Proponents of dependency theory postulated that a country did not thrive or falter simply because of its own national endowments. Rather, progress could be attributed to the power it had to set the rules of the international economic game. Center countries, or the industrialized countries, defined the rules; the periphery, or developing countries, were pawns in the international pursuit of profit.

*Id.* at 53.

This led to the emergence of the structuralist school of economic development, headed by Raúl Prebisch, an Argentinean economist who became chair of the United Nations Economic Commission for Latin America ("ECLA") in 1949. *Id.* 53-54. Franko notes:

Under the leadership of Raúl Prebisch, ECLA analysts looked at the disappointing economic performance of Latin America in the first half of the century, focusing on the volatility of primary product exports, and the progressive difficulty of paying for more technologically sophisticated (and expensive) products with the limited agricultural returns. Technological progress was controlled by the powerful center-industrialized countries and spread slowly into the periphery. ECLA researchers in the 1950s were also fascinated by seeming correlation between the interruption of normal trade patterns with the industrialized countries during war periods and accompanying robust

Cold War politics prompted the United States to promote some economic cooperation with Latin American countries, despite the latter's protectionist policies.<sup>42</sup> For example, in 1961, President Kennedy initiated the Alliance for

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internal growth in the Latin America regions. Isolation from the international system apparently helped growth at home.

In part the disadvantaged position of the periphery countries in the international system derived from the kind of goods they offered. Developing countries principally traded primary products, such as raw materials and agricultural goods, for more technologically advanced products in the international arena. Within this unequal framework, they faced what was seen as declining terms of trade for their products. There are only so many bananas that people want to eat or so much coffee that they can drink. Given the low income elasticity for agricultural products, as the global economy grows, the relative demand for primary products declines. Instead, rewards tend to accrue to those engaged in technological entrepreneurship. Technological sophistication adds value to good, increasing its market price well beyond the cost of basic inputs. Declining terms of trade for primary products reflected the argument that as the prices of sophisticated goods rose, developing countries would need to export more and more oranges or wheat to pay for the more expensive technological machinery. Without mastering technology, countries had little hope of advancement.

*Id.* at 53-55.

The prescription, therefore, according to the structuralists, was for Latin American governments to play a prominent role in regulating trade and focusing on acquiring technology and improving industrial capacity. Protectionism and high tariff rates thus swept across Latin America, where "[a]verage nominal protection over consumer and manufactured goods was 131 percent in Argentina, 168 percent in Brazil, 138 percent in Chile, 112 percent in Colombia, 61 percent in Mexico, and 21 percent in Uruguay in 1960. *Id.* at 59. Governments also overvalued exchange rates to promote cheaper imports and promulgated monetary and fiscal policies that included subsidizing domestic enterprises through nationalized lending institutions, while also providing such enterprises with tax credits and special interest rates. *Id.* at 60-62. These protectionist policies, ironically, had the effect of stimulating foreign investment in manufacturing in many Latin American countries because multinational corporations found it profitable to establish a presence in those countries rather than deal with protectionist trade policies. *Id.* at 62-64. "In or about 1970, 24 percent of manufacturing in Argentina, 50 percent in Brazil, 30 percent in Chile, 43 percent in Colombia, 35 percent in Mexico, 44 percent in Peru and 14 percent in Venezuela was under foreign control. *Id.* at 62; see also MICHAEL C. MEYER ET AL., *THE COURSE OF MEXICAN HISTORY* 611-614 (6th ed. 1999) (discussing the trends and implications of industrialization policies in Mexico in the mid-twentieth century). During ISI, Latin American countries experienced high growth rates and significant industrialization, but the negative effects of ISI became apparent in the 1970s and 80s. See FRANKO, *supra* note 38, at 64-8. (discussing numerous negative effects of ISI on Latin American economies, including high deficits and inflation, balance-of-payment crises, debt accumulation, the rise of politically oppressive military regimes and government corruption, to name a few); see also WEAVER, *supra* note 35, at 169-79 (discussing the demise of ISI and subsequent debt crises in Latin America). Nonetheless, the gradual abandonment of ISI policies in Latin America set the stage for a new discussion of economic integration efforts between Latin America and the United States.

42. In July of 1947, George Kennan, then director of the Policy Planning Staff of the U.S. Department of State and formerly a U.S. Ambassador to Russia and Yugoslavia, issued his famous "Memorandum X" which advocated for U.S. policy of containment of the spread of Soviet communism. See PATERSON, *supra* note 29, at 244-45. Coinciding with that policy, U.S. politicians began speculating that if one country in region fell to communism, the entire region would fall, and then eventually the rest of the world, which became known as the "domino theory." *Id.* at 254-57. Kennan's policy recommendation dominated the U.S. foreign policy mindset throughout the Cold War. *Id.* Consequently, any hint of communism in Latin America encouraged U.S. policymakers to take

Progress through the Organization of American States (“OAS”).<sup>43</sup> Kennedy “envisioned spending \$20 billion in funds from the U.S. and international organizations” to promote economic development in Latin America.<sup>44</sup> The Alliance for Progress was rather unsuccessful in achieving its goals for economic development, but it did symbolize U.S. commitment to preserving its interests in Latin America—a further extension of the Monroe Doctrine, over one hundred years later.<sup>45</sup>

In the 1980s, the U.S. began to focus on the vital connection between democracy and economic integration in Latin America. One commentator notes that, “despite selective unevenness and all the other caveats, there still was a significant sea change in U.S. policy in the 1980s: U.S. governments actively encouraged transitions from military to electoral regimes in South and Central America and pressured Mexico to clean up its electoral act.”<sup>46</sup> Specifically, in response to communist revolutions in Central America, President Reagan instituted the Caribbean Basin Initiative (“CBI”).<sup>47</sup> As one commentator describes,

[T]he CBI stressed the need for economic development and the development of free enterprise in the region as a means of combatting communist expansionism. Twenty Caribbean basin countries were designated as the beneficiaries of a program that included a combination of foreign aid, investment incentives, and reduction of barriers to United States markets. This included twelve years of duty-free access to United States markets for most exports from designated countries and industries.<sup>48</sup>

With the end of the Cold War, the Bush Administration faced the task of developing a new U.S. foreign policy model for Latin America. One author summarizes that “[t]he Bush administration joined most Latin American states in adopting a primarily economic foundation for inter-American relationships, with agreement on the essentiality of continued democratic development.”<sup>49</sup> In 1990, President Bush announced his Enterprise for the Americas Initiative (“EAI”),

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action to dispel such political change. *Id.*

43. *See id.* at 331.

44. *Id.*

45. *See id.* at 332. The Alliance for Progress did not prove to be an economic success for a variety of reasons, some of which included lack of U.S. investor initiative, corruption in Latin American politics, and the rise of military regimes in Latin America. *Id.* Nonetheless, it did achieve some political success in rallying pro-American, as opposed to Soviet, support in Latin America. *See, for example, ANTONIO H. OBAID & NINO MARITANO, AN ALLIANCE FOR PROGRESS: THE CHALLENGE AND THE PROBLEM 11* (1963), writing in the first few years after its inception that “it deserves full credit for the noticeable improvement which is taking place in the political atmosphere . . . . The anti-American feelings prevalent in the 1950’s have subsided considerably . . . . There is much admiration, respect, and affection for this country.”

46. WEAVER, *supra* note 35, at 186. This set the groundwork for future negotiations regarding economic integration under the George H.W. Bush Administration. *See supra* notes 39–41.

47. Caribbean Basin Economic Recovery Act 19 U.S.C. § 2701 (2004).

48. Paul A. O’Hop, Jr., *Hemispheric Integration and the Elimination of Legal Obstacles under NAFTA-Based System*, 36 HAR. INT’L L.J. 127, 149 (1995) (internal footnotes omitted).

49. G. POPE ATKINS, *LATIN AMERICA IN THE INTERNATIONAL POLITICAL SYSTEM* 130 (3d ed., Westview Press 1995).

which served to spearhead U.S. negotiations for free trade, increased investment and debt relief in the Western Hemisphere as well as to ignite the modern process of economic integration.<sup>50</sup> Indeed, negotiations for NAFTA arose in the context of the EAI.<sup>51</sup>

The Clinton Administration continued the push for free trade in the Americas. In fact, "[t]he Clinton Administration's economic policy toward Latin America [was] largely a continuation of President Bush's EAI."<sup>52</sup> Not only was President Clinton successful in getting NAFTA in place, but his efforts also led several countries in the Western Hemisphere to meet and officially declare their mutual goal of achieving hemispheric free trade through an FTAA.<sup>53</sup> The current administration has reaffirmed U.S. commitment to free trade and increased economic integration in the Americas. A free trade agreement with Chile entered into force at the beginning of this year.<sup>54</sup> Most recently, the United States and

50. George Bush, *Remarks Announcing the Enterprise for the Americas Initiative*, 26 WEEKLY COMP. PRES. DOC. 1009 (June 27, 1990). O'Hop, *supra* note 49, at 149 (commenting that "[t]he three pillars of this initiative were: (1) reduction of trade barriers, (2) increase of investment into the region, and (3) debt relief," which led the U.S. to actively pursue bilateral and multilateral negotiations aimed at liberalizing trade with countries in the Americas.). *Id.* at 150 ("The EAI encouraged rapid development of subregional associations.").

51. O'Hop, *supra* note 49 at 149.

52. *Id.* at 151.

53. *See id.* In December of 1994, thirty four democratic countries in the Americas met in Miami, Florida at the Summit of the Americas, with the goal of fashioning the FTAA. *Antecedents of the FTAA Process*, at [http://www.ftaa-alca.org/View\\_e.asp](http://www.ftaa-alca.org/View_e.asp) (last visited Feb. 23, 2003) [hereinafter "FTAA Website"] and *Summit of the Americas Information Network*, at <http://www.summit-americas.org> (last visited Feb. 23, 2003) [hereinafter "Summit of Americas Website"]. "The idea behind the FTAA is the consolidation of the nearly twenty-five free trade pacts already operating in a region of nearly 800 million inhabitants. FRANKO, *supra* note 38, at 241. Since the Miami Summit, summits have taken place in San Jose (1996), Santiago (1998) and Quebec City (2001). Summit of Americas Website, *supra*. The FTAA would serve as an enormous regional trade agreement, creating "a market of [over] 719 million people and could expand trade within the hemisphere to unprecedented levels. Richard L. Bernal, *Free Trade Areas: The Challenge and Promise of Fair vs. Free Trade*, 27 LAW & POL'Y INT'L BUS. 945, 946 (1996). The Second Draft of the Consolidated Text of the FTAA is available at the official website for the United States Trade Representative ("USTR"), <http://www.ustr.gov/regions/whemisphere/ftaa.shtml> (last visited Mar 2, 2004) [hereinafter "Draft FTAA"].

Through the Declaration of Principles and Plan of Action, negotiating states have agreed to make decisions on a consensus basis, to ensure that the decision-making process is transparent, to follow WTO-based guidelines, to take into account the needs of less-developed countries, and to complete negotiations for the FTAA by 2005. *Declaration of Principles and Plan of Action*, 34 I.L.M. 808 (1995) [hereinafter "FTAA Declaration"]; FTAA Website, *supra*. The Declaration also expresses the negotiating states' commitment to "build on existing subregional and bilateral agreements in order to broaden and deepen hemispheric economic integration and to bring the agreements together. FTAA Declaration, *supra*, at 811. For detailed discussions on the FTAA, dispute resolution and economic integration, see Frank J. Garcia, *Americas Agreements"—An Interim Stage in Building the Free Trade Area of the Americas*, 35 COLUM. J. TRANSNAT'L L. 63 (1997), Frank J. Garcia, *New Frontiers in International Trade: Decisionmaking and Dispute Resolution in the Free Trade Area of the Americas: An Essay in Trade Governance*, 18 MICH. J. INT'L L. 357 (1997), and David Lopez, *Dispute Resolution under Free Trade Area of the Americas*, 28 U. MIAMI INTER-AM. L. REV. 597 (1997).

The implications of NAFTA Chapter 11 direct access dispute resolution on the FTAA is also an important and interesting topic, however, such a discussion is beyond the scope of this article.

several Central American countries signed the Central American Free Trade Agreement (“CFTA”).<sup>55</sup> In addition, the United States has continued to sign and negotiate bilateral investment treaties with Latin American countries.<sup>56</sup>

### *B. Latin America and the Emergence of Trade and Investment Agreements*

In 1948, as ISI policies began to emerge in Latin America,<sup>57</sup> another economic trend took hold. Despite encouraging protectionist economic policies as a means to achieve internal growth, the United Nations Economic Commission for Latin America (“ECLA”) actually encouraged trade cooperation between Latin American countries in the form of regional trading blocs.<sup>58</sup> The result was the formation of the Latin American Free Trade Association (“LAFTA”) in 1960,<sup>59</sup> which evolved into the Latin American Integration Association (“LAIA”) in 1980.<sup>60</sup> The second half of the twentieth century also witnessed the emergence of various subregional trade agreements in Latin America, including the Central American Common Market (“CACM”) in 1960,<sup>61</sup> the Andean Community in 1969,<sup>62</sup> the Caribbean Community (“CARICOM”) in 1973,<sup>63</sup> and the Mercado del

54. For discussion of the negotiations, the signing and the text of the Chile-U.S. Free Trade Agreement, see the official website for the United States Trade Representative (“USTR”), at <http://www.ustr.gov/new/fta/chile.htm> (last visited Mar. 9, 2004). See also Scott R. Jablonski, *iSi Pol, Foreign Investment Dispute Resolution Does Have a Place in Trade Agreements in the Americas: Chapter 10 of the United States-Chile Free Trade Agreement*, \_\_\_ U. MIAMI INTER. AM. L. REV. \_\_\_ (forthcoming 2004).

55. USTR, “U.S. & Central American Countries Conclude Historic Free Trade Agreement,” at <http://www.ustr.gov/releases/2003/12/03-82.pdf> (last visited Feb. 23, 2003). The Central American countries are Honduras, Nicaragua, El Salvador, Guatemala and Costa Rica. *Id.*

56. Jame R. Holbein & Gary Carpentier, 25 CASE W. RES. J. INT’L L. 531, 567-569 (1993). The authors note that “pursuant to EAI, the U.S. has signed seventeen framework agreements on trade and investment. *Id.* at 567. These framework agreements provide the foundation for negotiations of bilateral investment treaties (“BITs”) between the United States and Latin American countries. See *id.* at 568-69.

57. See *supra* note 29.

58. O’Hop, *supra* note 49, at 133.

59. Treaty Establishing a Latin American Free Trade Area and Instituting the Latin American Free Trade Association, Feb. 18, 1960, 1484 U.N.T.S. 223 (1960); O’Hop, *supra* note 49, at 131.

60. Treaty of Montevideo Establishing the Latin American Integration Association, Aug. 12, 1980, reprinted in 20 I.L.M. 672 (1980). “The long range objective of this process shall be the gradual and progressive formation of a Latin American common market. *Id.* at 673. The eleven original signatory countries to LAIA include Argentina, Bolivia, Brazil, Chile, Colombia, Ecuador, Mexico, Paraguay, Peru, Uruguay and Venezuela. Cuba became the twelfth member in 1999. ORGANIZATION OF AMERICAN STATES, TOWARD FREE TRADE IN THE AMERICAS 118-21 (Jose M. Salazar-Xirinachs & Maryse Robert eds., 2001) [hereinafter “OAS FREE TRADE”] (discussing LAIA in detail) and Atkins, *supra* note 50, at 189-90 (commenting that LAIA provides Latin American countries with political forum for trade negotiations on many levels, including the promotion of developing strong market-based economies, special treatment for less-developed countries and participation by nonmember countries and private parties in some instances).

61. General Treaty on Central American Economic Integration, Dec. 13, 1960, 455 U.N.T.S. 3, available at <http://mba.tuck.dartmouth.edu/cib/tradeagreements/CACM.pdf> (last visited May 1, 2004).

62. Agreement on Andean Subregional Integration, May 26, 1969, reprinted in 8 I.L.M. 910 (1969).

63. Treaty Establishing the Caribbean Community, July 4, 1973, 946 U.N.T.S. 17, reprinted in 12

Cono Sur ("MERCOSUR")<sup>64</sup> in 1991. Through the OAS, Latin American countries have discussed and continue to discuss all aspects of integration, including the harmonization of private international law and other cooperation conducive to economic integration.<sup>65</sup> Moreover, Latin American countries have been responsive to ongoing negotiations for the FTAA.<sup>66</sup>

In addition, with regard to foreign investment, "[c]ountries in Latin America and the Caribbean have signed approximately three hundred BITs, virtually all of which were negotiated in the 1980s and 1990s."<sup>67</sup> As discussed below, the Mexican approach to economic integration traditionally had been more limited compared to other Latin American countries. Mexico's policy on the interplay between international law and foreign investment did, however, influence foreign investment policies throughout Latin America prior to the 1980s.<sup>68</sup> Those policies stood in stark contrast to U.S. policy initiatives. Until the negotiation of NAFTA became a reality Mexico stood firm in its opposition to international standards for foreign investment dispute resolution.

### 1. The Traditional Mexican Approach to Foreign Investment

The international-based, investor-friendly provisions found in Chapter 11 and discussed in detail later run counter to traditional Mexican law regarding foreign investment.<sup>69</sup> It has been noted that "[s]ince the nineteenth century, Mexico has contested vehemently the traditional principles of international law governing the protection of foreigners and foreign property"<sup>70</sup> This policy originated from Mexican dissatisfaction with foreign investors at the end of the nineteenth

I.L.M. 1033 (1973).

64. Treaty Establishing a Common Market, Apr. 19, 1991, *reprinted in* 30 I.L.M. 1041 (1991).

65. O'Hop, *supra* note 49, at 135-37. The OAS sponsors talks for hemispheric legal harmonization through its Inter-American Specialized Conferences on Private International Law (known as "CIDIPs"). *Organization of American States*, at [http://www.oas.org/dil/privateintl\\_interamericconferences.htm](http://www.oas.org/dil/privateintl_interamericconferences.htm) (last visited Mar. 2, 2004) [hereinafter "OAS Website"]. There have been six CIDIPs to date, covering topics such as jurisdiction, enforcement of judgments and secured financial transactions, to name a few. *Id.*

66. *See supra* note 54.

67. *House of Representatives Committee on Ways and Means Subcommittee on Trade Hearing on the Outcome of the Summit of the Americas and Prospects for Free Trade in the Hemisphere*, 27 CAN. U.S. L.J. 313, 18 (2001) (testimony of Daniel M. Price on behalf of the U.S. Council for International Business).

68. Gloria L. Sandrino, *The NAFTA Investment Chapter and Foreign Direct Investment in Mexico: A Third World Perspective*, 27 VAND. J. TRANSNAT'L L. 259, 323 (1994); Daniel R. Loritz, *Corporate Predators Attack Environmental Regulations: It's Time to Arbitrate Claims Filed Under NAFTA's Chapter 11*, 22 LOY. L.A. INT'L & COMP. L. REV. 533, 537-38 (2000).

69. Indeed, NAFTA "represents the first time Mexico has entered into an international agreement providing for investor-state arbitration. Daniel M. Price, *An Overview of the NAFTA Investment Chapter: Substantive Rules and Investor-State Dispute Settlement*, 27 INT'L LAW 727 (1993) (no pagination electronic version) [hereinafter "Price, Overview"].

70. *See* NAFTA: A PROBLEM-ORIENTED COURSEBOOK 24-8 (Ralph H. Folsom, Michael Wallace Gordon, & David Lopez eds., 2000) [hereinafter "NAFTA COURSEBOOK"]. *See also* Loritz, *supra* note 69, at 536 (noting Mexico's history of expropriation of foreign investment without compensation).

century<sup>71</sup> For example, the open investment policy of President Porfirio Díaz in the late-nineteenth and early-twentieth centuries was a major contributor to economic and social problems in Mexico, and consequently a significant cause of the Revolution.<sup>72</sup> The view in Mexico that foreign investment was a threat to state sovereignty and Mexico's economic well-being remained pervasive throughout most of the twentieth century<sup>73</sup>

Developed countries, on the other hand, traditionally have argued it is a basic principle of international law that a country must provide an investor with just compensation in the event that a country expropriated an investment.<sup>74</sup> Indeed, the view advocated by the United States and other developed countries<sup>75</sup> was in stark contrast to that which developing countries, like Mexico, espoused:

At the end of the 1970s, the world remained sharply divided in its view of international investment policy, particularly the issue of compensation for expropriation. The developed states asserted that expropriation required payment of prompt, adequate and effective compensation. The socialist states contended that no compensation was required, although they frequently did agree to pay compensation in settlement of claims by expropriated foreign investors. The developing states also rejected the prompt, adequate and effective standard, generally taking the position that the calculation of compensation should depend upon a variety of factors, such as the return that the investor already had received

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71. See NAFTA COURSEBOOK, *supra* note 71, at 26.

72. Sandrino, *supra* note 69, at 279-81. The author explains:

Although actual figures are not available, recent studies suggest that by the end of Porfirato, foreigners owned over half of the total wealth of Mexico and foreign capital dominated most areas of productive enterprise.

The presence of foreign investors during the Porfiriato was largely to blame for many of Mexico's economic ills at the beginning of this century and fueled the Mexican Revolution of 1910. The Revolution established the ideological and political foundation for a fundamentally different state role in the Mexican economy. The new boundaries for the role of the Mexican state were established in the Mexican Constitution of 1917, which placed restraints on foreign economic activities and foreign land ownership. By incorporating the anti-foreign sentiments of the Mexican revolutionaries, the Mexican Constitution emphasized Mexican sovereignty and independence from foreign economic control.

*Id.* at 280-81; see also Loritz, *supra* note 69, at 535-36.

73. Sandrino, *supra* note 69, at 279-81.

74. See generally John A. Westberg, *International Transactions and Claims Involving Government Parties: Case Law of the Iran-United States Claims Tribunal* 219 (1991) (discussing the Restatement (Third) of Foreign Relations Law of the United States 15 (1987), explaining that "compensation in the case of expropriation or nationalization [must] be 'appropriate' and 'just' which means it must be in 'an amount equivalent to the value of the property taken' which means 'fair market value' where that can be determined."); Kenneth J. Vandeveld, *Sustainable Liberalism and the International Investment Regime*, 19 MICH. J. INT'L L. 373 (1998) (discussing the differing views on international law and investment among developed and developing countries.).

75. Sandrino, *supra* note 69, at 265 ("Since the end of the nineteenth century, the developed states have been preoccupied with securing international standards for the protection of investments of their nationals and firms abroad, fashioned on the traditional rules of the protection of property.").

prior to the expropriation and the content of local law on the subject.<sup>76</sup>

The principle that local law should govern foreign investment disputes thus traditionally has been the centerpiece of Mexican policy on the issue.

The Mexican Constitution accomplishes this policy in what is known as the "Calvo Clause."<sup>77</sup> In the mid-nineteenth century, the Argentinean diplomat and publicist Carlos Calvo set forth a series of "assertions" that formed the basis of what became known as the Calvo Doctrine.<sup>78</sup> Calvo argued that international law and principles of state sovereignty prohibited diplomatic and military intervention by foreign countries to resolve commercial disputes on behalf of their investors.<sup>79</sup> Such intervention exacerbated the inequality between developed and developing countries by obliging developing countries to give foreigners more protection in commercial dealings than was given to their own citizens.<sup>80</sup> The Calvo Doctrine, therefore, is based on two key principles: absolute "nonintervention" by foreign states and "absolute equality of foreigners with nationals" with regard to foreigners' commercial dealings in another country.<sup>81</sup>

The Calvo Doctrine became immediately popular throughout Latin America.<sup>82</sup> Latin American countries for years tried to implement the Calvo Doctrine through international treaties, in national constitutions and in municipal legislation, but the most popular and successful approach has been to implement Calvo's principles through contractual stipulation.<sup>83</sup> Calvo's principles are still pervasive in many Latin American countries today and stand as a point of contention between developed and developing countries.<sup>84</sup> In Mexico, the Constitution provides:

Only Mexicans by birth or naturalization and Mexican corporations have the right to acquire ownership of lands, waters, and the appurtenances, or to obtain

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76. Vandevelde, *supra* note 75, at 385-86. During the 1970s this divide was evidenced in the United Nations system, wherein a number of developing and less-developed countries formed the New International Economic Order ("NIEO") in an attempt to assert more control over an international system which those countries viewed as exploitative to their interests and oppressive to their aspirations for development. Sandrino, *supra* note 69, at 269-76. In fact, one of the main aspects of the NIEO was to "challenge[] traditional principles of customary international law that govern foreign direct investment, such as determining compensation for expropriation or nationalization and settling foreign investment disputes. *Id.* at 274.

Interestingly, as result of the NIEO movement in the United Nations, a series of resolutions were passed by the United Nations General Assembly in the 1970s that outright rejected principles of customary international law regarding foreign investment disputes. See RONALD A. BRAND, FUNDAMENTALS OF INTERNATIONAL BUSINESS TRANSACTIONS 983-93 (Kluwer Law International 2000) [hereinafter "BRAND IBT"].

77. Constitución Política de los Estados Unidos Mexicanos, art. 27 (1976), <http://www.ilstu.edu/class/hist263/docs/1917const.html> (last visited Mar. 18, 2004).

78. DONALD R. SHEA, THE CALVO CLAUSE 17 (1955).

79. *Id.* at 18.

80. *Id.* at 18-19.

81. *Id.* at 19-20.

82. *Id.* at 21.

83. *Id.* at 21-32.

84. Christopher K. Dalrymple, *Politics and Foreign Direct Investment: The Multilateral Investment Guarantee Agency and the Calvo Clause*, 29 CORNELL INT'L L.J. 161, 168-69 (1996).



concessions for working mines or for the utilization of waters or mineral fuel in the Republic of Mexico. The nation may grant the same rights to aliens, provided they agree before the Ministry of Foreign Relations to consider themselves Mexicans in respect to such property, and bind themselves not to invoke the protection of their governments in matters relating thereto, under penalty, in the case of noncompliance, of forfeiture of the property so acquired.<sup>85</sup>

Thus, for most of the twentieth century, the Mexican approach to foreign investment disputes was to handle such disputes according to national law, disregarding any “international” standards for foreign investment dispute resolution. Since the NAFTA negotiating process began, however, Mexican policy has undergone significant changes—namely, the Calvo Clause no longer applies to investors from NAFTA Parties.<sup>86</sup> Moreover, the Mexican legal system has undergone much reform over the last two decades, paving the way for the application of international law in Mexican courts, comporting with Mexico’s goals for economic openness and development.<sup>87</sup>

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85. See *Constitución Política de los Estados Unidos Mexicanos* (1976), <http://www.ilstu.edu/class/hist263/docs/1917const.html> (last visited Mar. 18, 2004). See also NAFTA COURSEBOOK, *supra* note 71, at 324 (noting that the Calvo Clause “stipulate[d] that foreign persons operating in Mexico should be considered in all respects as Mexicans, thus limiting the resolution of disputes to local courts adjudicating under domestic law provisions and prohibiting any intervention by the home government.”); Charles N. Brower & Lee A. Steven, *Who Then Should Judge? Developing the International Rule of Law under NAFTA Chapter 11*, 2 *CHI. J. INT’L L.* 193-95 (2001) (discussing the history of Mexico’s unfriendly foreign investor provisions and explaining that “the United States lobbied hard to include Chapter 11’s investment protections precisely because it wanted ‘to liberalize Mexican restrictions on investment’”) (internal footnotes omitted). See Sandrino, *supra* note 69, at 283-87, for a good discussion of how the traditional anti-foreign investment sentiment in Mexico is embedded in the Mexican Constitution and in Mexican law.

86. Isidro Morales, *NAFTA: The Governance of Economic Openness*, 565 *ANNALS* 35, 50 (1999) (internal citations omitted), explaining that the traditional Mexican approach:

was completely opposed to the international minimum standard that the U.S. government has traditionally required all states to comply with when dealing with foreign investments. According to the U.S. view, even if state does not provide its own nationals with minimum international rights, it may not escape international responsibility to guarantee minimum standards to nationals of other countries. Though Latin American countries, including Mexico, have moved progressively from the national-centered paradigm to that of the “minimum international standard” approach, chapter 11 of NAFTA is a turning point in this regard.

87. See generally Jorge A. Vargas, *Enforcement of Judgments and Arbitral Awards in Mexico*, 5 *U.S.-MEX. L.J.* 137, 140 (1997) (discussing the significant changes in Mexican laws in recent years, noting that “[f]or over half century, Mexico’s absolute territorialism led to the virtual exclusion of foreign law from that country’s court system” and that “[f]rom 1932 to 1988, over fifty years, Mexico was so territorialistic that no foreign judgments were enforced in Mexico.”); Jorge Cicero, *International Law in Mexican Courts*, 30 *VAND. J. TRANSNAT’L L.* 1035 (1997) (discussing the progressive evolution of international law in the Mexican legal system); Miguel Jauregui Rojas, *A New Era: The Regulation of Investment in Mexico*, 1 *U.S.-MEX. L.J.* 41 (1993) (discussing the changes in law in Mexico in the 1980s regarding foreign investment, such as reducing restrictions on foreign ownership of domestic enterprises, in order to comply more with international practices and enhance foreign investment in Mexico); Sandrino, *supra* note 69, at 301-07 (discussing in detail the changing regulatory scheme of foreign investment in Mexico in the latter part of the twentieth century).

### C. NAFTA

The idea that modern trade and investment agreements provide the framework for economic integration in the Western Hemisphere, as discussed, has foundations in U.S. political and economic interests beginning in the nineteenth century as well as in efforts at economic integration by Latin American countries since the mid-twentieth century. The current reality is, nevertheless, clear: globalization has finally linked historical political agendas and economic trends in the Americas and countries are seeking structured, legal frameworks within which to control trends in economic integration. It is within this historical context that NAFTA emerged as the first official milestone in economic integration in the Americas—the first official trade agreement between developed countries and a developing country<sup>88</sup>

#### 1. Background

Canada, Mexico and the United States began negotiations for a free trade area in North America in 1991, largely on account of President Bush's EAI.<sup>89</sup> The United States and Canada were already parties to a free trade agreement, the U.S. Canada Free Trade Agreement ("CFTA"),<sup>90</sup> and the United States led the charge toward creating a new free trade agreement for all of North America.<sup>91</sup> In fact, in the early 1990s, the United States began to experience increasing economic competition from a more unified European Community, and it was feared that if the United States did not act to stimulate more economic cooperation in the Western Hemisphere, a strong Europe may gain an advantage in Latin American markets.<sup>92</sup> Thus, for President Bush, NAFTA served as a critical maneuver to counter economic competition in Latin America from an integrating Europe, as well as a first step toward hemispheric integration. For President Carlos Salinas de Gortari of Mexico, NAFTA represented a great opportunity to stimulate the Mexican economy and effectively assure that Mexico could not return to its protectionist policies of the past.<sup>93</sup>

Indeed, President Salinas had engineered tremendous fiscal and economic policy reform in Mexico since his term began in 1988, making negotiations for NAFTA with the United States and Canada possible in the first place.<sup>94</sup> Both President Salinas and his successor, President Ernesto Zedillo, were responsible for opening Mexico's economy in preparation for NAFTA by privatizing state

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88. FRANKO, *supra* note 38, at 228; Gwynne & Kay, *supra* note 18, at 130 ("NAFTA is the only example so far of a scheme of economic integration involving two advanced economies and one emerging or developing economy."); Sandrino, *supra* note 69, at 261-62 (noting that NAFTA "is the first regional trade pact between a Third World state and two industrialized states.").

89. See *supra* notes 39-42.

90. Dec. 22, 1987, U.S.-Can. (effective Jan. 2, 1988), reprinted in 27 I.L.M. 281 (1988).

91. RALPH FOLSOM & W. DAVIS FOLSOM, UNDERSTANDING NAFTA AND ITS INTERNATIONAL BUSINESS IMPLICATIONS 119 (1996) [hereinafter "FOLSOM & FOLSOM"].

92. See Gwynne & Kay, *supra* note 18, at 93.

93. See MEYER, *supra* note 42, at 670-73.

94. See *id.*

enterprises, reducing government spending and transforming the Mexican economy into a free market economy<sup>95</sup> The three countries signed NAFTA in 1993, and after President Clinton spearheaded negotiations for side agreements on labor and the environment, the U.S. Congress passed NAFTA marking the beginning of a truly historic cooperative.<sup>96</sup> Under the direction of President Zedillo, Mexico continued to liberalize its economy throughout the 1990s in implementing NAFTA.<sup>97</sup> Interestingly, because of Chile's stable political and economic climate, NAFTA countries met with Chile on five occasions to discuss Chile's accession to NAFTA.<sup>98</sup> However, Chile suspended talks regarding its accession, waiting for the U.S. Congress to approve fast-track negotiating authority for President Clinton, which never happened.<sup>99</sup>

Although some commentators opine that "the jury is still out on the effects of NAFTA,"<sup>100</sup> trade has increased dramatically among NAFTA Parties since the agreement took effect, and Parties continue to hold meetings to accelerate the elimination of all tariffs and non-tariff barriers to trade in North America.<sup>101</sup> In terms of stimulating trade and foreign investment, NAFTA has been a positive tool for Mexican economic policy<sup>102</sup> Ten years after NAFTA went into effect North American trade has doubled.<sup>103</sup> Mexican exports to the United States have increased by 234% and by 203% to Canada.<sup>104</sup> Increased exports have generated new jobs for Mexican workers (one out of five jobs are export-oriented), which pay on average 37% more than manufacturing jobs in Mexico.<sup>105</sup> Mexico also continues to receive large amounts of foreign investment from its NAFTA partners in a variety of sectors, ranging from manufacturing to mining to services.<sup>106</sup>

95. NAFTA COURSEBOOK, *supra* note 71, at 28.

96. See FOLSOM & FOLSOM, *supra* note 92, at 120-21 (1999); Dr. Elvia Acelia Quintana Adriano, *The North American Free Trade Agreement and Its Impact on the Micro- Small- and Medium-Sized Mexican Industries*, 39 ST. LOUIS U. L.J. 967 (1995) (explaining that NAFTA created "the largest free trade area in the world.").

97. See NAFTA COURSEBOOK, *supra* note 71, at 28.

98. *Id.* at 746.

99. *Id.* at 746-47 Thereafter, Chile has entered into free trade agreements with Canada and Mexico. OAS FREE TRADE, *supra* note 61, at 103-104. And, in June 2003, the United States and Chile signed free trade agreement. USTR, *Chile Free Trade Agreement*, <http://www.ustr.gov/new/fta/chile.htm> (last visited Feb. 27, 2004).

100. FRANKO, *supra* note 38, at 232.

101. See OAS FREE TRADE, *supra* note 61, at 89.

102. Patricia Kowsmann, *World Bank says NAFTA Has Had Positive Impact On Mexico*, U.N. Wire, Dec. 18, 2003, at [http://www.unwire.org/UNWire/20031218/449\\_11452.asp](http://www.unwire.org/UNWire/20031218/449_11452.asp) (last visited May 1, 2004).

103. See United States Trade Representative, "NAFTA at Ten: A Success Story," at <http://www.ustr.gov/regions/whemisphere/2003-12-08-nafta10-factsheet.pdf> (last visited April 7, 2004).

104. See United States Trade Representative, "NAFTA. A Decade of Strengthening a Dynamic Relationship," at <http://www.ustr.gov/regions/whemisphere/nafta2003/brochure-english.pdf> (last visited April 7, 2004).

105. See United States Trade Representative, "Myth: NAFTA was a Failure for Mexico," at [http://www.ustr.gov/regions/whemisphere/ftaa2003/factsheet-myth-nafta\\_mexico.pdf](http://www.ustr.gov/regions/whemisphere/ftaa2003/factsheet-myth-nafta_mexico.pdf) (last visited April 7, 2004).

106. See U.S. Embassy in Mexico, "North American Free Trade Agreement: Tenth Anniversary," at [http://www.usembassy-mexico.gov/eNAFTA\\_figures.htm](http://www.usembassy-mexico.gov/eNAFTA_figures.htm) (last visited April 7, 2004) (graphing FDI

Mexico is now receiving three times the amount of capital inflow it received in the five-year period immediately prior to NAFTA.<sup>107</sup> Moreover, Mexico has "become the third highest recipient of foreign direct investment ("FDI") among developing countries."<sup>108</sup> FDI-related jobs in Mexico have grown twice as fast as other jobs in Mexico and pay on average some 50% more than national average wages.<sup>109</sup> Notably, Mexico has signed free trade agreements with several Central American countries, has joined the Group of Three with Colombia and Venezuela establishing a free trade area with those countries, and also has free trade agreements with Bolivia and Chile.<sup>110</sup>

NAFTA itself is a highly technical trade document. It lacks, however, the institutional framework that characterizes the more progressive European Union, for example.<sup>111</sup> NAFTA is, at base, a free trade agreement between the Parties, with no provisions for additional party accession and no schedules for achieving higher forms of economic integration such as a customs union, common market or economic union.<sup>112</sup> It does, however, cover a wide range of trade-related topics,

in Mexico by sector).

107. See OECD Global Forum on International Investment, "New Horizons and Policy Changes for Foreign Direct Investment in the 21<sup>st</sup> Century," at <http://www.oecd.org/dataoecd/23/52/2424050.pdf> (last visited April 7, 2004) [hereinafter "OECD Global Forum"].

108. See *id.*; see also Secretaria de Economía de México, Comisión Nacional de Inversiones Extranjeras, "Informe Estadístico Sobre el Comportamiento de la Inversión Extranjera Directa en México (Enero – diciembre de 2003)," at <http://www.economia.gob.mx/pics/p/p1175/03-dic.doc> (last visited April 7, 2004). That report, which covers foreign investment statistics in Mexico from January 2003 to December 2003, points out a 24.7% estimation of new investment in Mexico. *Id.* (translation mine) ("la estimación de la IED realizada en el lapso enero diciembre de 2003 asciende 10,731.4 md, y se integra en un 24.7% (2651.0 md) de nuevas inversiones "). It also notes that during that time period 54.1% of total foreign investment came from the United States. *Id.* (graphing foreign investment inflows by country). Statistics regarding foreign investment from U.S. businesses are particularly staggering. In fact, "[in] September of 2002 there were 15,356 businesses with U.S. capital, which is 55.0% of all businesses with foreign direct investment (FDI) registered in Mexico (27,936). Secretaria de Economía, Subsecretaria de Normatividad, Inversión Extranjera y Practicas Comerciales Internacionales, "Dirección General de Inversión Extranjera: Inversión de Estados Unidos en México," at <http://www.economia.gob.mx/pics/p/p1240/EUASEP03.doc> (last visited April 7, 2004) (translation mine) ("Al mes de septiembre de 2003 se cuenta con un registro 15,356 sociedades con participación estadounidense en su capital social, esto es, el 55.0% del total de sociedades con inversion extranjera directa (IED) registradas en México (27,936)."). Further, "[b]etween January 1999 and September 2003, businesses with U.S. capital realized \$51,903.7 million, which represents 68.0% of all FDI invested in the country during that time (\$76,286.5 million) "). *Id.* (translation mine) ("Entre enero de 1999 y septiembre de 2003, las empresas con capital estadounidense realizaron inversiones por 51,903.7 millones de dólares (md), cantidad que representa el 68.0% de la IED total que ingresó al país en ese lapso (76,286.5 md) "). Moreover, since the inception of NAFTA, U.S. FDI in Mexico continues to climb: "U.S. investment since 1994 has reached \$80,325.4 million, equivalent to 65.1% of all FDI destined to the country between January 1994 and September 2003. *Id.* (translation mine) ("La inversión estadounidense acumulada a partir de 1994 asciende a 80,325.4 md y equivale al 65.1% de la IED total destinada al país entre enero de 1994 y septiembre de 2003.").

109. See OECD Global Forum, *supra* note 108.

110. *Id.* at 95-104.

111. See Gal-Or, *supra* note 5, at 5-11.

112. See NAFTA, *supra* note 10, at Ch. 1; see also Gustavo Vega Canovas, *Convergence: Future Integration between Mexico and the United States*, 10 U.S.-MEX. L.J. 17 (2002) (discussing the characteristics and limitations of NAFTA as an integrative agreement).

some of which include trade in goods and services, foreign investment, intellectual property rights, government procurement, strict rules of origin for products, anti-dumping provisions, labor issues, environmental issues, and dispute resolution.<sup>113</sup> The NAFTA Central Trade Commission (“Commission”) is the central governing body charged with overseeing implementation and dispute resolution among Parties.<sup>114</sup> The Commission has established several Working Groups dedicated to promoting cooperation in specific areas of NAFTA and to conducting day-to-day business.<sup>115</sup> The dispute resolution framework of NAFTA is, of course, of particular interest for purposes of this article. A discussion of that framework in general underscores the preference for international arbitration in modern economic integration and, further, the unique and important character of Chapter 11 dispute resolution.

## 2. Dispute Resolution

The NAFTA dispute resolution framework serves to facilitate the purposes of NAFTA—to provide a concrete regulatory structure for the reality of economic integration in North America in an era of expansive trade and investment. In this respect, the NAFTA framework underscores how international law is inextricably intertwined with economic policy. As is the case in most international trade and investment agreements, the NAFTA framework depends on alternative means of dispute resolution through which the link between law and economics is maintained and developed.<sup>116</sup> All three NAFTA Parties have unique legal traditions, and the differences between Mexico’s legal system and the legal systems of the United States and Canada are tremendous. Thus, it is important to be aware of these differences in order to understand why NAFTA Parties chose the ADR framework and why ADR is the best method for resolving NAFTA-type disputes, especially those involving a private investor and a NAFTA Party.

### a. Differing Legal Traditions

A brief note on the differences between legal systems in NAFTA countries is appropriate at this point. Some scholars have stated that:

NAFTA at its heart is about changing market forces, but law is the instrument and to a degree the guarantor of change. It is through legal enactments and proceedings that the new rules of the business game in North America are to be realized. Each legal system brings with it traditions that can be expected to influence how the NAFTA accords are interpreted, implemented, and applied.<sup>117</sup>

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113. See Canovas, *supra* note 113.

114. NAFTA, *supra* note 10, at art. 2001.

115. USTR, “NAFTA Organizations,” at <http://www.ustr.gov/regions/whemisphere/organizations.shtml#committees> (last visited Feb. 23, 2003) [hereinafter “NAFTA Organizations”].

116. NAFTA Secretariat, *Overview of the Dispute Settlement Provisions of the North American Free Trade Agreement (NAFTA)*, at <http://www.nafta-sec-alena.org> [last visited Feb. 28, 2004].

117. FOLSOM & FOLSOM, *supra* note 92, at 32.

The Canadian and U.S. legal systems are based on the common law tradition, which derives its roots primarily from English jurisprudence.<sup>118</sup> That is, law has primarily developed and continues to be modified through judicial decisions.<sup>119</sup> This does not mean that Canadian and U.S. law do not rely on other primary sources of law. On the contrary, the Canadian and U.S. legal systems today are indeed vast networks of case law, legislation, and administrative rules and regulations.<sup>120</sup> This, however, does not obscure the tremendous differences between those countries' legal systems and Mexico's legal system. In contrast, Mexico's legal system is based on the civil law tradition, deriving its roots mainly from Spain, France and other Continental European legal traditions.<sup>121</sup> The principle characteristic of the civil law tradition is that law is developed and modified through enacted law, or legislative proscriptions.<sup>122</sup>

While an elaborate discussion of the differences among the legal systems of NAFTA Parties is beyond the scope of this comment, it is worth mentioning that the differences highlight conflicting ideas regarding the role of lawyers and judges in the dispute resolution process, rules of procedure and jurisdictional principles.<sup>123</sup> Additionally, there are differences in the legacy of the rule of law among NAFTA Parties. The United States and Canada can generally boast of individual histories committed to the rule of law. In Mexico, however, where a written constitution and general commitment to democracy "has successfully avoided military coups of the kind that have been common throughout much of Latin America, one-party rule and elitism have tainted the degree to which the rule of law has been able to flourish."<sup>124</sup> This difference is especially pertinent in the context of foreign investment and dispute resolution involved therein.

These differences serve as major obstacles to achieving uniformity of dispute resolution procedures for suits involving private parties and NAFTA Parties in order to deal with increased flows of commerce and investment across borders. One author summarizes the effects of this non-uniformity on private individuals

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118. See generally *id.* at 32-42, 49-56 (providing general overview of some major facets of the Canadian and U.S. legal systems). Canada is common law country like the United States, and thus similarly stands in contrast to Mexico's civil law system, but it can hardly be said that the Canadian and U.S. legal systems are the same for purposes of achieving harmonization of dispute resolution procedures. *Id.* Additionally, the Province of Québec maintains its own civil code, which has roots in the French Civil Code and is thus something of an amalgamation between the common law and civil law, bearing some similarity to Mexico's legal system. *Id.* This adds further complexity to the task of achieving uniform dispute resolution procedures among NAFTA Parties. *Id.* at 39-42. See also generally MARY ANN GLENDON ET AL., COMPARATIVE LEGAL TRADITIONS 438-764 (1994) (discussing the foundations and characteristics of the common law tradition).

119. FOLSOM & FOLSOM, *supra* note 92, at 33.

120. See FOLSOM & FOLSOM, *supra* note 92, at 35-38, 53-56.

121. *Id.* at 43-44. See generally GLENDON, *supra* note 119, at 44-276 (discussing the foundations and characteristics of the civil law tradition) and JOHN H. MERRYMAN, THE CIVIL LAW TRADITION: AN INTRODUCTION TO THE LEGAL SYSTEMS OF WESTERN EUROPE AND LATIN AMERICA (1999) (discussing the same).

122. See GLENDON, *supra* note 119, at 192-94.

123. See generally *id.* at 130-251.

124. See PATERSON, *supra* note 29, at 48.

engaged in transnational business in the United States and Mexico:

[Mexican law] limits damages that may be recovered in a civil action, whereas United States law creates opportunities for unlimited damages, including punitive damages. In Mexico, an injunction is not available as a remedy in commercial disputes where damages are irreparable or cannot be measured in monetary terms. In the United States, an injunction is often the preferred remedy for resolving a commercial dispute. The jury is not a part of adjudication of civil disputes in Mexico, whereas it is an integral part of the system in the United States. In Mexico, trial evidence is mainly presented by documentation in front of judges who question the witnesses, and pre-trial discovery is not allowed on the same scale as in the United States. These differences and others reinforce a party's doubts that the legal system of his or her counterpart will lead to a definitive resolution of a commercial dispute that will be fair.<sup>125</sup>

The NAFTA dispute resolution framework establishes ADR procedures for dispute settlement as a means of bypassing the complexities involved in transnational litigation and legal harmonization. Understanding the basics of ADR is thus essential to understanding the NAFTA dispute resolution framework.

#### b. ADR<sup>126</sup>

ADR includes methods of resolving disputes without involving litigation in a particular court system.<sup>127</sup> These methods include consultation, mediation and arbitration.<sup>128</sup> Mediation, also known as conciliation, is simply "a process in which parties to a dispute appoint a neutral third party to assist them in resolving their disputes, and the goal is "a voluntary negotiated settlement."<sup>129</sup> Arbitration also involves resolution of disputes by a neutral third party, but it is a more formal step for parties to take.<sup>130</sup> Decisions of arbitration panels can be either binding or non-binding, depending upon the rules to which the disputing parties have agreed.<sup>131</sup> There are several organizations that offer international arbitration guidelines, such as the United Nations Commission on International Trade Law ("UNCITRAL"),<sup>132</sup>

125. Robert K. Paterson, *A New Pandora's Box? Private Remedies for Foreign Investors under the North American Free Trade Agreement*, 8 WILLAMETTE J. INT'L L. & DISP. RESOL. 77, 89 (2000) [hereinafter "Robert Paterson"].

126. For an introductory discussion on ADR, see International Trade Administration, *Primer on International Alternative Dispute Resolution*, at <http://www.osec.doc.gov/ogc/occic/adr.html> (last updated Nov. 6, 1998) [hereinafter "*International ADR*"].

127. *Id.*

128. *Id.*

129. *Id.*

130. American Arbitration Association, *AAA Glossary of Dispute Resolution Terms*, available at <http://www.adr.org/index2.1.jsp?JSPssid=15784> (last visited Mar. 1, 2004).

131. *International ADR*, *supra* note 127.

132. United Nations Commission on International Trade Law (UNCITRAL), *general information*, at <http://www.uncitral.org/english/commiss/geninfo.htm> (last visited Feb. 23, 2003) [hereinafter "UNCITRAL Website"]. UNCITRAL is the main legal body of the United Nations for international trade law. *Id.* It has set forth several rules and guidelines regarding international commercial arbitration and conciliation, and, in particular, the UNCITRAL Arbitration Rules adopted in 1976 are

and others that offer guidelines and services such as the American Arbitration Association ("AAA")<sup>133</sup> and the International Centre for the Settlement of Investment Disputes ("ICSID").<sup>134</sup>

Given the availability and characteristics of arbitration procedures for the settlement of disputes involving parties from different countries, international arbitration is increasingly favored by those involved in international business. One scholar has summarized the advantages and disadvantages to arbitration in the context of international commercial transactions:

[T]he common arguments favoring arbitration include the following:

Arbitration can be simpler and less subject to rules of procedure and rules of evidence.

Arbitration can be set in a neutral location, thus avoiding either party giving up the "home court" advantage.

Parties to arbitration can select both the procedural and substantive law applicable to the dispute.

Arbitration can more often take place without termination of contract

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often selected by parties to disputes in international arbitration. *Id.* NAFTA Chapter 11 gives private investors the option to select UNCITRAL rules as the applicable arbitration rules in an investor-state dispute. *See infra* Part III.B.

133. American Arbitration Association, available at <http://www.adr.org/index2.1.jsp> (last visited Feb. 23, 2003).

134. *See* International Centre for Settlement of Investment Disputes, *About ICSID*, at <http://www.worldbank.org/icsid/about/main.htm> (last visited Feb. 23, 2003) [hereinafter "ICSID Website"]. The ICSID was created by the World Bank in 1966, believing "that an institution specially designed to facilitate the settlement of investment disputes between governments and foreign investors could help could help promote increased flows of international investment. *Id.* The ICSID is particularly important in the context of NAFTA Chapter 11 dispute resolution, as discussed in Part III.B., *infra*. Notably,

ICSID provides facilities for the conciliation and arbitration of disputes between member countries and investors who qualify as nationals of other member countries. Recourse to ICSID conciliation and arbitration is entirely voluntary. However, once the parties have consented to arbitration under the ICSID Convention, neither can unilaterally withdraw its consent. Moreover, all ICSID Contracting States, whether or not parties to the dispute, are required by the Convention to recognize and enforce ICSID arbitral awards.

Besides providing facilities for conciliation and arbitration under the ICSID Convention, the Centre has a set of Additional Facility Rules authorizing the ICSID Secretariat to administer certain types of proceedings between States and foreign nationals which fall outside the scope of the Convention.

Provisions on ICSID arbitration are commonly found in investment contracts between governments of member countries and investors from other member countries. Advance consents by governments to submit investment disputes to ICSID arbitration can also be found in about twenty investment laws and in over 900 bilateral investment treaties.



performance, allowing dispute resolution to fill gaps in performance issues in long-term contracts without otherwise disrupting performance.

Arbitral awards are more likely to be enforceable in the courts of multiple countries because of the New York Arbitration Convention and the lack of any similar multilateral convention dealing with the enforcement of court judgments.

Arbitral awards generally are not subject to appeal, thus bringing more certain finality to the process.

In addition, the following factors may lead to a decision that litigation is more desirable:

Court decisions are more often a matter of public record, making the interpretation of the law in a given jurisdiction more predictable than in arbitration where the arbitrators may have no published record and the institution under which arbitration is conducted may not make public prior arbitral awards on similar issues.

If the other party will agree to jurisdiction in a local court, the “home court” advantage of litigation may be available.

Preliminary relief, such as prejudgment attachment, has traditionally been more often available in litigation than in arbitration.

Litigation is most often subject to appeal, allowing for correction or erroneous application of the substantive law by the tribunal.<sup>135</sup>

The preference for and importance of international arbitration in modern trade agreements, and in particular investment agreements, has been summarized as follows:

Arbitration has become a fixture in international trade and investment because it compares favorably to the alternatives. It provides a neutral mechanism characterized by private proceedings, flexible procedures, expert decision-makers, relative finality, and enforceability of the result. For a host state, private adjudication before a learned tribunal within a relaxed procedural framework will often be preferable to defending against litigation in an investor’s home state.<sup>136</sup>

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135. BRAND IBT, *supra* note 77, at 584-85.

136. Clyde C. Pearce & Jack Coe, Jr., *Arbitration Under NAFTA Chapter Eleven: Some Pragmatic Reflections upon the First Case Filed Against Mexico*, 23 HASTINGS INT’L & COMP L. REV. 311, 318 (2000); see also Gal-Or, *supra* note 5, at 19 (discussing the obvious advantages of such international arbitration).

The NAFTA dispute resolution framework is thus not unique to this preference in that it establishes five different mechanisms for arbitration involving NAFTA Parties.

### c. NAFTA Framework in General

As mentioned, NAFTA lacks a concrete institutional framework. Dispute resolution mechanisms are thus dispersed throughout the document in five main areas.<sup>137</sup> Notably, “[t]he NAFTA dispute settlement system is a decentralized system [It] operates by channeling certain types of trade conflicts into the appropriate specialized dispute settlement mechanism of limited jurisdiction and limited powers.”<sup>138</sup> Mechanisms are found in Chapter 20, Chapter 19, Chapter 11,<sup>139</sup> and in provisions under the North American Agreement on Environmental Cooperation (“NAAEC”)<sup>140</sup> and the North American Agreement on Labor Cooperation (“NAALC”).<sup>141</sup>

The Chapter 20 mechanism is the general trade dispute mechanism for NAFTA countries. Parties may seek to resolve disputes on virtually any matter related to the terms of NAFTA.<sup>142</sup> Dispute settlement under Chapter 20 proceeds as follows: (1) Parties first undergo consultations; (2) if they cannot agree on resolution of the dispute, the aggrieved Party may submit the dispute to the Commission for resolution and recommendation; (3) if the Commission does not facilitate a resolution, a Party may request that an arbitral panel hear the dispute, administered by the NAFTA Secretariat; (4) the arbitration panel will then issue a non-binding decision.<sup>143</sup> A decision by an arbitration panel does not directly affect national law.<sup>144</sup> Further, if a Party does not comply with the arbitration ruling, the prevailing Party has the right to withhold temporarily NAFTA benefits from the non-compliant Party until the situation is remedied.<sup>145</sup>

The Chapter 19 mechanism allows Parties to request arbitral panel review in the first instance regarding dumping and countervailing duties.<sup>146</sup> In a Chapter 19 dispute, the arbitral panel will issue a binding decision, as “[p]anels and committees in Chapter 19 proceedings replace judicial review in the courts of

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137 Cherie O’Neal Taylor, *Dispute Resolution as a Catalyst for Economic Integration and an Agent for Deepening Integration: NAFTA and MERCOSUR?* 17 N.W. J. INT’L L. & BUS. 850, 854 (1996).

138. *Id.* at 854-55. For more discussion on the NAFTA dispute resolution framework, see *id.* at 854-58, and Lopez, *supra* note 54, at 606-09.

139. Taylor, *supra* note 138, at 854-55.

140. North American Agreement on Environmental Cooperation, Sept. 14, 1993, U.S.-Can.-Mex., arts. 22-36, 32 ILM 1480, 1482 (text) (entered into force Jan. 1, 1994) [hereinafter NAAEC].

141. North American Agreement on Labor Cooperation, Sept. 14, 1993, U.S.-Can.-Mex., arts. 27-41, 32 I.L.M. 1499, 1502 (text) (entered into force Jan. 1, 1994) [hereinafter NAALC].

142. NAFTA, *supra* note 10, at art. 2004.

143. *Id.* at arts. 2006-2017

144. Taylor, *supra* note 138, at 856.

145. NAFTA, *supra* note 10, at art. 2019; Lopez, *supra* note 54, at 606.

146. NAFTA, *supra* note 10, at art. 1904; NAFTA COURSEBOOK, *supra* note 71, at 434.

competent jurisdiction in the NAFTA countries.”<sup>147</sup>

The NAALC mechanism creates “a four-step dispute settlement process that progresses sequentially from initial consultations to ministerial consultations, to expert evaluations to further consultations which may lead to non-binding arbitration,”<sup>148</sup> pertaining to labor matters. However, only “controversies involving occupation safety child labor, or minimum wage concerns may” reach an arbitration panel.<sup>149</sup> Only Parties have access to this mechanism, and decisions are non-binding.<sup>150</sup>

In the case of disputes regarding the environment, the NAAEC mechanism authorizes the Environmental Secretariat “to conduct an investigation and to prepare a report, potentially for distribution to the public.”<sup>151</sup> Parties may request such an investigation when another Party allegedly fails to enforce effectively its own environmental laws or when another Party’s environmental laws are arguably inadequate.<sup>152</sup> Decisions regarding such disputes, if they reach an arbitral panel, are non-binding, and compliance is left to the threat of monetary damages or suspension of NAFTA benefits to the Party in error.<sup>153</sup>

The common characteristic of the four NAFTA dispute settlement mechanisms discussed above is that only NAFTA Parties have access to the ADR proceedings. Moreover, apart from the binding nature of arbitration decisions under Chapter 19 the other three mechanisms only allow for non-binding decisions and depend on political and economic pressure for enforcement.<sup>154</sup> The Chapter 11 mechanism, on the other hand, stands in contrast to the general NAFTA dispute resolution framework in its procedures, results and implications. Chapter 11 bridges the gap between private parties and governments by establishing a binding, international law-based dispute resolution regime for disputes between NAFTA investors and NAFTA Parties.<sup>155</sup> In this sense, it is a progressive and pragmatic approach to incorporating private actors and international law into the process of governing economic integration.

Chapter 11 is thus a distinctive feature of NAFTA, and warrants careful analysis. More importantly for the purposes of this article, given the Chapter 11 framework and Mexico’s traditional outlook on the applicability of international law to foreign investment, this analysis prompts discussion of whether Chapter 11 dispute resolution is beneficial to Mexico. With the background information now in place, a more narrow discussion of Chapter 11 and Mexico is in order. A look at the Chapter 11 text in detail and the first four final arbitration awards involving Mexico provides the proper focus for that analysis.

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147. NAFTA COURSEBOOK, *supra* note 71, at 437; NAFTA, *supra* note 10, at art. 1904.

148. Lopez, *supra* note 54, at 607-08. See NAALC, *supra* note 142, at arts. 27-41.

149. Lopez, *supra* note 54, at 607-08. See NAALC, *supra* note 142, at art. 29.

150. See NAALC, *supra* note 142, arts. 27-49; see also Lopez, *supra* note 54, at 608.

151. Lopez, *supra* note 54, at 607. See NAAEC, *supra* note 141, at arts. 22-36.

152. NAAEC, *supra* note 141, at arts. 22-34; Lopez, *supra* note 54, at 606-07.

153. NAAEC, *supra* note 141, at art. 36; Lopez, *supra* note 54, at 607.

154. Lopez, *supra* note 54, at 605-08.

155. See *infra* Part III.B.

### III. NAFTA CHAPTER 11

#### *A. Substantive Provisions*

As mentioned, NAFTA Chapter 11 deals specifically with foreign investment in North America. It creates broad protections for foreign investors in an effort to stimulate integration beyond trade.<sup>156</sup> Indeed, there is a strong correlation between foreign investment and trade. As one author notes, “[t]he subject of international investment arises from one basic idea: the mobility of capital. If there is a competitive advantage to be gained, capital can and will get there.”<sup>157</sup> Moreover, “[t]he flow of capital takes four forms: foreign direct investment, bond purchases, portfolio equity flows, and lending directly to support trade.”<sup>158</sup> Foreign direct investment (“FDI”) represents the deepest form of investment commitment, as it is “investment by foreigners through ownership of equity shares or setting up production facilities within a country”<sup>159</sup>

Section A of Chapter 11 is devoted to reducing barriers to foreign investment. In doing so, it broadly defines what constitutes investors and investment. Investment includes any economic interest in an enterprise, including equity securities, debt securities, loans, and real estate or other property acquisitions.<sup>160</sup>

156. Indeed, one of the objectives of NAFTA is to “increase substantially investment opportunities in the territories of the Parties. NAFTA, *supra* note 10, at art. 102(c); *see also* Office of NAFTA and Inter-American Affairs, “Investment, at <http://www.mac.doc.gov/nafta/investment.htm> (last visited Feb. 23, 2003) [hereinafter “NAFTA Investment”]:

Chapter 11 of NAFTA addresses investment issues among Canada, Mexico and the United States. U.S. objectives for the protection of investors and investments in the NAFTA Chapter 11 were to eliminate barriers to investment within the context of U.S. policy and law, to encourage adoption of market-oriented domestic policies that treat investment fairly and in a non-discriminatory manner, and to protect investment through appropriate dispute settlement mechanisms. The NAFTA Chapter 11 succeeds in obtaining these goals, thereby allowing companies to invest throughout the NAFTA region on a level playing field.

For a detailed review of the provisions in and objectives of Chapter 11, *see* Rodolpho Sandoval, *Chapter Eleven: Investments under the North American Free Trade Agreement*, 25 ST. MARY’S L.J. 1195 (1994); *see also* Price, *Overview*, *supra* note 70.

157. CZINKOTA, *supra* note 23, at 175.

158. FRANKO, *supra* note 38, at 177

159. *Id.* at 467: *see generally* CZINKOTA, *supra* note 23, at 175-79 (discussing in detail foreign direct investment and the rationale behind engaging in such investment); *see generally* JOAN E. SPERO & JEFFREY A. HART, *THE POLITICS OF ECONOMIC RELATIONS*, Ch. 8 (5<sup>th</sup> ed. 1997) (discussing foreign direct investment in detail and the arguments for and against such investment in developing countries).

160. NAFTA, *supra* note 10, at art. 1139(a)-(f). *See also* NAFTA COURSEBOOK, *supra* note 71, at 302 (discussing the breadth of the definition of investment under NAFTA Chapter 11, pointing out specifically that “[i]nvestment covers interests that entitle an owner to share income or profits of an enterprise, assets of the enterprise on dissolution, real estate, and tangible or intangible property, including intellectual property.”). However, investment does not include:

- (i) claims to money that arise solely from
- (i) commercial contracts for the sale of goods or services by a national or enterprise in the territory of a Party to an enterprise in the territory of another Party, or
- (ii) the extension of credit in connection with a commercial transaction, such as trade

An investor of a NAFTA Party is “a Party or state enterprise thereof, or a national or an enterprise of such Party, that seeks to make, is making or has made an investment.”<sup>161</sup> In line with the hallmarks of modern trade agreements, Chapter 11 sets forth national treatment<sup>162</sup> and most-favored nation treatment<sup>163</sup> standards for investors in NAFTA Parties, and mandates a minimum standard of treatment in accordance with principles of international law.<sup>164</sup> Article 1106 attempts to facilitate the free flow of investment across borders by limiting NAFTA Parties’ abilities to establish performance requirements on investments, such as export or domestic content minimums, or restrictions on sales volume and technology transfer.<sup>165</sup> Other key provisions in Section A of Chapter 11 geared toward stimulating investment include a prohibition on excluding foreign nationals from being officers of an investor enterprise<sup>166</sup> and a restriction on placing limitations on monetary transfers.<sup>167</sup>

Perhaps most importantly, Chapter 11 establishes firm guidelines for government expropriation of investments covered by NAFTA. It “covers direct, indirect, and so-called ‘creeping’ expropriation.”<sup>168</sup> Article 1110 provides:

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:

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financing, other than a loan covered by subparagraph (d); or  
 (j) any other claims to money, that do not involve the kinds of interests set out in subparagraphs (a) through (h).

NAFTA, *supra* note 10, at art. 1139(h)-(j).

161. NAFTA, *supra* note 10, at art. 1139.

162. *Id.* at art. 1102. “Each Party shall accord to investors of another Party treatment no less favorable than that it accords, in like circumstances, to its own investors *Id.*”

163. *Id.* at art. 1103. “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 non-Party *Id.*, see also NAFTA COURSEBOOK, *supra* note 71, at 302 (explaining “that treaty-protected investments will be treated at least as favorably by the NAFTA state as nationals and firms from any third state.”).

164. See NAFTA, *supra* note 10, at arts. 1104-1105. For example, under Article 1105(1), NAFTA Parties must “accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security. *Id.* This is of particular interest given Mexico’s traditional policy on the applicability of international law to foreign investment. See *supra* Part II.B.1.

165. NAFTA, *supra* note 10, at art. 1106(1)-(3); see also NAFTA COURSEBOOK, *supra* note 71, at 303 (explaining that “NAFTA prohibits the imposition of performance requirements includ[ing] export performance, domestic content, domestic sourcing, trade balancing, product mandating, and technology transfer requirements.”).

166. NAFTA, *supra* note 10, at art. 1107. However, “[a] Party may require that majority of the board of directors, or any committee thereof, of an enterprise of that Party that is an investment of an investor of another Party, be of a particular nationality, or resident in the territory of the Party *Id.* at art. 1107(2).

167. *Id.* at art. 1109; see also NAFTA COURSEBOOK, *supra* note 71, at 304 (explaining that “[t]his includes transfers to the investor, such as remittance of profits and dividends, the payment of interest and capital gains, management fees, and proceeds from the sale of liquidation of an investment.”).

168. Price, *Overview*, *supra* note 70, at 730.

- (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.

2. Compensation shall be equivalent to the fair market value of the expropriated investment immediately before the expropriation took place ("date of expropriation"), and shall not reflect any change in value occurring because the intended expropriation had become known earlier. Valuation criteria shall include going concern value, asset value including declared tax value of tangible property, and other criteria, as appropriate, to determine fair market value.

3. Compensation shall be paid without delay and be fully realizable.<sup>169</sup>

It should be noted that Chapter 11 also takes steps to protect legitimate government regulations regarding the environment and public health. Article 1114 provides:

1. Nothing in this Chapter shall be construed to prevent a Party from adopting, maintaining or enforcing any measure otherwise consistent with this Chapter that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental concerns.

2. The Parties recognize that it is inappropriate to encourage investment by relaxing domestic health, safety or environmental measures.<sup>170</sup>

The substantive provisions in Chapter 11 thus embody established principles of international law, and carry out a significant policy change for Mexico regarding the applicability of international law to foreign investment. The direct access dispute resolution framework set out in Section B of Chapter 11 further serves to facilitate cross border investment by providing a predictable legal structure based on principles of international law within which to resolve investment disputes.<sup>171</sup>

### *B. Direct Access Dispute Resolution*

The Chapter 11 investor-state dispute resolution framework derives its structure from Bilateral Investment Treaties ("BITs") promoted by the United

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169. NAFTA, *supra* note 10, at art. 1110(1)-(3).

170. *Id.* at art. 1114.

171. *Id.* at arts. 1115-1138.

States.<sup>172</sup> Notably, such investment treaties “commonly dealt with the key issue[s] of mechanisms for settling disputes between foreign investors and host governments, which included provisions for binding international arbitration.”<sup>173</sup> The purpose of the Chapter 11 dispute settlement provisions is clear: “this Section establishes a mechanism for the settlement of investment disputes that assures both equal treatment among investors of the Parties in accordance with the principal of international reciprocity and due process before an impartial tribunal.”<sup>174</sup> A principle goal of Chapter 11 is therefore to establish a friendly investment climate via predictable legal rules and principles as derived from international law.

Articles 1116 and 1117 grant private investors from NAFTA Parties the right to seek arbitration, on behalf of themselves or on behalf of an enterprise from a NAFTA Party, against NAFTA Parties for injury or loss due to alleged violations of the provisions in Section A of Chapter 11, and also in other limited circumstances arising from Parties’ obligations pursuant to other Chapters of NAFTA.<sup>175</sup> There is a three-year time limit for filing a claim, running “from the date on which the investor first acquired, or should have first acquired, knowledge

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172. Currently, there is no multilateral framework for the regulation of foreign investment. See R. Todd Shinkin, *Trade-Related Investment Measures in Bilateral Investment Treaties and the GATT. Moving Toward Multilateral Investment Treaty*, 55 U. PITT. L. REV. 541, 544, 567 (1994); see also BRAND IBT, *supra* note 78, at 1061. Conversely, the WTO provides a framework for international trade. See WTO, “Trade and Investment,” at [http://www.wto.org/english/tratop\\_e/invest\\_e/invest\\_e.htm](http://www.wto.org/english/tratop_e/invest_e/invest_e.htm) (last visited Feb. 23, 2003) [hereinafter “WTO Investment”] (“Despite several efforts since the end of WWII, to date there does not exist a set of coherent, substantive, and binding multilateral rules governing foreign investment.”). Absent such a framework to regulate foreign investment, the United States has signed BITs with several countries, and these agreements contain standard provisions for dispute resolution in accordance with established principles of international law. See BRAND IBT, *supra* note 78, at 1053, 1058-59; see generally Shinkin, *supra* at 541-82. BITs have thus become a key component of economic integration in addition to free trade agreements:

“The U.S. Model BIT covers five main subjects:

- general principles for treatment of foreign investors;
- conditions of expropriation and the measure of compensation payable;
- the right to free transfer without delay of profits and other funds associated with investments;
- the prohibition of inefficient and trade distorting practices; and
- access to international arbitration for settlement of investment disputes.

FUNDAMENTALS OF INTERNATIONAL BUSINESS TRANSACTIONS: DOCUMENTS 124 (Ronald Brand ed., 2000) [hereinafter “Brand, FUNDAMENTALS”]. Notably, the Model BIT provides for binding international arbitration against signatory states. *Id.* at 125. To view a version of the U.S. Model BIT, see Brand, FUNDAMENTALS at 126-32; available at <http://www.osec.doc.gov/ogc/occic/modelbit.html> (last visited May 1, 2004).

173. NAFTA COURSEBOOK, *supra* note 71, at 325-26.

174. NAFTA, *supra* note 10, at art. 1115.

175. *Id.* at arts. 1116-1117. An investor has standing to submit a claim to arbitration when: (1) [T]he government of another NAFTA party has breached an obligation under Section A of Chapter 11; (2) [a] NAFTA party has acted in a manner inconsistent with the party’s obligations under Chapter 11 (investment) or Chapter 14 (financial services) in the exercise of its regulatory, administrative or other governmental authority; or (3) a state monopoly has acted in a manner inconsistent with a party’s obligations under Chapter 11 where the entity ‘exercises any regulatory, administrative, or other governmental authority that the Party has delegated to it’ ”

of the alleged breach and knowledge that the investor has incurred loss or damage” in the case of individual claims,<sup>176</sup> and “from the date on which the enterprise first acquired, or should have first acquired, knowledge of the alleged breach and knowledge that the enterprise has incurred loss or damage” in the case of claims filed on behalf of an enterprise.<sup>177</sup> Thus, the hallmark of NAFTA Chapter 11 investment dispute resolution, which sets it apart from other NAFTA dispute settlement mechanisms, is that private investors have direct access to arbitration against Parties.

The procedure for Chapter 11 dispute settlement is set out in Articles 1118 through 1137. Disputing parties are directed to engage in consultation and negotiation to resolve the dispute before arbitration is commenced.<sup>178</sup> An investor that decides to submit a claim for arbitration against a NAFTA Party must notify that Party at least ninety days prior to submitting the claim.<sup>179</sup> However, an aggrieved investor may not submit a claim for arbitration unless a minimum of six months have passed since the alleged breach and injury.<sup>180</sup> If an investor submits a claim to arbitration pursuant to either Article 1116 or 1117 the claimant must consent in writing to the arbitration procedures set forth in Chapter 11, and must waive in writing any right to litigate before the courts of any NAFTA Party on the issues submitted for settlement in arbitration.<sup>181</sup> With respect to Mexico specifically, the Chapter 11 text prohibits an investor from simultaneously submitting a claim in arbitration against Mexico and bringing a similar action in a Mexican court.<sup>182</sup>

Section B of Chapter 11 also sets forth guidelines for appointing arbitrators,<sup>183</sup>

NAFTA COURSEBOOK, *supra* note 71, at 327. *See also* Gal-Or, *supra* note 5, at 27-28 (listing scenarios where investors may have standing under Chapter 11).

176. NAFTA, *supra* note 10, at art. 1116(2).

177. *Id.* at art. 1117(2).

178. NAFTA, *supra* note 10, at arts. 1118-1137.

179. *Id.* at art. 1119.

180. *Id.* at art. 1120(1).

181. NAFTA, *supra* note 10, at art. 1121(1)-(3) (Under article 1121(1)(b) and (2)(b), a private investor utilizing Chapter 11 arbitration is not barred from obtaining declaratory or injunctive relief from the courts of NAFTA Parties. Article 1122 assures that NAFTA Parties consent to private investor arbitration as set out in Chapter 11), available at <http://tech.mit.edu/Bulletins/Nafta/11.invest> (last visited May 1, 2004).

182. *Id.* at annex 1120.1(a).

183. *See* NAFTA, *supra* note 10, at arts. 1123-1125 (Arbitral tribunals consist of three arbitrators, unless the disputing parties agree otherwise under article 1123); *see also* Ray C. Jones, *NAFTA Chapter 11 Investor-to-State Dispute Resolution: A Shield to Be Embraced or a Sword to Be Feared?* 2002 B.Y.U.L. REV. 527, 534-35 (2002) (In practice, “each party to the dispute selects one arbitrator, and the two selected arbitrators in turn choose a third arbitrator who will preside over the proceeding.”). Thus the very composition of the arbitral tribunal is neutral. Jones summary of the general procedures that follow after the arbitration panel is selected:

Once the arbitration panel is selected, it is not uncommon for all interested parties to meet and allow the panel to hear an outline of each respective case “on the merits. Before the formal oral hearing, the claimant in the case will submit a “memorial, the “chief moving document” of the arbitration, containing “a statement of relevant facts; statement of law; and the submissions. The respondent will then issue his “counter-memorial. This interaction may take place a second time if the parties agree. Also,



selecting the place of arbitration,<sup>184</sup> consolidating of claims,<sup>185</sup> and for the applicable law.<sup>186</sup> Section B also provides for participation by non-disputing NAFTA Parties.<sup>187</sup> Other provisions in Section B deal with damages awards and the finality and enforcement of an arbitral decision.<sup>188</sup> The arbitration tribunal may award an injured private investor monetary damages, interest, restitution of property and costs for arbitration, but it “may not order a Party to pay punitive damages.”<sup>189</sup>

The arbitration panel may grant interim relief to a disputing party to protect rights in property, but it “may not order attachment or enjoin the application of the measure alleged to constitute a breach”<sup>190</sup> Moreover, an arbitral decision is binding only between the disputing parties,<sup>191</sup> and “[e]ach Party shall provide for

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before the oral hearing, post-brief/pre-hearing conferences may take place to accomplish the “marshaling of evidence” that the parties plan to present at the hearing. According to modern international arbitration rules, the parties have the option to forgo the oral hearing and to rest on their written submissions. However, very few claimants rest on their written submissions, as the overwhelming majority considers the oral hearing to be invaluable to their case.

*Id.* at 535-56.

In addition, disputing parties often submit post-hearing briefs to the arbitration panel in order to clarify their positions on certain issues. *Id.* See also Pearce & Coe, *supra* note 137, at 319-22.

184. NAFTA, *supra* note 10, at art. 1129 (Arbitration must take place within the territory of a Party “which is a party to the New York Convention, unless otherwise agreed); Jones, *supra* note 184, at 535 (acknowledging that normally “disputing parties will elect to hold the arbitration in the third country not involved in the dispute to add a measure of neutrality to the proceedings.”).

185. See NAFTA, *supra* note 10, at art. 1125; Price, *Overview*, *supra* note 70, at 727 (no pagination electronic version).

186. See NAFTA, *supra* note 10, at arts. 1120, 1130, 1131. (Under Article 1120, an investor may submit a claim to arbitration under the ICSID Convention, the Additional Facility Rules of ICSID or under the UNCITRAL rules for arbitration, and the relative procedural rules apply to the arbitration. Article 1130 is the general governing law provision, stating that an arbitration panel “shall decide the issues in dispute in accordance with this Agreement and applicable rules of international law. Article 1131(1) is the general governing law provision, stating that an arbitration panel “shall decide the issues in dispute in accordance with this Agreement and applicable rules of international law”); see also *supra* notes 133 and 135 (discussing those organizations). Currently, of the NAFTA Parties only the United States is a signatory to the ICSID. ICSID Website, *supra* note 135. As Jones notes, “[t]herefore, and arbitration claim brought by an American investor against either Canada or Mexico would need to be governed by either ICSID’s Additional Faculty Rules or the UNCITRAL Rules. Jones, *supra* note 184, at 534. Jones also mentions that the number of Chapter 11 arbitrations governed by UNCITRAL or the ICSID thus far have been about equal. *Id.*

187. NAFTA, *supra* note 10, at arts. 1128, 1129, 1133. (“On written notice to the disputing parties, a Party may make submissions to a Tribunal on question of interpretation” of NAFTA. Additionally, there are provisions for submissions by expert witnesses); Jones, *supra* note 184, at 536, (commenting that the arbitration panel has “a great deal of discretion in determining the timing and manner of third party submissions that will be allowed”).

188. NAFTA, *supra* note 10, at arts 1134-1135; Jones, *supra* note 184, at 536 (decisions are made on a majority vote basis).

189. NAFTA, *supra* note 10, at art. 1134.

190. NAFTA, *supra* note 10, at art. 1133 (a NAFTA Chapter 11 tribunal has no authority to require a NAFTA Party to change its laws).

191. *Id.* at art. 1135(1) (thus Chapter 11 arbitral have no precedential value. However, tribunals often look to previous awards for some guidance); see Price, *Overview*, *supra* note 70, at 727 (no

the enforcement of an award in its territory.”<sup>192</sup> In order to effect enforcement of an award, an investor “may seek enforcement of an arbitration award under the ICSID Convention, the New York Convention or the Inter-American Convention.”<sup>193</sup> Additionally, if a NAFTA Party does not comply with an arbitral award, the Party of the investor may temporarily suspend extension of NAFTA benefits to the non-compliant Party under Chapter 20.<sup>194</sup> It is important to note also that a losing NAFTA Party may bring an action in the country where the arbitration decision was rendered to have that decision modified or vacated.<sup>195</sup> However, there is no official process for appellate review of Chapter 11 arbitrations.<sup>196</sup>

### C. Arbitrations against Mexico

At the time of this writing, there have been nine instances when private investors have invoked the NAFTA Chapter 11 dispute resolution mechanism against Mexico.<sup>197</sup> Arbitral tribunals have made four final awards in arbitrations involving Mexico so far, one of which is again pending after the claimants resubmitted their claim.<sup>198</sup> This discussion focuses on the first four final arbitral awards involving Mexico. All of the claims filed against the United States and Canada have been brought by private investors in those countries—none have been brought by an investor or enterprise based in Mexico against the United States or Canada.<sup>199</sup>

#### 1. *Azimian v. United Mexican States*<sup>200</sup>

In late 1993, Naucalpan, a suburb of Mexico City, entered into a multi-year

pagination electronic version).

192. NAFTA, *supra* note 10, at art. 1135(4).

193. NAFTA, *supra* note 10, at art. 1135(6); ICSID Website, *supra* note 137 (the United States is the only NAFTA Party that is signatory to the ICSID Convention); SICE, *Inventory*, *supra* note 2 (both the United States and Mexico are signatories to the Inter-American Convention on International Commercial Arbitration); UNCITRAL Website, *supra* note 133 (all three NAFTA Parties, however, are signatories to the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards (New York Convention)). Thus, for example, a NAFTA investor who is successful in Chapter 11 arbitration against Mexico may seek to have the award enforced in Mexico pursuant to the New York Convention or the Inter-American Convention).

194. Price, *Overview*, *supra* note 70, at 735.

195. Jones, *supra* note 184, at 536.

196. See generally NAFTA, *supra* note 10; see *infra* Part IV.B.

197. U.S. Department of State, at <http://www.state.gov/s/l/> (last visited June 12, 2003) [hereinafter “State Department Website”] (for an official listing of the pending arbitrations and accessible documents related thereto); Todd Weiler, *NAFTALAW.ORG*, at <http://www.naftaclaims.com/> (last visited Feb. 23, 2003) [hereinafter “Weiler Website”].

198. Weiler Website, *supra* note 198 (look at “Mexico” under the Dispute link).

199. State Department Website, *supra* note 198; Weiler Website, *supra* note 198 (for a list, background discussion, and links to documents for such arbitrations).

200. *Azimian & Davitian & Baca v. Mex.*, Case No. ARB(AF)/97/2 (Nov. 1, 1999), available at Weiler Website, *supra* note 198 [hereinafter “Azimian Award”]; see generally Robert Paterson, *supra* note 126, at 110 (discussing the Azimian Award in detail).

waste-management contract with Desechos Solidos de Naucalpan S.A. de C.V. (“DESONA”), a Mexican corporation that had some U.S. citizen shareholders.<sup>201</sup> From the beginning of its operations, DESONA did not perform according to its contract obligations.<sup>202</sup> The Ayuntamiento of Naucalpan, dissatisfied with DESONA’s performance, annulled the contract four months after DESONA began operations, and the State Administrative Tribunal upheld the annulment.<sup>203</sup> On appeal, the Superior Chamber of the Administrative Tribunal affirmed, finding nine “irregularities” by DESONA relating to the contract.<sup>204</sup> DESONA then filed an action in *amparo* in the Federal Circuit Court, and that court upheld the Administrative Tribunal’s rulings.<sup>205</sup>

In 1997 two years after the Circuit Court’s ruling, Azinian and other U.S. shareholders filed a claim in arbitration against Mexico under Chapter 11, arguing that the Ayuntamiento’s cancellation of the waste-management contract was a breach of the provisions on expropriation and minimum standard of treatment.<sup>206</sup> The claimants requested damages in an average amount of \$16 million plus various costs and interest.<sup>207</sup> The arbitral tribunal noted that, as a threshold issue, it first had to determine whether it had competence to review the dispute.<sup>208</sup> Indeed, the tribunal candidly asserted that “[i]t 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. NAFTA was not intended to provide foreign investors with blanket protection from this kind of disappointment.”<sup>209</sup> Thus, an investor cannot use Chapter 11 arbitration simply as a forum within which to argue disapproval of government actions or domestic court decisions with respect to the investor’s business dealings in a NAFTA Party.<sup>210</sup>

The tribunal found that the claimants had satisfied the notice and waiver

201. Azinian Award, *supra* note 201, ¶¶ 1-9.

202. *Id.* ¶ 10. Specifically, DESONA did not operate with proper or sufficient equipment necessary to conduct the waste-management services as called for by the contract. *Id.*

203. *Id.* ¶¶ 17-20 (“Ayuntamiento” translates to city or local government).

204. *Id.* ¶ 21.

205. *Id.* ¶ 22 (the Mexican *amparo* is a legal action whereby an alleged injured party may challenge judicial decisions and administrative acts, seek protection of constitutional rights, and challenge the constitutionality of law); see generally Fix Zamudio, *A Brief Introduction to the Mexican Writ of Amparo*, 9 CAL. W. INT’L L.J. 306 (1979) and KENNETH KARST & KEITH S. ROSENN, LAW AND DEVELOPMENT IN LATIN AMERICA. A CASEBOOK 127-60 (1975) (for more discussion on the Mexican *amparo*).

206. Azinian Award, *supra* note 201, ¶¶ 24, 75.

207. *Id.* ¶ 75.

208. *Id.* ¶ 35. The panel explained:

Arbitral jurisdiction under Section B is limited not only as to the persons who may invoke it (they must be nationals of a State signatory to NAFTA), but also as to subject matter: claims may not be submitted to investor-state arbitration under Chapter Eleven unless they are founded upon the violation of an obligation established in Section A.

*Id.* ¶ 82.

209. *Id.* ¶ 83.

210. *Id.* ¶ 84.

requirements under Chapter 11 arbitration,<sup>211</sup> but ultimately ruled that the claimants did not have a valid claim under Chapter 11.<sup>212</sup> The panel had particular difficulty with the way in which the claimants argued their case. Specifically the complaint averred, at base, that the Ayuntamiento's actions were a breach of contract.<sup>213</sup> The tribunal explained that "NAFTA cannot possibly be read to create a regime, which would have elevated a multitude of ordinary transactions with public authorities into potential international disputes."<sup>214</sup> The critical issue was therefore whether the Ayuntamiento's annulment of the contract violated the Article 1110 provisions regarding expropriation;<sup>215</sup> or in other words, whether the alleged breach of contract was an expropriation.

The tribunal summarized the problem in *Azimian* as follows:

The Ayuntamiento believed it had grounds for holding the Concession Contract to be invalid under Mexican law governing public service concessions. At DESONA's initiative, these grounds were tested by three levels of Mexican courts, and in each case were found to be extant. How can it be said that Mexico breached NAFTA when the Ayuntamiento of Naucalpan purported to declare the invalidity of a Concession Contract which by its terms was subject to Mexican law, and to the jurisdiction of the Mexican courts, and the courts of Mexico then agreed with the Ayuntamiento's determination?<sup>216</sup>

Thus, claimants had to prove that the decisions of the Mexican courts breached Chapter 11, which, although theoretically possible according to the tribunal, was not even argued by claimants.<sup>217</sup>

The tribunal also discussed at length the circumstances surrounding the status of the investors themselves. It found that the claimants misled the Ayuntamiento with regard to their background in the waste-management business, the availability of capital to effect contract performance and the viability of the long-term aims of the waste-management services.<sup>218</sup> Indeed, the tribunal found that claimants were

211. *Id.* ¶ 36.

212. *Id.* ¶¶ 35, 128.

213. *Id.* ¶ 87

214. *Id.*

215. *Id.* ¶ 91.

216. *Id.* ¶ 96.

217. *Id.* ¶¶ 97, 100. The panel explained that international arbitral panels can be called upon to assess the validity of judicial decisions with regard to international law and treaty obligations. *Id.* ¶¶ 98-99. Given that the claimants in *Azimian* did not allege misconduct by the Mexican courts, the panel concluded "[f]or if there is no complaint against a determination by a competent court that a contract governed by Mexican law was invalid under Mexican law, there is by definition no contract to be expropriated. *Id.* ¶ 100. Further, finding no violation of Article 1110, the panel dismissed *fortiori* claimants' Article 1105 claim. *Id.* ¶ 92.

Paterson notes that "[t]he ruling of the tribunal in the *Azimian* case is characterized by complete absence of any discussion of the meaning of Article 1110. Robert Paterson, *supra* note 126, at 116. He notes that the panel's analysis indicates that it did not consider whether the annulment itself violated Article 1110, but rather focused on the decisions of the Mexican courts. *Id.* Nonetheless, Paterson admits that *Azimian* stands for "effective use of Chapter 11 to resolve claim that was clearly found unpersuasive on its merits. *Id.* at 118.

218. *Azimian Award*, *supra* note 201, ¶¶ 29-33, 105. The panel also noted various facts regarding

not “an inherently plausible group of investors.”<sup>219</sup> *Azıman*, therefore, is important for Mexico, and all NAFTA Parties, in that it demonstrates that (1) investors may not use Chapter 11 as a means of resolving normal business disputes; (2) such investors may not use Chapter 11 to eviscerate domestic court rulings regarding such disputes, and; (3) a Chapter 11 tribunal will scrutinize the plausibility of an investor and the soundness of an investment when deciding whether the investor should prevail in a Chapter 11 claim.<sup>220</sup>

## 2. *Waste Management, Inc. v. United Mexican States*<sup>221</sup>

In 1998, Waste Management, Inc. (formerly USA Waste Services, Inc.), a U.S. corporation, filed a Chapter 11 arbitration claim against Mexico on behalf of itself and its Mexican subsidiary, Acaverde, S.A. de C.V.<sup>222</sup> The claimants alleged that Mexico, through the actions of the municipality of Acapulco, the State of Guerrero and Banco Nacional de Obras y Servicios Públicos, S.N.C. (“BANOBRAS”), violated Articles 1105 and 1110 of NAFTA.<sup>223</sup> In its Notice of Arbitration, Waste Management averred that Acapulco did not treat Acaverde according to international standards as required by Article 1105 by failing to make full payment to Acaverde for services performed under a long-term waste-management contract and then transferring Acaverde’s contract rights to a third party.<sup>224</sup> Claimants then argued that Acapulco’s default on payment was unlawful expropriation as per Article 1110, as such nonperformance “rendered worthless Claimants’ rights acquired and investments made under the concession” and “effectively extinguished Acaverde’s viability as an enterprise.”<sup>225</sup> Waste Management claimed \$60 million in damages plus interest.<sup>226</sup>

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one of the claimant-investor’s business record which clearly indicated a pattern of questionable conduct. *Id.* ¶ 121.

219. *Id.* ¶ 29.

220. Despite its final ruling, the tribunal did not award costs to Mexico, which it could have done under Chapter 11. *Id.* ¶¶ 125-26; NAFTA, *supra* note 10, at art. 1135(1). Several factors dissuaded the tribunal from awarding costs, one of which was the fact that the Chapter 11 mechanism was “a new and novel mechanism for the resolution of international investment disputes. *Azıman* Award, *supra* note 201, ¶ 126. Indeed, *Azıman* was the first investor-state arbitration decided under NAFTA. *Id.* ¶ 79.

221. *Waste Management, Inc. v. United Mexican States (U.S. v. Mex.)*, 2000 Case No. ARB (AF)/98/2 (Jun. 2), available at [http://www.worldbank.org/icsid/cases/waste\\_award.pdf](http://www.worldbank.org/icsid/cases/waste_award.pdf) [hereinafter “Waste Management I Award”]. See also William S. Dodge, *International Decision: Waste Management, Inc. v. Mexico*, 95 A.J.I.L. 186 (2001) [hereinafter “Dodge, *Waste Management*”], and Jacob S. Lee, *No “Double-Dipping” Allowed: An Analysis of Waste Management, Inc. v. United Mexican States and the Article 1121 Waiver Requirement for Arbitration under Chapter 11 of NAFTA*, 69 FORDHAM L. REV. 2655 (2001) (both discussing the first *Waste Management* arbitration award in detail).

222. *Waste Management I Award*, *supra* note 222, ¶ 1.

223. *Id.*

224. ICSID Arbitration (Additional Facility), *Notice of Institution of Arbitration Proceedings*, Sep. 29, 1998, USA Waste Services, Inc. and Acaverde, S.A. de C.V. v. United Mexican States, available at <http://state.gov/documents/organization/3999.pdf> (last visited May 1, 2004).

225. *Id.*

226. *Id.*

The arbitral award centered on whether the arbitral tribunal had jurisdiction to resolve the dispute, or more specifically, whether claimants followed the proper waiver requirements set out in Article 1121.<sup>227</sup> Under that article, claimant was required to waive its right to litigate in Mexican courts the claims it brought before the tribunal.<sup>228</sup> The claimants submitted a waiver with an exception that such waiver did not bar them from seeking relief against the government entities and BANOBRAS for alleged violations of Mexican law other than the alleged violations of NAFTA.<sup>229</sup> Mexico contested this waiver and thus the jurisdiction of the arbitral tribunal.<sup>230</sup>

In fact, subsequent to filing the Chapter 11 arbitration, Acaverde pursued two pending claims against BANOBRAS in Mexican courts for breach of a letter of credit until Acaverde lost both claims at the appellate level in March and October of 1999.<sup>231</sup> Acaverde also filed a claim in arbitration against Acapulco in October of 1998, one month after the Chapter 11 arbitration was filed, from which it did not withdraw until July 1999.<sup>232</sup> The arbitration tribunal ultimately found that claimants did not comply with Article 1121, and dismissed the claim for want of jurisdiction.<sup>233</sup>

In holding that compliance with the waiver requirements of Article 1121 was a "condition precedent" to the arbitration, the tribunal stated that it had to determine whether claimants submitted "the waiver in accordance with the formalities envisaged under NAFTA and whether it has respected the terms of same through the material act of either dropping or desisting from initiating parallel proceedings before other courts or tribunals."<sup>234</sup> Although claimants satisfied the formal requirements of Article 1121, they failed to comply materially with that article.<sup>235</sup> Acaverde pursued other legal action with respect to the conduct of Acapulco and BANOBRAS for more than a year after it filed for Chapter 11 arbitration.<sup>236</sup> Notably, the tribunal summarized:

In effect, it is possible to consider that proceedings instituted in a national forum may exist which do not relate to those measures alleged to be in violation of the NAFTA by a member state of the NAFTA, in which case it would be feasible that such proceedings could coexist simultaneously with an arbitration proceeding under the NAFTA. However, when both legal actions have a legal basis derived from the same measures, they can no longer continue simultaneously in light of

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227. Waste Management I Award, *supra* note 222, ¶¶ 7, 17

228. *Id.*; NAFTA, *supra* note 10, at art. 1120-1122.

229. Waste Management I Award, *supra* note 222, ¶ 5.

230. *Id.* ¶ 6.

231. *Id.* ¶ 25.

232. *Id.*

233. *Id.* ¶ 31. Interestingly, the tribunal rejected Mexico's argument that the arbitral tribunal must, as one of its duties emanating from Article 1121, notify domestic tribunals of disputing investor's waiver. *Id.* ¶ 15. It held that such a task is that of the Mexican government, as the tribunal does not have the authority to preclude a disputing investor from litigating in other fora. *Id.*

234. *Id.* ¶ 20.

235. *Id.* ¶¶ 23-24.

236. *Id.* ¶ 31.

the imminent risk that the Claimant may obtain the double benefit in its claim for damages. This is precisely what NAFTA Article 1121 seeks to avoid.<sup>237</sup>

Thus, Article 1121 is clear in that it prohibits a tribunal from entertaining jurisdiction over the dispute given that Acaverde maintained what were essentially duplicate proceedings in Mexican courts.<sup>238</sup>

In September of 2000, Waste Management re-filed for Chapter 11 arbitration.<sup>239</sup> Mexico again contested the jurisdiction of the arbitral tribunal, arguing that claimants' first unsuccessful attempt at Chapter 11 arbitration barred them from resubmitting their case to another Chapter 11 panel.<sup>240</sup> The first tribunal did not indicate whether its decision was *res judicata* as to claimants' re-filing of its Chapter 11 claims.<sup>241</sup> The second tribunal posited that the issue of its jurisdiction over the resubmitted claim depended on "what amounts to a submission of a claim within the meaning of Article 1121."<sup>242</sup>

It found that Article 1121 contemplates a submission of a claim for adjudication on the merits,<sup>243</sup> and therefore even if Chapter 11 envisaged that investors have one opportunity to submit a claim for arbitration, a claim that is dismissed for lack of jurisdiction for failure to comply with Article 1121 waiver

237. *Id.* ¶ 27.

238. In the dissenting opinion, Mr. Highet argued that claimants did not violate the waiver requirements, and that the panel had jurisdiction. *Waste Management, Inc. v. Mexico, (U.S. v. Mex.), Dissenting Opinion, 2000 Case No. ARB(AF)/00/3 (Jun. 2) ¶ 39, available at [http://www.worldbank.org/icsid/cases/waste\\_diss.pdf](http://www.worldbank.org/icsid/cases/waste_diss.pdf) (last visited May 1, 2004).* He argued that the Article 1121 waiver requirements should not be read strictly, and also should not be read to include "that litigations subject to the waiver be affirmatively withdrawn, that no further litigation be instituted, and that no appeals be conducted. *Id.* ¶ 32. Mr. Highet posited that Chapter 11 is not explicit to the termination of such litigation in light of pending Chapter 11 arbitration, as Annex 1120.1 already bars investors from simultaneously pursuing remedy for expropriation and violation of international law under Chapter 11 arbitration and through litigation in Mexican courts. *Id.* ¶¶ 34, 38. Here, claimants' actions in Mexican tribunals were based on different causes of action than their claims under Chapter 11, and therefore their continued litigation in Mexican courts should not have prevented the panel from asserting jurisdiction over the claim. *Id.* ¶ 39. Even more, for Mr. Highet, the question of whether claimants' waiver is valid should go to the admissibility of particular claim rather than to the jurisdiction of the panel, because the majority's interpretation presents "drastically preclusive effect. *Id.* ¶¶ 56, 9. See also Dodge, *Waste Management, supra* note 224, at 188. Dodge notes that Mr. Highet believed "the purpose of Article 1121 was not to bar local remedies for related commercial claims, but to protect the NAFTA parties from 'parallel actions in their own judicial systems that would raise NAFTA claims.'" *Id.* Dodge, nonetheless, agrees with the majority's opinion in that claimants did not comply with the waiver requirements. *Id.* at 189. He also adds that an investor has three years to seek remedy from domestic courts before filing for Chapter 11 arbitration. *Id.* at 190.

239. *Waste Management, Inc. v. United Mexican States, (U.S. v. Mex.), Award on Jurisdiction, 2002 Case No. ARB(AF)/00/3 (Jun. 26) ¶ 1, available at <http://www.state.gov/documents/organization/12244.pdf> (last visited May 1, 2004) [hereinafter "Waste Management II Jurisdiction Decision"].*

240. *Id.* ¶ 3. Indeed, Mexico interpreted NAFTA Article 1121 to mean that "an election under that provision is irrevocable and allows Claimant a single opportunity to vindicate its NAFTA claim before a Chapter 11 tribunal. *Id.* ¶ 17

241. *Id.* ¶¶ 20, 22.

242. *Id.* ¶ 32.

243. *Id.* ¶ 34.

requirements would still not bar a claimant's resubmission.<sup>244</sup> Also, none of the Mexican tribunals in which Acaverde brought actions entertained claimants' NAFTA claims,<sup>245</sup> and further, under international law "if the jurisdictional flaw can be corrected, there is in principle no objection" to allowing a disputing party the opportunity to resubmit its claim."<sup>246</sup> The arbitral tribunal therefore held that neither NAFTA nor international law precluded claimants from resubmitting their case before a Chapter 11 panel.<sup>247</sup> Moreover, the tribunal did not find that claimants abused process in submitting their claims for arbitration under NAFTA, and therefore could proceed.<sup>248</sup> The tribunal has not yet made a final ruling on the merits.

### 3. *Metalclad Corp. v. United Mexican States*<sup>249</sup>

In 1996, Metalclad (a U.S. corporation) filed for arbitration under Chapter 11 on behalf of Confinamiento Técnico de Residuos Industriales ("COTERIN"), a Mexican waste disposal company wholly-owned by Metalclad's wholly-owned U.S. subsidiary, Eco-Metalclad Corporation ("ECO").<sup>250</sup> In 1993, Metalclad had acquired COTERIN via a purchase-option agreement on the basis that COTERIN had obtained all necessary permits from Mexican authorities to operate a hazardous waste landfill in Guadalcázar, State of San Luis Potosí.<sup>251</sup> Pursuant to federal and state construction permits and under the assumption that the State of San Luis Potosí approved of the project, Metalclad began construction of a landfill in May of 1994 and continued work until October of 1994, when Guadalcázar ordered Metalclad to stop construction because Metalclad did not have a construction permit from that city.<sup>252</sup> Metalclad resumed construction in November of 1994 after federal officials informed it that its city permit application would be granted "as a matter of course."<sup>253</sup>

Both a study conducted by the Autonomous University of San Luis Potosí as

244. *Id.* ¶ 33.

245. *Id.* ¶ 35.

246. *Id.* ¶ 36.

247. *Id.* ¶ 37. The tribunal stated that "there is no doubt that, in general, the dismissal of a claim by an international tribunal on grounds of lack of jurisdiction does not constitute a decision on the merits and does not preclude a later claim before a tribunal which has jurisdiction. *Id.* ¶ 43. Thus Mexico's argument that the first tribunal's decision was *res judicata* as to the merits of claimants' action failed. *Id.*

248. *Id.* ¶¶ 48-50. The claimants were "open" in the prior proceedings and did not act in "bad faith" so to give the tribunal reason to reject the resubmission. *Id.*

249. *Metalclad Corp. v. United Mexican States* (U.S. v. Mex.) Case No. ARB(AF)/97/1 (Aug. 30, 2000), available at State Department Website, *supra* note 203 [hereinafter "Metalclad Award"]. See Pearce & Coe, *supra* note 137, at 35 (discussing the arbitral tribunal phase of *Metalclad* in detail); William S. Dodge, *International Decision: Metalclad Corp. v. Mexico*, 95 A.J.I.L. 910 (2001) [hereinafter "Dodge, *Metalclad*"] (discussing all phases of *Metalclad*); Brower II, *supra* note 13, at 51-69 (same).

250. *Metalclad Award*, *supra* note 250, ¶¶ 1-2.

251. *Id.* ¶¶ 35-36.

252. *Id.* ¶¶ 38-40, 78.

253. *Id.* ¶¶ 41-42.



well as an audit by the Mexican Federal Attorney's Office for the Protection of the Environment confirmed the suitability of Metalclad's project, and Metalclad completed construction in March of 1995.<sup>254</sup> Protestors in Guadalcázar, however, prevented the landfill operation from commencing.<sup>255</sup> Metalclad thereafter entered into extensive negotiations with independent federal agencies, the result of which was a detailed agreement ("Convenio") permitting operation of the landfill in exchange for several concessions on the part of Metalclad.<sup>256</sup> The State of San Luis Potosí denounced the Convenio, and Guadalcázar officially denied Metalclad's construction permit.<sup>257</sup>

In 1996, Guadalcázar obtained an order from a Mexican court enjoining Metalclad's operation of the landfill.<sup>258</sup> Negotiations to resolve the matter failed, prompting Metalclad to file a claim against Mexico under Chapter 11 in January of 1997.<sup>259</sup> Metalclad alleged breaches of Articles 1105 and 1110<sup>260</sup> and requested more than \$43 million in damages.<sup>261</sup> In September of 1997 just before leaving office, the Governor of San Luis Potosí issued an ecological decree declaring the area encompassing the landfill an environmentally protected zone "for the protection of rare cactus" found in the area.<sup>262</sup>

The arbitral tribunal first ruled that Mexico violated NAFTA Article 1105 in its treatment of Metalclad.<sup>263</sup> It stated that "[p]rominent in the statement of principles and rules that introduces [NAFTA] is the reference to 'transparency' inferring that the principle of transparency thus extends to a NAFTA Party's obligations under Chapter 11-type investment."<sup>264</sup> The tribunal noted that at all times Metalclad operated construction of the landfill with reassurance from federal authorities that it did not need approval from Guadalcázar for the project.<sup>265</sup> Consequently, the tribunal held:

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 or procedure 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

254. *Id.* ¶¶ 44-45.

255. *Id.* ¶ 46.

256. *Id.* ¶ 47-48. Metalclad agreed to correct certain "deficiencies" existing at the landfill site, to set aside a significant portion of its land for animal conservation purposes, to provide free medical advice to citizens of Guadalcázar, to give employment and training preferences to citizens of Guadalcázar, to give the city a discount for disposal of the city's hazardous waste and to consult with citizens and government authorities regarding issues arising from the operation of the landfill. *Id.* ¶ 48.

257. *Id.* ¶ 56.

258. *Id.* Guadalcázar's case was dismissed and the injunction was lifted, but not until May of 1999. *Id.*

259. *Id.* ¶ 58.

260. *Id.* ¶ 72.

261. *Id.* ¶¶ 114-16.

262. *Id.* ¶ 59.

263. *Id.* ¶ 74.

264. *Id.* ¶ 76.

265. *Id.* ¶¶ 85-87.

required by NAFTA.<sup>266</sup>

The tribunal pointed out that Guadalcázar denied Metalclad's permit after negotiation of the Convenio when construction was basically completed, and did not notify Metalclad of the denial proceedings or afford Metalclad an opportunity to be heard at those proceedings.<sup>267</sup> Metalclad was thus not given fair and equitable treatment in accordance with international law standards imposed on Mexico under in Chapter 11.<sup>268</sup>

According to the tribunal, it followed that Mexico violated Article 1110 through "indirect expropriation" of Metalclad's investment by allowing Guadalcázar to prevent operation of the landfill.<sup>269</sup> In other words, Mexico's actions were "tantamount to expropriation," in violation of Chapter 11.<sup>270</sup> Further, the tribunal found that, although such a ruling was not necessary, the Governor's ecological decree covering Metalclad's land was itself "an act tantamount to expropriation."<sup>271</sup> The tribunal then took into account a number of factors in assessing damages. It noted that Metalclad had been deprived of its entire investment, and assessed damages in the amount of the claimant's actual investment in the landfill operation.<sup>272</sup>

This assessment did not include future projected earnings, which Metalclad demanded.<sup>273</sup> The tribunal based its determination of "fair market value" on its analysis of prior international arbitration investment disputes.<sup>274</sup> In the end, Metalclad was awarded almost \$16.7 million in damages plus legal interest at a monthly rate of six percent.<sup>275</sup>

Thereafter, Mexico filed a petition with the Supreme Court of British Columbia asking the court to set aside the award.<sup>276</sup> Chapter 11 prohibits final

266. *Id.* ¶ 88. The tribunal found that under Mexican law, the federal government has authority over projects for managing hazardous waste regardless of whether Metalclad needed approval from Guadalcázar. *Id.* ¶¶ 82-86.

267. *Id.* ¶¶ 90-91. The tribunal further found that the permit denial "was denied without any consideration of, or specific reference to, construction aspects or flaws of the physical facility." *Id.* ¶ 93. Moreover, the tribunal gave weight to the Convenio in holding that the project was not violative of environmental concerns. *Id.* ¶ 98.

268. *Id.* ¶¶ 99-101.

269. *Id.* ¶¶ 104-07. The tribunal explained what "expropriation" means under Chapter 11:

[E]xpropriation under NAFTA includes not only open, deliberate and acknowledged takings of property but also covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use or reasonably-to-be-expected economic benefit of property even if not necessarily to the obvious benefit of the host State.

*Id.* ¶ 103.

270. *Id.* ¶ 104.

271. *Id.* ¶ 111.

272. *Id.* ¶¶ 113-22.

273. *Id.* ¶ 122.

274. *Id.*

275. *Id.* ¶ 131.

276. *United Mexican States v. Metalclad Corp.*, 2001 B.C.S.C. 644, [2001] 89 B.C.L.R.3d 359, available at: [www.naftaclaims.com](http://www.naftaclaims.com) (last visited May 1, 2004) [hereinafter "Metalclad"].

enforcement of an arbitral tribunal's award until "a court has dismissed or allowed an application to revise, set aside or annul the award."<sup>277</sup> There is, of course, no provision in NAFTA for appealing Chapter 11 arbitrations, but nothing in NAFTA prevents Mexico from proceeding as it did. In determining what law it should apply, the court reasoned that the International Commercial Arbitration Act was applicable, given the international commercial nature of the investment dispute in the *Metalclad* arbitration.<sup>278</sup> The British Columbia court then noted that that Act permitted the court to set aside the arbitration award only if the arbitral tribunal decided issues outside the scope of the arbitration or if the award was against the public policy of British Columbia.<sup>279</sup>

Under that standard of review, the court first dealt with the Article 1105 claim. It held that the minimum standard of treatment principle set forth in that article is based on "customary international law," "developed by common practices of countries, and is not based on "conventional international law which is comprised of treaties."<sup>280</sup> The court thus rejected the arbitral tribunal's finding that Mexico violated Article 1105 based on lack of transparency, as "[n]o authority was cited or evidence introduced to establish that transparency has become a part of customary international law."<sup>281</sup> The court then held that the tribunal's Article 1105 ruling "infected its analysis of Article 1110."<sup>282</sup> Because the tribunal held that Mexico's actions were "tantamount to expropriation" due in part to the tribunal's flawed analysis regarding transparency, the court ruled that the tribunal acted outside the scope of its mandate in ruling that Mexico violated Article 1110.<sup>283</sup>

At the end of the day, however, *Metalclad* prevailed. The court upheld the tribunal's finding that the Governor's ecological decree was itself tantamount to expropriation.<sup>284</sup> It noted that the tribunal's broad definition of expropriation was a question of law that the court could not review, and that the tribunal's finding of expropriation based on the ecological decree was separate from its other flawed findings and within its scope of review.<sup>285</sup> The court then dismissed Mexico's arguments that *Metalclad* had acted improperly and against the public policy of British Columbia by allegedly engaging in corruption, bribery and fraud in

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277. NAFTA, *supra* note 10, at art. 1136(b)(3)(ii). The British Columbia Court noted that neither party contested the jurisdiction of the court given that the arbitration took place in Vancouver. *Metalclad*, *supra* note 277, ¶ 39; see also Dodge, *Metalclad*, *supra* note 250, at 914-15 (discussing the Canadian court's decision, noting that Mexico filed its suit in British Columbia because that is where the arbitration took place).

278. *Metalclad*, *supra* note 277, ¶¶ 39-49.

279. *Id.* ¶ 50.

280. *Id.* ¶ 62.

281. *Id.* ¶ 68. The court found that the arbitral tribunal wrongly stated the applicable law in inferring the requirement of transparency in NAFTA, and thus decided a matter outside the scope of its mandate. *Id.* ¶¶ 70-74.

282. *Id.* ¶ 78.

283. *Id.* ¶ 79.

284. *Id.* ¶ 92.

285. *Id.* ¶¶ 94-99.

pursuing its Chapter 11 claim.<sup>286</sup>

Mexico also argued that the award should be set aside on grounds that the arbitral tribunal did not address all of Mexico's arguments.<sup>287</sup> This argument was also rejected, as the court found that the tribunal "adequately dealt with the principle issues before it" and thus did not impair Mexico's case to warrant setting aside the award.<sup>288</sup> Lastly, the court modified Metalclad's damages according to its holding, reducing the amount of interest Mexico owed on the award by fixing the date of interest due on the award from the date of the ecological decree in 1997 rather than in 1995.<sup>289</sup>

#### 4. *Feldman v. United Mexican States*<sup>290</sup>

*Feldman* differs significantly from the other Chapter 11 arbitrations discussed thus far. It raised a variety of complex jurisdictional questions before the tribunal could rule on the merits. Its complexity and in some instances incomplete factual

286. *Id.* ¶¶ 106-118. The court found no evidence indicating such corruption or impropriety and confirmed the findings of the arbitral tribunal with respect to those issues. *Id.*

287. *Id.* ¶ 119.

288. *Id.* ¶ 130.

289. *Id.* ¶ 137. The court also ordered Metalclad to pay seventy-five percent of Mexico's court costs because Mexico prevailed in having the court set aside two of the tribunal's findings. *Id.* Interestingly, Dodge makes the following observation regarding *Metalclad*:

One often thinks of courts as being concerned with setting precedents to guide future conduct, and of arbitrators as being both less concerned with the content of the law and more willing to fashion compromises to satisfy the parties. In *Metalclad*, however, those roles were reversed. The arbitral tribunal tried hard to advance international law concerning foreign investment by finding that "fair and equitable treatment" required transparency and by adopting an expansive definition of expropriation. It was Justice Tyson who gave each party what it wanted most—setting aside for Mexico the transparency aspects of the award, while giving Metalclad most of its money. More broadly, the case may lead one to wonder whether it is appropriate to allow national courts to review Chapter 11 awards.

Dodge, *Metalclad*, *supra* note 250, at 915-16.

Dodge goes on to argue that the *Metalclad* proceedings demonstrate the need for NAFTA Parties to create an appellate body for Chapter 11 arbitrations. *Id.* at 918-19.

Interestingly, the court did not rule explicitly on whether Mexico had breached Articles 1105 and 1110, and held that Metalclad had the option of resubmitting its claims to the arbitral tribunal regarding those issues, excluding any arguments regarding Mexico's alleged lack of transparency. *Id.* ¶ 136. In a supplemental decision, the Supreme Court of British Columbia confirmed its ruling to permit Metalclad to resubmit certain claims to arbitration, and the court postponed its own adjournment until the arbitral tribunal could rule on those claims in resubmission. *United Mexican States v. Metalclad*, 2001 BCSC 1529, 95 B.C.L.R. (3d) 169, 41 C.E.L.R. (N.S.) 298, ¶¶ 18-19 (Sup. Ct. Brit. Col. 2001) (additional reasons to (2001) 89 B.C.L.R. (3d) 359 (B.C.S.C.)). Mexico appealed the court's decision not to set aside the award in whole. *Id.* ¶ 9. However, soon thereafter it abandoned its appeal. *Mexico v. Metalclad Corp.*, Notice of Abandonment of Appeal, Oct. 30, 2001, Case No. CA028568, Doc. No. L002904, available at <http://www.naftaclaims.com> (last visited May 1, 2004).

290. *Marvin Feldman v. United Mexican States*, ICSID Case No. ARB(AF)/99/1, Final Award (Dec. 16, 2002), available at <http://www.state.gov/s/l/c3751.htm> (last visited May 1, 2004) [hereinafter "Feldman Award"]

history<sup>291</sup> also provide for a rather lengthy opinion. In April of 1999 Mr. Feldman (a U.S. investor) filed a claim in arbitration against Mexico on behalf of his Mexican corporation, Corporación de Exportaciones Mexicanas, S.A. de C.V. (“CEMSA”), which was a reseller/exporter of cigarettes produced in Mexico.<sup>292</sup> Mr. Feldman based his claim on Articles 1102, 1105 and 1110,<sup>293</sup> requesting 475 million pesos (\$50 million) in damages.<sup>294</sup>

The dispute involved CEMSA’s tremulous relations with the Ministry of Finance and Public Credit (“SHCP”). Mexico’s tax laws imposed a zero percent tax rate on the resale of cigarettes produced in Mexico sold as exports as well as granted rebates on the initial taxes the resellers/exporters paid to Mexican producers or retailers, as long as the resellers met certain invoice requirements.<sup>295</sup> In essence, Mr. Feldman’s claim arose from SHCP’s refusal to rebate excise taxes paid by CEMSA on its exported cigarettes, and SHCP’s later denial of CEMSA’s export registration license.<sup>296</sup>

In fact, legal action between CEMSA and SHCP began before NAFTA even took effect.<sup>297</sup> CEMSA received rebates from 1990-91, but in 1991 the Mexican Congress amended the tax laws to deny the rebates and the zero percent tax rate for resellers of cigarettes.<sup>298</sup> CEMSA then filed an *Amparo* petition in a Mexican court challenging the validity of the legislation,<sup>299</sup> later winning on appeal in 1993.<sup>300</sup> In that same year, however, SHCP “shut down” CEMSA’s exports on grounds that CEMSA could not provide separate, itemized invoices of domestic taxes paid on cigarettes as required by Mexican law, even though it was impossible for it to comply with the invoice requirement.<sup>301</sup> SHCP soon after agreed to allow CEMSA to export cigarettes at the zero percent tax rate, but refused to give it the rebates.<sup>302</sup> In 1996 and 1997 however, SHCP paid rebates to CEMSA despite the fact that CEMSA could not produce the required invoices.<sup>303</sup>

At the end of 1997 SHCP stopped rebate payments to CEMSA, and in 1998 Congress amended the tax laws, establishing that only “first-sale” retailers could receive the rebates and that resellers had to register with the SHCP in order to get the zero percent tax rate on cigarette exports.<sup>304</sup> SHCP then denied CEMSA’s registration request and demanded CEMSA to pay some \$25 million in rebates that

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291. *Id.* ¶ 6.

292. *Id.* ¶ 1.

293. *Id.*

294. *Id.* ¶ 24.

295. *Id.* ¶ 7.

296. *Id.* ¶¶ 7-21.

297. *Id.* ¶¶ 11-26.

298. *Id.* ¶¶ 9-10.

299. *Id.* ¶ 11. CEMSA also filed a criminal complaint against certain SHCP officials alleging abuse of authority and conspiracy in refusing rebates. *Id.*

300. *Id.* ¶ 16.

301. *Id.* ¶ 14. CEMSA could not comply with the invoice requirements because it did not have access to the itemized invoices as a reseller—only producers had access to those invoices. *Id.* ¶ 15.

302. *Id.* ¶ 17.

303. *Id.* ¶¶ 19-20.

304. *Id.* ¶ 21.

it had received.<sup>305</sup> CEMSA then filed an action in a Mexican court to stop SHCP from assessing criminal sanctions on it.<sup>306</sup> That case was still pending at the time of the arbitration.<sup>307</sup>

The arbitral tribunal first ruled on several preliminary jurisdictional issues. It ruled that Mr. Feldman did have standing to bring the claim under Chapter 11 as a U.S. citizen, even though he was a permanent resident of Mexico.<sup>308</sup> It also held that the three-year time limit on Chapter 11 claims began to run in 1996 when CEMSA experienced obstacles from the SHCP and therefore claimants' arguments for relief from Mexico's action prior to 1996 were barred from consideration.<sup>309</sup> Perhaps most interestingly, the tribunal held that it only had jurisdiction to resolve the disputed matters insofar as they related to measures or actions taken by Mexico after NAFTA became effective in 1994.<sup>310</sup>

The tribunal had jurisdiction despite CEMSA's pending action in a Mexican court (regarding SHCP's claim for reimbursement of rebates).<sup>311</sup> This was because (1) Mexican law required CEMSA to respond in litigation to SHCP's demand, and (2) CEMSA had since requested a termination of that litigation, leaving Chapter 11 arbitration as its only real opportunity for remedy.<sup>312</sup> The tribunal also held that Mexico was estopped from arguing that CEMSA was not entitled to rebates from 1996-97 for not complying with the invoice requirements, precisely because SHCP had paid CEMSA despite the noncompliance and because CEMSA could not possibly have complied.<sup>313</sup> The arbitral tribunal conceded that under Chapter 11's broad investment protection framework, it is difficult to determine whether certain government actions are "tantamount to expropriation."<sup>314</sup> The tribunal concluded, in taking a variety of facts together as a

305. *Id.* ¶ 21-22.

306. *Id.* ¶ 22. Before that decision, however, Congress amended the challenged law to allow resellers like CEMSA the rebates and favorable export tax rates. *Id.* ¶¶ 12-13.

307. *Id.*

308. *Id.* ¶ 48.

309. *Id.* ¶ 49. The tribunal rejected CEMSA's claim that the three-year time period should be tolled so to include rebates that CEMSA did not get in the early 1990s. *Id.* ¶ 58.

310. *Id.* ¶ 51.

311. *Id.* ¶¶ 67-68.

312. *Id.* ¶ 68.

313. *Id.* ¶ 59. The tribunal found reasoning for this in both Mexican law and international law, and further proffered that "[t]he doctrine of estoppel, based on the fundamental legal interest in predictability, reliance and consistency, is particularly important in the context of NAFTA, regime designed to protect and promote trade and investment among the parties. *Id.* ¶ 60.

314. *Id.* ¶¶ 100-101. The tribunal noted that "tax measures, even if they are designed to and have the effect of an expropriation, will be indirect, with an effect that may be tantamount to expropriation. *Id.* ¶ 101. Further, the issue of whether such regulatory measures are expropriation is a fact-specific inquiry. *Id.* ¶ 102. The tribunal summarized the thin line between domestic tax policy and Chapter 11 obligations:

The Tribunal notes that the ways in which governmental authorities may force company out of business, or significantly reduce the economic benefits of its business, are many. In the past, confiscatory taxation, denial of access to infrastructure or necessary raw materials, imposition of unreasonable regulatory regimes, among others, have been considered to be expropriatory actions. At the same time, governments must

whole, that SHCP's denial of excise tax rebates to CEMSA was not "creeping expropriation" in violation of Article 1110.<sup>315</sup> The tribunal explained that, although the claimant experienced "great difficulties" as a result of the government's conduct, that conduct did not amount to a violation of Chapter 11.<sup>316</sup> Also, the changes in tax laws adversely affecting claimant were found not to be prohibited by Chapter 11, as NAFTA Parties have broad discretion over their respective tax policies.<sup>317</sup>

Further, NAFTA does not require Mexico to create a market for resellers like CEMSA to export cigarettes, and in fact Mexico may have a legitimate public policy reason for limiting such activity.<sup>318</sup> The tribunal held that Mexico did not destroy claimant's investment by refusing to pay CEMSA the excise tax rebates, as CEMSA continued to generate profit through the benefit of the zero percent tax rate on exports of its cigarettes.<sup>319</sup> CEMSA still has control of its business.<sup>320</sup> As to claimant's Article 1105 claim, the tribunal noted that such a claim was not directly available because the dispute involved a tax measure, and further, an Article 1105 violation could not be inferred here because there was no Article

be free to act in the broader public interest through protection of the environment, new or modified tax regimes, the granting or withdrawal of government subsidies, reductions or increases in tariff levels, imposition of zoning restrictions and the like. Reasonable governmental regulation of this type cannot be achieved if any business that is adversely affected may seek compensation, and it is safe to say that customary international law recognizes this

*Id.* ¶ 103.

315. *Id.* ¶¶ 110-111.

316. *Id.* ¶ 113. The tribunal cited *Aziman* in its discussion:

To paraphrase *Aziman*, not all government regulatory activity that makes it difficult or impossible for an investor to carry out particular business, change in the law or change in the application of existing laws that makes it uneconomical to continue a particular business, is an expropriation under Article 1110.

*Id.* ¶ 112.

317. *Id.* ¶ 116. Additionally, the tribunal held that the 1993 Mexican court decision regarding the unconstitutionality of the tax laws pertained only to CEMSA's ability to receive the zero percent tax rate. *Id.* ¶¶ 120-128. Because CEMSA could not comply with the invoice requirements, it really never had "right" to the rebates in the first place for purposes of complaining of expropriation. *Id.* The tribunal also made reference to previous Chapter 11 arbitrations against Mexico in dismissing some of claimant's arguments. It rejected claimant's argument that the lack of transparency in SHCP procedures was grounds for a Chapter 11 violation, referring specifically to the decision by the Supreme Court of British Columbia in *Metalclad*. *Id.* ¶ 133. It also rejected claimant's argument that it had been denied justice in Mexico. *Id.* ¶ 139. CEMSA had continued access to Mexican courts throughout the 1990s, and like the claimants in *Aziman*, claimants here made no argument that the decisions of the Mexican courts violated NAFTA. *Id.* ¶ 139.

318. *Id.* ¶¶ 115-16.

319. *Id.* ¶ 119. The Mexican law at issue required cigarette exporters to submit their paid taxes on separate invoices so that tax authorities could determine amounts subject to rebate. *Id.* ¶ 15. CEMSA did not do this because it was apparently impossible for it to do so because of the means by which it purchased its cigarettes from first sellers. *Id.* ¶ 17. CEMSA argued that for several years SHCP accepted this despite the technical flaw. *Id.* ¶¶ 18-19. The tribunal did not find invalid the law requiring the claimant to provide separate invoices for tax purposes invalid. *Id.* ¶ 129.

320. *Id.* ¶ 142.

1110 violation.<sup>321</sup>

In discussing CEMSA's Article 1102 claim, however, the tribunal reached a different result. Under Chapter 11's national treatment requirement, the issue was "whether rebates have *in fact* been provided for domestically owned cigarette exporters while denied to a foreign re-seller, CEMSA[.]" because "Mexico is of course entitled to strictly enforce its laws but it must do so in a non-discriminatory manner, as between foreign investors and domestic investors."<sup>322</sup> The tribunal found that other Mexican resellers of cigarettes had received rebates and did not experience any problems with obtaining export licenses from SHCP even though those resellers could not comply with the invoice requirements for rebates.<sup>323</sup> In accordance with its reasoning regarding the Article 1110 claim, the tribunal held that different treatment of producers and resellers of cigarettes in Mexico does not violate international law, because Mexico may have legitimate public policy reasons for doing so.<sup>324</sup>

However, Mexico violated Article 1102 when SHCP gave other similarly situated domestic cigarette resellers rebates but denied the same rebates to CEMSA, even though the domestic resellers could not comply with the invoice requirements either—this was *de facto* discrimination according to the tribunal.<sup>325</sup> Interestingly, the tribunal admitted that the evidence of discrimination was weak, but ultimately decided that the claimant's argument carried the day because Mexico was unable to refute the allegations with any tangible evidence.<sup>326</sup> Thus, in its lengthy analysis, the tribunal gave great deference to Mexico's authority over its own tax policies, and found a violation under the national treatment standards rather than under the expropriation provisions, which amounted to far less damages.

In assessing damages, the tribunal reasoned that the drafters of NAFTA did not provide much guidance for valuating damages other than a fair market value standard for expropriation, signaling confidence in the fact that Chapter 11 tribunals are competent to make such a determination.<sup>327</sup> The tribunal held that

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321. *Id.* ¶ 141.

322. *Id.* ¶ 169 (emphasis in original).

323. *Id.* ¶¶ 154.

324. *Id.* ¶ 135-36.

325. *Id.* ¶¶ 173, 184-88. The tribunal also pointed out that CEMSA was the only reseller that SHCP audited, which further evinced discriminatory treatment. *Id.* ¶ 174.

326. *Id.* ¶¶ 176, 186. Notably, the tribunal stated that "[t]he majority's view is based first on the conclusion that the burden of proof was shifted from the Claimant to the Respondent, with the Respondent then failing to meet its new burden, and on an assessment of the record as a whole. *Id.* ¶ 176.

One tribunal member, however, took an opposing viewpoint. In his dissent, Mr. Bravo agreed with the award except for the finding of discrimination and hence violation of Article 1102. Marvin Feldman v. United Mexican States, ICSID Case No. ARB(AF)/88/1, ¶ 1, Dissenting Opinion, (Dec. 16, 2002). available at <http://www.state.gov/s/l/c3751.htm> (last visited May 1, 2004). Specifically, Mr. Bravo argued that claimant failed to provide sufficient evidence that domestic resellers of cigarettes received sporadic rebates like the claimants, and in fact read the record to indicate that domestic resellers went through similar hurdles with the SHCP. *Id.* ¶ 6.

327. Feldman Award, *supra* note 291, ¶¶ 194-98.



claimant's damages for Mexico's Article 1102 breach should be for claimant's "loss adequately connected with the breach."<sup>328</sup> Here, there was no expropriation and claimant's argument for lost profits was not persuasive given its continued operation; rather, the only issue regarding damages was the total amount of the rebates wrongly withheld from CEMSA.<sup>329</sup> The tribunal then awarded claimant 16.9 million pesos plus interest, and ordered each party to pay its own costs because each party was successful in part.<sup>330</sup> The award was substantially less than the 475 million pesos in damages that Mr. Feldman requested. Mexico subsequently petitioned the Ontario Superior Court of Justice to set aside the tribunal's award, however, the court denied the petition and ruled that the tribunal did not act outside its scope.<sup>331</sup>

At this point it should be clear that for Mexico Chapter 11 represents quite a departure from its traditional approach to international law and investment, and that the elaborate design of Chapter 11 presents, in the very least, an objective and alternative approach to international law and foreign investment.<sup>332</sup> The question that remains is whether Chapter 11 dispute resolution ultimately serves as a benefit or as a detriment to Mexico.

#### IV CHAPTER 11 AND MEXICO: THREATENING SOVEREIGNTY AND DEMOCRACY?

The text of Chapter 11 and its application are the critical sources for testing the validity of the concerns with Chapter 11, and then for addressing the real implications for Mexico. This is a less abstract method of deciphering the reality behind Chapter 11 dispute resolution, and it is a good way to emphasize the purposes and positive implications of Chapter 11 for Mexico. Overall, this analysis supports the argument that the broad concerns with Chapter 11 are unfounded. Indeed, while a few concerns are noteworthy and while some critics in the very least offer some pragmatic suggestions for possible reform, most of the criticisms are unsubstantiated.<sup>333</sup> Most importantly, the following discussion also illustrates how international law is a positive force in the governance of economic integration in Mexico as well as for Mexico's future participation in the

328. *Id.* ¶ 194.

329. *Id.* ¶¶ 199-202.

330. *Id.* ¶¶ 205-08.

331. *United Mexican States v. Karpa*, [2003] CarswellOnt 4929 (Sup. Ct. Ont. 2003) (Doc. No. 03-CV-23500).

332. For more discussion on the intricacies of Chapter 11 arbitration, see Frederick M. Abbott, *The Political Economy of NAFTA Chapter Eleven: Equality Before the Law and the Boundaries of North American Integration*, 23 HASTINGS INT'L & COMP. L. REV. 303, 305 (2000); Justin Byrne, *NAFTA Dispute Resolution: Implementing True Rule-Based Diplomacy Through Direct Access*, 35 TEX. INT'L L.J. 415, 422-23 (2000); Camp, *supra* note 5, at 86-7.

333. One NAFTA commentator candidly asserts that "[s]o much attention has been paid to the phantoms and foibles of investor-state arbitration 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. Todd Weiler, *NAFTA Investment Arbitration and the Growth of International Economic Law*, 2 Bus. L. Int'l 158 (2002), available at <http://www.naftaclaims.com> (last visited Feb. 23, 2003) [hereinafter "Weiler, *NAFTA Investment*"].

international political economy.

Concerns with Chapter 11 emanate, at base, from the fact that Chapter 11 provides for binding international arbitration for the resolution of investment disputes between private investors and NAFTA Parties. Notably, the literature on Chapter 11 illustrates the debate between critics and proponents of NAFTA Chapter 11 in general, as applied to all NAFTA Parties.<sup>334</sup> And, most of the criticisms of Chapter 11 stem from two major general assertions: Chapter 11 is a threat to national sovereignty and is an abrogation of democracy.<sup>335</sup> The most often-cited arguments for this are that Chapter 11 promotes frivolous litigation and permits disproportionate compensation, lacks an adequate award review process, uses "secret" tribunals to reduce transparency, prevents legitimate governmental regulation, and derogates from notions of equality and sustainable development.<sup>336</sup> With respect to Mexico, these concerns are summarized and dealt with below.

#### A. *Frivolous Litigation and Disproportionate Compensation*

One argument against Chapter 11 is that it opens up NAFTA Parties to meritless, excessive litigation brought by market-hungry foreign corporations bent on using direct access to control their piece of the market share in a NAFTA Party.<sup>337</sup> This in turn is costly for NAFTA Parties and acts as a check on the governments' ability to regulate, which infringes upon national sovereignty and principles of democratic governance.<sup>338</sup> More than one commentator has suggested that NAFTA Parties establish some sort of screening mechanism, and Jones has specifically stated that such a mechanism would be useful "to diminish the ability of powerful U.S. companies to take advantage of a weaker Mexican government and would provide a level playing field for private investors from all three NAFTA countries."<sup>339</sup> Indeed, one would think that if the result of Chapter 11 has been to encourage frivolous lawsuits, Mexico would be experiencing the brunt of those suits.

First, however, the text of Chapter 11 reveals that an investor must go through various procedural requirements in order to utilize the Chapter 11 mechanism against a NAFTA Party.<sup>340</sup> These requirements on their face seem to dispel any concern that Chapter 11 grants investors free, unconditional opportunities to bring

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334. *Id.*

335. *Id.*

336. Jones, *supra* note 184, at 545-46; Byrne, *supra* note 333, at 434; Public Citizen, "NAFTA Chapter 11 Investor-to-State Cases: Bankrupting Democracy, available at <http://www.citizen.org/publications/release.cfm?ID=7076> (last visited Feb. 26, 2003) [hereinafter "Public Citizen"]; Daniel M. Price, *NAFTA Chapter 11 Investor-State Dispute Settlement: Frankenstein or Safety Valve?* 26 CAN. U.S. L.J. 1, 8 (2001) [hereinafter "Price, *Safety Valve*"]; Ian Laird, *NAFTA Chapter 11 Meets Chicken Little*, 2 CHI. J. INT'L L. 223, 226 (2001).

337. Jones, *supra* note 184, at 545-46; Byrne, *supra* note 333, at 434; Public Citizen, *supra* note 337; Price, *Safety Valve*, *supra* note 337, at 8; Ian Laird, *supra* note 337, at 226.

338. See Jones, *supra* note 184, at 543.

339. *Id.* at 546; Byrne, *supra* note 333, at 434.

340. See *supra* notes 178-82.

frivolous litigation against NAFTA Parties. Even more, the text encourages dispute resolution through consultation and negotiation before the arbitration provision is invoked.<sup>341</sup> For Mexico, this promotes dialogue between a foreign investor and Mexican authorities so that foreign investment can flourish in a friendly environment, but in one that is politically acceptable to Mexican authorities, who are ultimately responsible to their citizens.<sup>342</sup>

Second, the facts also refute the criticism that Chapter 11 gives investors the opportunity to bring frivolous actions against Mexico and take advantage of Mexico's weaker economic status compared to its NAFTA counterparts. After eight years of NAFTA, less than ten claims have been filed against Mexico.<sup>343</sup> There has been no evidence of an onslaught of U.S. or Canadian-based corporations seeking to use direct access dispute resolution as a means to trample Mexico's legitimate governance and obtain a greater market share. This in and of itself dispels the criticism that Chapter 11 has encouraged frivolous litigation and opens up Mexico to the mercy of litigious North American investors. The bottom line here is that there has not been excessive use of Chapter 11 against Mexico. Moreover, regarding those arbitrations that have proceeded against Mexico so far, Chapter 11 tribunals have scrutinized investors' adherence to the various jurisdictional requirements that must be met before an investor could proceed.

The tribunal's analysis in *Azimian* indicates that Chapter 11 is not to be exploited by private investors.<sup>344</sup> NAFTA Parties designed Chapter 11 for the purpose of protecting and thus stimulating investment activity in order to achieve greater economic integration. The tribunal's analysis lends direct support to the competence of a Chapter 11 tribunal to ensure those purposes and guide the dispute resolution process, and not to permit investor evasion of Mexican courts where legal actions beyond that which set forth in Chapter 11 should be taken. The competence of the tribunal to scrutinize these jurisdictional requirements provides further evidence that frivolous litigation against Mexico, in application, is not a reality

In *Waste Management*, the tribunal properly applied Annex 1137.1 of Chapter 11, which specifically protects Mexico against parallel or excessive litigation.<sup>345</sup> This is important because it supports the idea that investors must follow the rules in bringing legal action against Mexico. Mexico has abandoned its traditional policy regarding foreign investment and made a commitment to rules, despite its historically skeptical view of foreign investors. Investors must comply with the rules for bringing Chapter 11 arbitrations against Mexico. As evidenced in *Waste Management*, Chapter 11 in application does protect Mexico from the costs and burden of excessive litigation with foreign investors.<sup>346</sup> It also curtails any perceived advantage an investor may have in bringing actions against Mexico in

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341. *Id.*

342. *Id.*

343. See State Department Website, *supra* note 198.

344. See *Azimian Award*, *supra* note 201.

345. *Waste Management I Award*, *supra* note 222, § 27

346. *Id.*

both arbitration and Mexican courts, in that an investor does not have two chances to prevail on its claim.<sup>347</sup>

*Feldman* supports the argument that a Chapter 11 tribunal engages in sophisticated legal analysis to decipher whether it has jurisdiction according to the NAFTA.<sup>348</sup> There, Mexico appropriately was not subjected to retroactive liability.<sup>349</sup> Moreover, the investor's claim was narrowed so as to comport with the time limit requirements of Chapter 11, and thus Mexico was protected from possibly paying for the claimant's lack of following the rules.<sup>350</sup> These objective, balanced conclusions of the tribunal encourage a framework within which investment and potential compensation for damages to that investment in Mexico are to be determined with prudence. Such prudence coincides with both the economic reality of the investment as well as the protection of Mexico from improper claims.

Third, Weiler comments that an investor must take into account the political costs of bringing a frivolous lawsuit against a NAFTA Party, as such action could taint the investor's reputation and future prospects for investment.<sup>351</sup> This is particularly true in the case of Mexico, where history has not been kind to the reputation of foreign investors.<sup>352</sup> Even more, Price points out that there is a possibility of frivolous lawsuits in every legal system, every day, but that does not threaten democracy or sovereignty.<sup>353</sup> Again, there has not been excessive use of Chapter 11 against Mexico. Moreover, the text of Chapter 11 and the need of foreign investors to maintain a good reputation in Mexican markets provide adequate checks for potentially frivolous litigation. In this respect, a screening mechanism for Chapter 11 disputes is simply not necessary.

Another related criticism of Chapter 11 is that the potential damage award amounts could be astronomical even when there is a legitimate government measure taken for the protection of society, and thus foreign investors should not be able to claim such high amounts because taxpayers ultimately foot the bill.<sup>354</sup> Here, the argument seems to be that no compensation, or rather, some nominal compensation, is in order if a government legitimately acts to remedy a public problem, regardless of whether the investment is wiped out totally.

First, Brower correctly asserts that Chapter 11 minimizes the inherent risk NAFTA Parties face in balancing regulation of foreign investment by eliminating

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347. *Id.*

348. Feldman Award, *supra* note 294, ¶ 47.

349. *Id.* ¶ 51.

350. *Id.* ¶¶ 57-58.

351. Weiler, *NAFTA Investment*, *supra* note 334, at 158 n.3.

352. *See supra* Part II.B.I.

353. *See Price, Safety Valve*, *supra* note 337, at 8. Price opines that "rather than being a threat to sovereignty, NAFTA checks the excesses of unilateral exercises of sovereignty by testing measures against generally accepted public international law standards. *Id.* at 7

354. Laird, *supra* note 337, at 228-29; Brower II, *supra* note 13, at 80; Public Citizen, *supra* note 337. "Bill Moyers Reports: Trading Democracy, February 5, 2002, 10:00pm (ET), PBS, transcript available at [http://www.citizen.org/trade/nafta/CH\\_11/articles.cfm?ID=6687](http://www.citizen.org/trade/nafta/CH_11/articles.cfm?ID=6687) (last visited Feb. 26, 2003) [hereinafter "Moyers"].

the possibility of punitive damages, as well as injunctive relief.<sup>355</sup> Also, Laird appropriately mentions the difficulty an investor faces in making a case for high damages under principles of international law, where the purpose of compensation is what makes an investor whole as measured by the value of the investment “the day before the expropriation, not after.”<sup>356</sup>

This is particularly true where a NAFTA Party legitimately acts to protect the public from a “hazardous” investment, because “if the product or investment is legitimately a health or environmental hazard, and this was known before the expropriation, it would be difficult to assert that on the day of expropriation the investment had any value.”<sup>357</sup> These realities seem to dispel the argument that Chapter 11 promotes disproportionate compensation at the expense of tax payers. As for Mexico, the Chapter 11 arbitrations demonstrate that it is difficult to make a case for high damages, and that Chapter 11 tribunals have been exercising a high degree of sophistication regarding damages.

With respect to *Azinian*, an important point is that Mexico did not have to pay damages after successfully arguing its case before a neutral tribunal.<sup>358</sup> The tribunal quickly dismissed the inappropriate claim of \$16 million in damages, without really even discussing the claim on the merits.<sup>359</sup> This is important for the development of the rule of law in Mexico as well as among NAFTA Parties and private individuals doing business in North America. It sends a signal to investors that Mexico is willing to play by the rules, and it sends a signal to Mexico that when it is in the right it can use the international system and international law to its advantage and reap the benefits of increased foreign investment at the same time. Moreover, this reality in application refutes concerns that the Chapter 11 dispute resolution framework gives “implausible investors” the ability to “bankrupt” Mexican democracy

In *Metalclad*, the tribunal awarded the investor \$16.7 million for Mexico’s breach of Chapter 11, this instead of the \$43 million in damages claimants demanded.<sup>360</sup> In this respect, little clout can be given to the argument that the tribunal was not careful in its damage calculation to decipher what part of claimant’s demand was inflated and non-compensable under Chapter 11. The idea that investors can obtain disproportionate compensation for investment losses in Mexico did not hold in application here. Further, *Feldman* represents an appropriate distinction in that Chapter 11 seeks to encourage investment and compensate damages to such investment, but only to the extent that compensation is fair and makes economic sense.<sup>361</sup> The tribunal was careful not to allow conditions in which the investor could receive a windfall, subjecting Mexico to the

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355. Brower II, *supra* note 13, at 80.

356. Laird, *supra* note 337, at 228.

357. *Id.* at 228.

358. See *Azinian Award*, *supra* note 201.

359. *Id.* ¶¶ 196-200.

360. *Metalclad Award*, *supra* note 250, at ¶ 131.

361. See *Feldman Award*, *supra* note 291, ¶¶ 189-207.

possibility of paying disproportionate compensation.<sup>362</sup> When *Feldman* is considered alongside *Metalclad*, it is difficult to say, even in those cases where Mexico has been required to compensate foreign investors, that Chapter 11 has subjected Mexico to disproportionate compensation to the detriment of the public.

### B. Lack of Review Process

Another common criticism of Chapter 11, and one that has been put forth in particular by NAFTA Parties, attacks the binding nature of arbitral decisions.<sup>363</sup> Abbot questions whether democratic NAFTA Parties and their citizens should be “comfortable” with arbitral decisions given that there is no appellate review process, and he suggests that NAFTA Parties establish an appellate body or provide national courts with more of a role in Chapter 11 arbitrations.<sup>364</sup> Brower and Steven note the criticism by Canada and Mexico that tribunals “may not make the right decisions, and therefore an appellate review process is necessary”<sup>365</sup>

It may be said that the argument for an appellate review mechanism for Chapter 11 arbitrations is a pragmatic suggestion to a concern for more transparency in the dispute resolution process.<sup>366</sup> First, however, regardless of whether an appellate review process is politically necessary or even a viable option for NAFTA Parties, Chapter 11 is not a threat to democracy because it lacks an appellate review mechanism per se.<sup>367</sup> A NAFTA Party may petition a court to modify or set aside an award if it believes a Chapter 11 tribunal acted outside its scope—outside the requirements of NAFTA in making a ruling.<sup>368</sup> A NAFTA Party therefore potentially has access to both a highly-sophisticated arbitration tribunal as well as the courts of a particular NAFTA Party in a given dispute.

*Metalclad* demonstrates that NAFTA Parties have some type of recourse to a court system for review of a Chapter 11 award, although critics do not mention this.<sup>369</sup> It demonstrates that, even if one agrees that Chapter 11 arbitral awards should be reviewed, a NAFTA Party can in fact get review of a Chapter 11

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362. See *id.*

363. Abbott, *supra* note 333, at 308; Brower II, *supra* note 13, at 47.

364. Abbott, *supra* note 333, at 308.

365. Brower & Steven, *supra* note 86, at 200.

366. Pending trade promotion authority legislation in the U.S. Congress calls for the establishment of an appellate review mechanism to review decisions rendered by international arbitration panels in investor-state disputes arising out of trade/investment agreements. CRS Report to Congress, *Trade Promotion (Fast-Track) Authority: Summary and Analysis of Selected Major Provisions of H.R. 3005*, April 15, 2002, available at <http://fpc.state.gov/documents/organization/10090.pdf> (last visited Nov. 22, 2003) [hereinafter “TPA”]. Interestingly, in an effort to bring greater transparency to the foreign investment dispute resolution process, the United States and Chile have left open the possibility for establishing an appellate mechanism for arbitration brought under the foreign investment chapter in the Chile-U.S. Free Trade Agreement. Chile-U.S. Free Trade Agreement, June 6, 2003, Chapter 10, at <http://www.ustr.gov/new/fta/Chile/final/10.investment.PDF> (last visited May 1, 2004).

367. TPA, *supra* note 369.

368. Jones, *supra* note 184, at 536.

369. *Metalclad*, *supra* note 277

award.<sup>370</sup> There, Mexico received the full benefit of the process by prevailing on two of its arguments.<sup>371</sup> Further, the British Columbia court served not only as a check on the tribunal's reasoning, but also on the damage calculation.<sup>372</sup> The court modified the damage award amount only slightly to correspond with its reasoning,<sup>373</sup> which gives further weight to the argument that Chapter 11 tribunals are sophisticated and fair when calculating damages against Mexico.

Second, in striking the balance between the need for economic efficiency and legal certainty, NAFTA Parties chose to side with finality over appellate litigation. One economic rationale behind this is to deal with an investment dispute in a neutral forum when it arises and move on, which lessens the likelihood of pending litigation inhibiting decisions to invest. Maintaining a steady flow of investment in Mexico is of course critical to building long term growth. Mexico has successfully used the two-tiered investment dispute review system and it continues to experience the benefit of increased foreign investment.<sup>374</sup> The Chapter 11 dispute resolution system is working.

In line with this, Brower adds a more abstract argument against appellate review of Chapter 11 arbitral awards, stating that

heightened judicial review "constitutes an independent violation of Chapter 11. Although heightened review might not, for technical and political reasons, subject the NAFTA Parties to additional claims for liability, it undermines the principle of voluntary compliance with authoritative decisions rendered at the international level by impartial bodies charged with the supervision of treaty compliance. Thus, heightened judicial review impairs the development of the rule of law in international economic relations."<sup>375</sup>

Thus, if an appellate review mechanism is established, it is possible that Mexico could be given a small window of opportunity to shy away from its commitment to comply in all cases with international law, which would hurt its prospects for economic growth. For Mexico, old ways should not be given a chance to surface and trump Mexico's commitment toward progress in law and economic policy since NAFTA.

Third, it is important to emphasize again, as Brower adds, that the expertise of the tribunals far exceeds that of the courts in NAFTA Parties.<sup>376</sup> The notion that Mexico or any NAFTA Party cannot be "comfortable" with an arbitration decision, given the expertise and the option to get a second review in a domestic trial court, is unfounded. A close analysis of the arbitrations involving Mexico so far further underscores the sophistication, expertise and prudence of the tribunals in sifting through the facts of the investment disputes and applying the law to make

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370. See *id.*

371. Metalclad, *supra* note 277, ¶¶ 133-34.

372. *Id.* ¶ 137.

373. *Id.*

374. See *id.*

375. Brower II, *supra* note 13, at 47

376. *Id.* at 78.

decisions. This approach facilitates Mexico's economic goals.

*Azimian* demonstrates the high degree of sophistication in the tribunal's analysis, discerning if an investor has a cause of action under Chapter 11 and whether what the investor alleged is something outside the scope of the tribunal's competence.<sup>377</sup> The complex factual history in *Feldman* and the tribunal's intricate analysis of the interlacing of previous court proceedings, tax issues and government regulations in that dispute further underscores the sophistication of Chapter 11 tribunals.<sup>378</sup> In *Waste Management*, the tribunal's sophisticated analysis of the jurisdictional requirements of Chapter 11 lends support to the idea that the tribunals are highly competent adjudicators and have a sophisticated knowledge of international law.<sup>379</sup> Mexico prevailed on its first jurisdictional objection, in line with the purpose of Chapter 11 to protect Mexico from excessive litigation.<sup>380</sup> The investors prevailed in round two, but they did so according to international law.<sup>381</sup> Another benefit to Mexico here is that Mexico has taken part in the development of the rule of law among NAFTA Parties and it has made important arguments, some of which have been successful. In other words, Mexico now has a stake in the Chapter 11 process and an important role in the development of international law pertaining to foreign investment.<sup>382</sup> And this is all being done through a highly competent adjudication system.

An additional comment on the adequacy of the dispute resolution framework as is and Mexico's participation in establishing the rule of law under Chapter 11 dispute resolution is important here. Although Chapter 11 arbitrations have no precedential value, the tribunal in *Feldman* stated that its decision regarding Article 1110 was consistent with the decisions in *Metalclad*, *Azimian* and other decisions.<sup>383</sup> This reference is both good for international law and foreign investment. It allows NAFTA Parties to acknowledge a common set of rules in developing the rule of law pertaining to North American investment activity, and it further adds to a more predictable legal environment for investors, which promotes investment. This in turn promotes deeper integration. Further, this reference supports the idea that even though there is no official appellate review process, Chapter 11 tribunals have sought "guidance" in prudently rendering their decisions.<sup>384</sup>

### C. "Secret" Tribunals

Critics of Chapter 11 also complain of the confidential nature of international arbitration.<sup>385</sup> Public interest groups and non-governmental organizations in

377. *Azimian Award*, *supra* note 201, ¶¶ 81-86.

378. *Feldman Award*, *supra* note 291, ¶¶ 6-23, 105-112.

379. *Waste Management II Jurisdiction Decision*, *supra* note 240, ¶¶ 26-37.

380. *Waste Management I Award*, *supra* note 222, § 31.

381. *See Waste Management II Jurisdiction Decision*, *supra* note 240.

382. *See id.*

383. *Feldman Award*, *supra* note 291, ¶ 107.

384. *See id.*

385. *See Jones*, *supra* note 184, at 549; Fulvio Fracassi, *Confidentiality and NAFTA Chapter 11*



particular denounce the Chapter 11 process because, in line with international arbitration practice, it does not have any provisions for non-government third party participation.<sup>386</sup> The Chapter 11 dispute resolution process has been described as occurring “not in courts of law but before secret trade tribunals.”<sup>387</sup> Others contest the principle of confidentiality in international arbitrations entirely, and vehemently oppose the confidentiality of NAFTA dispute settlement on grounds that investors must assume that documents will be made public for purposes of accountability to democratic governments.<sup>388</sup> In a more pragmatic tone, Jones recommends the implementation of mechanisms through which non-governmental organizations can access the proceedings.<sup>389</sup>

Whether or not Chapter 11 arbitrations should be more transparent with respect to third-party participation is certainly an issue for debate, but it is a misnomer to label the process as “secret. First, non-disputing NAFTA Parties may submit their interpretations of the law in a given dispute to a tribunal.<sup>390</sup> It is the NAFTA Parties, after all, who have the responsibility to monitor implementation and interpretation of NAFTA.<sup>391</sup> They do have access to influence Chapter 11 tribunals, even if they are not a party to the dispute. Also, there are provisions for expert witnesses, which further increases the opportunity for outside influences, where proper, to inform better the dispute resolution process in a particular case.<sup>392</sup>

Second, the NAFTA Free Trade Commission issued a clarification statement of NAFTA Chapter 11 dispute resolution, explaining that nothing in NAFTA precludes a Chapter 11 tribunal from accepting *amicus curiae* submissions.<sup>393</sup> Third, the argument for more public participation should be balanced with what others point out regarding confidentiality—that confidentiality in Chapter 11 arbitrations is an essential element in promoting international law along side foreign investment.<sup>394</sup> Loritz notes that the confidential nature of the arbitrations serves as an incentive for both parties to submit important documents regarding the investment dispute that would otherwise not come out in open court.<sup>395</sup> The

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*Arbitrations*, 2 CHI. J. INT'L L. 213, 217 (2001); Loritz, *supra* note 69, at 539; Maximo Romero Jimenez, *Considerations of NAFTA Chapter 11*, 2 CHI. J. INT'L L. 213,217 (2001); Public Citizen, *supra* note 337; Moyers, *supra* note 357.

386. See Public Citizen, *supra* note 337; Moyers, *supra* note 357; Abbott, *supra* note 333, at 308.

387. Moyers, *supra* note 357.

388. Fracassi, *supra* note 388, at 217, 221-22.

389. Jones, *supra* note 184, at 549.

390. NAFTA, *supra* note 10, at 645.

391. *Id.* at 645.

392. *Id.* at 646.

393. *Unofficial Statement of the Free Trade Commission on non-disputing party participation*, Oct. 7, 2003, available at <http://www.ustr.gov/regions/whemisphere/nafta2003/statement-nondisputingparties.pdf> (last visited Nov. 22, 2003). For example, in *United Parcel Service of America v. Canada*, available at <http://www.state.gov/documents/organization/6033.pdf> (last visited Mar. 23, 2004), the Chapter 11 tribunal accepted written briefs by non-disputing parties.

394. See Camp, *supra* note 5, at 91-92; Laird, *supra* note 337, at 225, and Jimenez, *supra* note 388, at 250.

395. Loritz, *supra* note 69, at 539.

advantages gained from limited outside intervention in foreign investment disputes, both with respect to future investment and to the facilitation of dispute resolution, are perhaps an advantage for Mexico in particular.

The Chapter 11 framework allows Mexico to be forthcoming in the resolution of disputes without potentially sending a negative signal to foreign investors who may perceive a disputed governmental measure, although not fully adjudicated, as a risk. This, in turn, could cause capital flight, which is not what Mexico wants.<sup>396</sup> Also, Mexico has and will take measures that are violative of an investor's right under Chapter 11, and those measures should be dealt with in a way that does not scare capital inflows while Mexico adjusts to the international rule-based system of dispute resolution under Chapter 11.

Critics also attack the fact that Annex 1137.4 of NAFTA allows either a disputing Party or a disputing investor the choice of whether to make the arbitral award public.<sup>397</sup> However, all final arbitral awards involving Mexico thus far have been published.<sup>398</sup> Further, most documents involving the arbitrations are readily available on the Internet.<sup>399</sup> Lack of transparency in this respect is simply not the reality, and the potential economic benefit of a certain degree of confidentially arguably substantiates a delay in releasing documents to the public. This is not to say that this is not an area where potential reform of Chapter 11 dispute resolution may be proper for political purposes. It is just to say that there are strong economic arguments to the contrary, particularly with regard to Mexico.

#### D. Prevents Government Regulation

An overriding criticism of Chapter 11, which is related to those discussed above but is important on its own, is that Chapter 11 prevents a NAFTA Party from effectively taking measures to protect the public health and the environment.<sup>400</sup> The argument is, at base, that investors can deter or unfairly make

396. John H. Chun, *Annual Survey Issue: International Insolvencies: NOTE. "Post-Modern Sovereign Debt Crisis: Did Mexico Need an International Bankruptcy Forum?"* 64 *FORDHAM L. REV.* 2647, 2647-2659 (1996).

397. NAFTA, *supra* note 10, at annex 1137.4.

398. State Department Website, *supra* note 198; Weiler Website, *supra* note 198.

399. *Id.* It should be noted that NAFTA Parties have released an interpretation of the text regarding publication of awards, emphasizing that nothing in NAFTA prevents the release of Chapter 11 arbitration documents to the public. State Department Website, *supra* note 198. Also, although discussion of Chapter 11 arbitrations not involving Mexico is outside the scope of this article, the parties to the Chapter 11 arbitration *United Parcel Service of America v. Canada*, *supra* note 396, have decided to hold the arbitration open to the public via closed circuit television. ICSID Website, *supra* note 135, at <http://www.worldbank.org/icsid/ups.htm> (last visited Mar. 14, 2004).

400. Jones, *supra* note 184, at 555; Abbott, *supra* note 333, at 309; Laird, *supra* note 337, at 227-29; Brower & Steven, *supra* note 86, at 198; Public Citizen, *supra* note 337; Moyers, *supra* note 357; *Vendiendo El Futuro: Un documento preparado por la Comision de Asuntos Sociales (CCCB-CECC) en vistas a la conferencia Humanizando la Economia Global*, Presentada en La Universidad de Católica de América, Washington, D.C., Enero 28 al 30, 2002, available at <http://www.citizen.org/documents/futuroGerardoTranslation.final.PDF> (last visited Mar. 14, 2004) [hereinafter "*Vendiendo El Futuro*"].

governments pay for legitimate government regulation, all in the name of money. For critics, this is a major intrusion on national sovereignty and democratic governance.<sup>401</sup> Jones voices his concern regarding environmental regulation and asserts that direct access “tips the scales too far for investors.”<sup>402</sup> In fact, with respect to Mexico, these criticisms are very similar to the justifications Mexico put forth throughout the twentieth century for rejecting the application of international law to commercial disputes in Mexico involving foreigners.<sup>403</sup>

A plain reading of the Chapter 11 text seems to indicate something quite contrary to the argument that Chapter 11 prevents legitimate government regulation. Article 1114 deliberately protects a government’s right to regulate—it does not prevent such a right.<sup>404</sup> Further, Loritz emphasizes that both a close reading of Chapter 11 and international law supports the legal conclusion that “the negative economic impact of environmental regulations does not trigger liability.”<sup>405</sup> Brower and Steven also acknowledge critics’ sentiments that corporate interests can ‘undermine’ legitimate governmental regulations in a ‘supranational’ forum insulated from the usual domestic political and legal processes, and respond by properly pointing out it is basic customary international law that states are responsible for indirect expropriation.<sup>406</sup>

It is here where Chapter 11 strikes a balance for all NAFTA Parties as the governments of those countries address the needs of their citizens. Those needs include not only necessary public health and environmental legislation, but also an environment where investment can flourish and economic livelihood can prosper. At base, Chapter 11 gives a qualified investor the right to argue a claim before a neutral tribunal.<sup>407</sup> The investor still has to argue its case—there is no blanket right for investors to strip away categorically a NAFTA Party’s right to enact legislation.

Further, the tribunal cannot prevent implementation of a challenged regulation during the dispute.<sup>408</sup> And, if a violation is found, the tribunal cannot force a NAFTA Party to change its laws.<sup>409</sup> Chapter 11 just requires that a foreign investor be treated according to international standards of fairness and that when that does not happen, a NAFTA Party must compensate the investor accordingly.<sup>410</sup> This stands in stark contrast to the lack of investment rules in place during the Porfiriato in Mexico, and hence the threat of foreign investors indirectly

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401. Public Citizen, *supra* note 337; Moyers, *supra* note 357; *Vendiendo El Futuro*, *supra* note 403; Abbott, *supra* note 333, at 309 (arguing that Chapter 11 does not take into account social policies and thus tribunal review should be further limited until the parties establish a more sufficient dispute resolution structure to account for government regulation).

402. Jones, *supra* note 184, at 556.

403. See *supra* Part II.B.1.

404. See *supra* note 170.

405. Loritz, *supra* note 69, at 551.

406. Brower & Steven, *supra* note 86, at 198.

407. See *supra* note 175.

408. See *supra* note 190.

409. *Id.*

410. See *supra* Part III.B.

controlling Mexico's social policies is non-existent.<sup>411</sup>

The arbitrations discussed herein reveal the balance in Chapter 11 between government regulation and the protection of investment. In *Metalclad*, both the tribunal and the Canadian court found that Mexico did in fact indirectly expropriate claimants' investment through the ecological decree.<sup>412</sup> This entitled the claimants to money damages for their loss, but in the end the State of San Luis Potosí and Guadalcazar were successful in their goal to shut down the landfill.<sup>413</sup> In effect, Chapter 11 dispute resolution here did not prevent local Mexican governments from doing what was the political will.

In *Feldman*, the tribunal's reasoning represents a careful analysis of NAFTA. The tribunal appropriately disallowed a Chapter 11 claim to impede Mexico's right to regulate its own tax policy.<sup>414</sup> Further, in accordance with its reasoning regarding the Article 1110 claim, the tribunal held that different treatment of producers and resellers of cigarettes in Mexico does not violate international law, because Mexico may have legitimate public policy reasons for doing so.<sup>415</sup> Here, the tribunal showed great deference to the legitimate authority of Mexico to govern, and did not impose restrictions on Mexico that are not in NAFTA. In application, therefore, critics' argument that Chapter 11 dispute resolution categorically strips NAFTA Parties' rights to regulation is not the case. The tribunal in *Feldman* was careful to distinguish between an investor's rights under Chapter 11 and a government's rights and responsibilities in a democratic society.<sup>416</sup>

Additionally, Laird points out that the obligation to compensate expropriated investment according to international standards is a "small price to pay" for the overall benefits of free trade and open investment.<sup>417</sup> This, of course, is especially so for Mexico, which as emphasized throughout this article needs a predictable, stable legal climate to encourage foreign investment. Laird further summarizes, most appropriately, that "governments make mistakes and sometimes they intentionally create measures that hurt foreigners."<sup>418</sup> That is the history of international disputes. It is misguided reasoning to think that holding governments accountable is a threat to democracy.<sup>419</sup>

Overall, the Chapter 11 setup underscores the importance that NAFTA Parties placed on foreign investment in drafting the NAFTA text. It encourages compliance with international law, NAFTA and other international conventions in

411. See *supra* Part II.B.1.

412. See *supra* note 271; *United Mexican States v. Metalclad Corp.*, 2001 BCSC 664, 89 B.C.L.R. (3d) 359, 38 C.E.L.R. (N.S.) 284, 14 B.L.R. (3d) 285, [2001] B.C.J. No. 950, ¶¶ 94-99 (Sup. Ct. Brit. Col. 2001) (Doc. No. L002904).

413. See *supra* Part III.C.3.

414. See *Feldman Award*, *supra* note 291, ¶¶ 209-13.

415. *Id.* ¶ 171.

416. *Id.* ¶ 185.

417. Laird, *supra* note 337, at 229.

418. *Id.*

419. *Id.*

an effort to create a balanced regulatory structure within which to govern cross-border investment. This is what is necessary for Mexico to realize its goals in becoming more competitive in the international political economy. It does not in the meantime, moreover, prevent Mexico or any other NAFTA Party from legislating for the protection of the public health and environment.

*E. Neglects Notions of Equality and Sustainable Development*

One commentator categorically disapproves of the inclusion of Chapter 11 in NAFTA.<sup>420</sup> Professor Alvarez argues against Chapter 11 dispute resolution entirely, contending that its structure does not comport with ideas of equality and sustainable development, and thus is harmful to Mexico.<sup>421</sup> He characterizes Chapter 11 as “a U.S. bilateral investment treaty on steroids, the “most bizarre human rights treaty ever conceived, and as “a human rights treaty for a special-interest group.”<sup>422</sup> He also asserts that Chapter 11 ignores “North/South power differentials” and merely “reflects U.S. law and perspectives.”<sup>423</sup> For Professor Alvarez,

There is no actual symmetry of direct benefits to the national investors of all three NAFTA parties—at least not for the foreseeable future. As few Mexican investors are likely to be in the position to penetrate the U.S. market, it is almost exclusively U.S., not Mexican, nationals that get the benefit of the investment chapter.<sup>424</sup>

Without a substantive commitment to investment rules applicable to all of North America, the policy interests of countries in North America as expressed in NAFTA to grow and integrate their economies would not have a chance of being realized. Moreover, without foreign investment, Mexico cannot realize its goals for economic growth. After years of opposition, Mexico believed it was necessary to accept international norms as pillars for governing transnational business activity in order to stimulate investment. In this respect, the contention that Chapter 11 is the antithesis of sustainable development and thus derogatory to human rights is something less than accurate.

First, although Chapter 11 provides broad substantive guarantees to NAFTA investors, it is hardly accurate to characterize it as derogating from human rights in

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420. See Jose E. Alvarez, *Critical Theory and the North American Free Trade Agreement's Chapter Eleven*, 28 U. MIAMI INTER-AM. L. REV. 303 (1996); see also Jones, *supra* note 184, at 544-45 (discussing Professor Alvarez's arguments).

421. Alvarez, *supra* note 420, at 307; see also Jones, *supra* note 184, at 544-45 (discussing Professor Alvarez); Sandrino, *supra* note 69, at 326 (arguing, also, against Chapter 11, adopting a traditional developing world skepticism to foreign investment, stating “[t]he open investment regime in NAFTA, with no provisions addressing either development objectives of the host state or TNC operations, in essence places the state in a position in which its sovereignty and autonomy are comprised”).

422. Alvarez, *supra* note 420, at 304, 307-08.

423. *Id.* at 312.

424. *Id.* at 304.

Mexico. In negotiating Chapter 11, NAFTA Parties realized—including Mexico—that investment is just as critical to economic growth and development as trade. Investment, after all, is the impetus for long-term economic growth in any economy. This is especially true for developing economies. Foreign investment is necessary to promote the efficiency of investments in a particular market by infusing that market with new ideas and new technology. This in turn leads to, on an aggregate scale, greater productivity, greater profits, rising incomes and hence rising standards of living. A treaty provision that has the intent to raise standards of living in Mexico is certainly not derogatory to human rights.

As discussed earlier, foreign investment covering a wide variety of sectors in Mexico continues to increase.<sup>425</sup> Moreover, for as much as Chapter 11 does do to stimulate investment in Mexico, its mandate is not to effect issues pertaining to the redistribution of wealth in Mexican society, which is the real issue for sustainable development. If the investment is not there in the first place, however, issues regarding sustainable development are not even reached.<sup>426</sup>

Second, Professor Alvarez correctly notes that Mexico abandoned its traditional policy by accepting Chapter 11, which is based on U.S. law perspectives.<sup>427</sup> But those perspectives happen to be in line with customary international law practices. The historical reality and position in the international political economy in which Mexico finds itself today illustrates that Mexico's outright rejection of international law pertaining to foreign investment was perhaps not the best course of action. Moreover, it is anti-progressive and borderline senseless to suggest that Mexico should reject Chapter 11 standards simply because they are in line with U.S. standards. Mexico has now, through a highly technical treaty, correctly chosen to accept international norms regarding foreign investment because that is what stimulates investment, and those standards are as much a part of Mexico now as they are of the United States and Canada.

Third, there is no basis in asserting that Mexico will not or has not derived a benefit from Chapter 11 because Mexican investors have not "taken advantage" of Chapter 11 dispute resolution. The point of Chapter 11 is to stimulate investment, particularly in Mexico, and that should be the measure of Mexico's benefit. The perceived benefit should not be measured as a tally card on how many Mexican-based firms invest in the United States and Canada or on how many Mexican-based firms have sued other NAFTA Parties under Chapter 11.

Fourth, the basic framework of Chapter 11 dispute resolution does not ignore power imbalances between Mexico and other NAFTA Parties, as has been suggested. In fact, it does just the opposite by establishing a neutral, rule-based dispute resolution mechanism for investment disputes. In discussing the differences between power-based diplomacy and rule-based diplomacy, Byrne

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425. See *supra* notes 108-110.

426. Alvarez, *supra* note 420, at 309. Alvarez somewhat admits that his comparison of Chapter 11 to human rights is somewhat tangential, stating that "[i]t might be said that the comparison between the NAFTA and human rights instruments is, in itself, a rhetorical stance that is as questionable as the NAFTA's invocation of 'equal rights' *id.*

427. *Id.* at 312.

astutely asserts that Chapter 11, as a rule-based regime, is more conducive to the development of international law.<sup>428</sup> This is especially advantageous for Mexico. By removing foreign investment disputes to a neutral, international mechanism, Mexico is not directly threatened by power-based political maneuvering by the United States or Canada with regard to a given investment dispute.<sup>429</sup>

Under Chapter 11, there is no altering of the rules of the game in the middle of an investment dispute to appease political demands adverse to Mexico's position. In this setting, then, "[j]ustice and fairness demand that Canada and the United States live up to the same substantive rules and procedural mechanisms as have been accepted by Mexico."<sup>430</sup> This is essential for the development of international law among NAFTA Parties and the rule of law in Mexico. And, because the role of power politics is diminished in investment disputes, it provides a framework within which Mexico can develop confidence in its decision to abandon its traditional policy regarding foreign investment.

Disallowing private investors direct access to dispute resolution would further exacerbate power differences between Mexico and the other NAFTA Parties, and would represent a step backward for Mexico. Leaving investor-state disputes up to NAFTA Parties for resolution "can be highly inefficient, arbitrary, and politically explosive."<sup>431</sup> This would do nothing to encourage foreign investment in Mexico, and it might in fact serve as a deterrent to such investment. Brower and Steven stress that "[w]ith each new case commenced, the NAFTA countries will be arguing their interpretations of international law and urging their views. [and] will gain expertise through their regular participation in such proceedings."<sup>432</sup> This is particularly important for Mexico, given its traditional stance on the applicability of international law to foreign investment. This new practice, in and of itself, is critical for Mexico's successful participation in an increasingly complex international political economy

Thus, Chapter 11 dispute resolution does not ignore power differentials between NAFTA Parties; rather, it successfully obfuscates those differentials by offering a neutral, international body for dispute resolution.<sup>433</sup> And, it is through this framework that Mexico can participate in and experience the link between international law and economic integration, which is imperative to Mexico's participation in the international political economy and economic growth.

#### *F Sovereignty in General*

A note on the sovereignty argument in general is appropriate here. At base,

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428. See Byrne, *supra* note 333, at 419-20.

429. *Id.* at 429.

430. Brower & Steven, *supra* note 86, at 200.

431. *Id.* at 197.

432. *Id.* at 201. The authors underscore that this enables NAFTA Parties to influence and shape investment policy in North America. *Id.* This gives Mexico an extraordinary opportunity to play its hand in such development along with two developed countries.

433. *Id.* at 200.

“[i]t is illogical for governments who have willingly incurred limits on their sovereignty in order to respond to a perceived common threat to their international competitiveness, to then argue against flexible private remedies on the basis of a sovereignty argument.”<sup>434</sup> Historical trends in integration in the Americas indicate that countries in the Western Hemisphere have acknowledged a common interest in establishing supranational frameworks in order to prosper economically, which, in essence, is an effort to protect themselves. The economics of global capitalism are in some ways outside the control of any particular country, and multilateral frameworks represent governmental efforts to join the system and make it more orderly for the benefit of their citizens.

Developing countries in the Americas, and in particular Mexico, have taken bold steps to build the groundwork for multilateral governance. Mexico took a more progressive step in agreeing to Chapter 11, acknowledging that in the world of foreign investment, international standards are the best ways to guarantee fair participation by itself and private investors in the investment dispute resolution process.<sup>435</sup> This in turn establishes a good environment for investment in Mexico, which in turn enhances its prospects for prosperity. It is an action of protection—it is a bold act of sovereignty that takes under consideration the realities of the age of globalization.

Notably, an international arbitration tribunal with binding or even non-binding authority serves as a “challenge” to traditional notions of sovereignty but the evolution of international law and the representations made by NAFTA Parties seem to obscure the line between exercising sovereignty in an era of globalization and maintaining sovereignty under archaic Westphalian conceptions of the international system.<sup>436</sup> Without international law and nation-states’ concessions to it economic integration, and more importantly progress, is impossible. Elaborating on the purpose of Chapter 11, Brower and Steven have offered the following insight:

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434. Robert Paterson, *supra* note 126, at 120; see also Price, *Safety Valve*, *supra* note 337, at 7 (“[A]ll treaties, all international agreements are in a sense a compromise of sovereignty. However, they are, first, an exercise of sovereignty.”).

435. Robert Paterson, *supra* note 126, at 85.

436. For good discussion on the changing notions of sovereignty today, see Ronald A. Brand, *Sovereignty: The State, the Individual, and the International Legal System in the Twenty First Century*, 25 HASTINGS INT'L & COMP. L. REV. 279 (2002). Professor Brand notes the growing trends in international economic law, wherein private parties are increasingly receiving more rights in the international system. *Id.* at 290. Moreover, in discussing the historical origins of sovereignty and the relationship between nation-states and individuals, he concludes, most correctly, that “[r]ecognition that international law now limits the conduct of states in their relationships with individuals is not a bad thing, nor does it necessarily represent diminution of the ‘sovereignty’ of states. *Id.* at 294. See also Robert Paterson, *supra* note 126, at 119:

In the future, there is likely to be less need for negotiations than for increasingly effective means of enforcing compliance with existing interstate rules. Without efficient means for private parties to secure enforcement of rules, such as those contained in NAFTA, the credibility of such agreements is undermined. At a time when the power of sovereign states to control transnational economic activity is at an all-time low, it seems contradictory that private international actors lack the ability to enforce new rules that are a direct response to this reality.



In establishing this investment regime, the NAFTA Parties wanted to achieve three main objectives: (1) to tear down existing foreign investment barriers by eliminating arbitrary and discriminatory restrictions; (2) to build investor confidence throughout the region through the elaboration and enforcement of clear and fair rules; and (3) to 'depoliticize' the resolution of investment disputes by eliminating the need for State-to-State adjudication. Any criticism of the Chapter 11 regime that fails to take account of these three factors is, literally, beside the point.<sup>437</sup>

The concerns with Chapter 11 discussed herein in many ways do not take these motives into account. They not only give cursory effect to the actual Chapter 11 text, but they also refuse to acknowledge the tremendous amount of investment that continues to flow among NAFTA Parties, and into Mexico, beyond the realm of politics. Chapter 11 has so far achieved NAFTA Parties' goals and after some years of application, as discussed, Mexico is not any less sovereign.

The Chapter 11 rule-based regime is also a lesser challenge to Mexico's sovereignty, and all NAFTA Parties' sovereignty, by virtue of its structure. Without the arbitration option, a NAFTA investor would be left with the options of either litigating in foreign courts or pressuring the investor's home government to use political channels to resolve the dispute. This, among other things, would not serve as a catalyst to investment in Mexico. In this respect, international arbitration may be viewed as the best means of preserving Mexico's sovereignty for the time being. Given Mexico's historic stance on protecting its sovereignty from outside influences, coupled with the reality of economic integration and the importance of foreign investment to Mexico, the arbitration option is less intrusive on Mexico's sovereignty than say, legal harmonization with its common law North American partners.<sup>438</sup> Perhaps most importantly, from a Mexican standpoint dealing with the litigious character of North American investors in general, Byrne's comments may be appropriate: "one of the greatest attributes of the kind of effective resolution that is provided by direct access is that 'it encourages dispute avoidance. When potential disputants, whether they are party-nations or private entities, can anticipate the uniformity with which the law will be applied, they will be less likely to 'break the rules.'"<sup>439</sup>

Lastly, taken as a whole, the Chapter 11 arbitrations against Mexico so far represent Mexico's participation in the development of international law while it reaps the benefits of increased investment and enjoys a more equal footing with other NAFTA Parties. *Metalclad* and *Feldman* represent good examples of when and to what extent awards against a Party are appropriate, and further provide guidelines for Mexican regulation with respect to foreign investment. On the other side, *Azinian* and *Waste Management* demonstrate that Mexico will prevail when investors' claims are either unsubstantiated or when investors do not follow the proper rules for resolving investor-state disputes. Rather than a detriment to national sovereignty and democratic governance in Mexico, an informed

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437 Brower & Steven, *supra* note 86, at 195 (footnotes omitted).

438. See *supra* Part II.C.2.a.

439. Byrne, *supra* note 333, at 429.

discussion of the Chapter 11 and its application reveal that the system as is has been successful in balancing Mexico's economic goals, historical political realities and the reality of international law in economic integration.

#### V CONCLUSION: A HEALTHY MIX

Historical policy interests in the Western Hemisphere have placed the Americas on a path toward economic integration. Modern trade and investment agreements are the main tools for governance of such integration, and they serve to fuel dramatic increases in cross-border business transactions and to create an environment in which the intersection of international law, economics and politics is a reality. Such integration creates the need for effective dispute resolution procedures, and this is especially the case with regard to disputes involving private investors and countries under trade and investment agreements. Investment is just as important as trade for deeper economic integration, and foreign investment is critical for growth in developing countries. And, it entails the interaction of private economic actors with sovereign entities in a way that begs adherence to objective, international norms.

International arbitration has emerged as a preferred method for international dispute settlement, and as an alternative to transnational litigation and diplomatic pressure it provides a sound, manageable framework for dispute resolution. It does so without forcing countries to engage in the monumental task of legal harmonization. This allows international law and economics to progress side-by-side.

NAFTA is a prime example of integration trends in the Americas. The Chapter 11 framework represents a historic, positive step by NAFTA Parties to grow and develop together and collectively aid in the development of international law. The significant changes made by Mexico to conform to Chapter 11, together with the Chapter 11 arbitrations involving Mexico thus far, serve as major stepping stones for the developed Mexico of tomorrow. Notably, some commentators offer potentially useful suggestions for future modification of Chapter 11 dispute resolution. However, although some concerns regarding Chapter 11 raise important questions regarding, for instance, appellate review, transparency and sustainable development, the record does not evince that Chapter 11 is detrimental to Mexico—or even to all Parties for that matter.

The broader criticisms that Chapter 11 is a threat to national sovereignty and an abrogation of democracy are unfounded. With respect to Mexico, this is supported by both a close look at the NAFTA text as well as the arbitrations involving Mexico so far. Rather, direct access dispute resolution, as an international law-based framework for investment dispute resolution, is an impetus for progression in Mexican law and a catalyst for increased investment in Mexico. It is also a platform for political equilibrium between Mexico and other NAFTA Parties. Indeed, Chapter 11 direct access dispute resolution is a healthy mix of international law, economics and politics for Mexico, and it is but one necessary tool for Mexico's successful participation in the international political economy.