

Beyond Courts: Harmonizing Practice and Principles in North America through Investor-State Arbitration

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ABSTRACT

The legal systems of the NAFTA nations have common features, yet the differences in terms of court practice and applicable substantive principles are notable. Within the context of NAFTA, however, a dispute resolution system not under the control of any single NAFTA nation—investor-state arbitration—is refining the concept of the minimum standard. The arbitral tribunals are guided by prior arbitral awards in shaping the important body of international law, and they are developing fairly consistent and harmonized principles concerning the contours of the minimum standard, particularly with regard to denial of justice.

Key words: North American Free Trade Agreement (NAFTA), customary international law, minimum standard of treatment of aliens, fair and equitable treatment

INTRODUCTION

A remarkable development is shaping international investment law and dispute resolution in North America. Under Chapter 11 of the North American Free Trade Agreement (NAFTA), non-domestic arbitral tribunals are helping shape the law governing certain aspects of foreign investment (32 I.L.M. 289, 635).¹ The adjudicators of the investment disputes are not judges from the NAFTA nations. Instead, they are law professors, private lawyers, former government officials, and others whom the

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¹ Professor Jose Alvarez has described NAFTA Chapter 11 dispute resolution as a “denationalized adjudication” process (Alvarez, 1997). Chapter 11 tribunals have also been described as “non-governmental adjudicatory bodies of international law” (Caruso, 2006).

disputing parties have selected to resolve their differences. At times, they are asked to resolve challenges that involve matters essential to governance within each NAFTA nation, such as domestic judicial decisions.

In addition to process, a key aspect of the system is the substantive law the arbitrators apply to resolve the disputes. Mexico, the United States, and Canada agree that foreign investment of investors from the NAFTA nations is entitled to a minimum standard of treatment. The standard recognizes that host nation's courts will not act to deny justice to the investment, whatever that may mean.

The arbitral awards issued in the NAFTA Chapter 11 disputes have put denial of justice into a meaningful context. In addition, substantive principles have been harmonized to a limited extent due to a system of *de facto* precedent (Franck, 2005a). Even though "arbitration awards technically have no *de jure* precedential value, practitioners, investors, and states rely upon such decisions as *de facto* precedents and as indicators of their potential rights and liabilities." These developments, which have clarified standards for foreign investment in North America, have largely occurred outside of the respective judicial systems of the NAFTA nations. The limited harmonization of investment standards is a result of the investor-state arbitration process yet not necessarily mandated by it.

THE CUSTOMARY INTERNATIONAL LAW MINIMUM STANDARD IN CONTEXT

For many years, Mexico recognized that investments of foreign investors were not entitled to better treatment than that afforded investments of Mexican nationals (Daly, 1994). Today, Mexico affords certain foreign investments a minimum standard of treatment. In NAFTA article 1105(1), Mexico promised to treat investments from Canada and the United States "in accordance with international law, including fair and equitable treatment and full protection and security" (NAFTA art. 1105). Canada and the United States have made the same commitment to investments from their respective NAFTA counterparts. The article 1105(1) standard is in addition to affording the investment and investors the better of national treatment (NAFTA art. 1103, 1104) or most-favored-nation treatment (NAFTA art. 1103, 1104). Further, the article 1105(1) obligation is separate from the obligation not to expropriate or take measures tantamount to expropriation subject to compensation and other conditions (NAFTA art. 1110).

The obligation to protect foreign investment is not without consequences. NAFTA provides for investor-state settlement of certain investment disputes through arbitration under the auspices of the International Centre for Settlement of Investment

Disputes (ICSID) or under the arbitration rules of the United Nations Commission on International Trade Law. The disputes are subject to investor-state arbitration and involve claims under Section A of NAFTA Chapter 11 and certain other NAFTA provisions (UNCITRAL) (NAFTA art. 1116, 1120). The arbitral tribunals apply NAFTA and applicable rules of international law to resolve the investment disputes. Also, NAFTA is to be interpreted in light of its objectives set out in article 102(1) and “in accordance with applicable rules of international law” (NAFTA art. 1113 [1]).

The arbitrations have brought to life the parties’ commitment under international law. The NAFTA nations could face a claim for substantial damages if they breach obligations owing a qualified investor. In fact, the NAFTA nations have been, and continue to remain, embroiled in disputes under article 1105(1). For example, an arbitral tribunal awarded a U.S. investor US\$16.685 million due to a Mexican municipality’s withdrawal of a permit to build a landfill in *Metalclad Corp. v. Mexico (Metalclad Award)*, holding Mexico liable because “Metalclad was not treated fairly or equitably” (40 I.L.M. 36, ¶¶ 99-101). The Supreme Court of British Columbia, however, ultimately set aside the award on the article 1105(1) finding, as it was beyond the scope of issues submitted to arbitration in *Mexico v. Metalclad* (2001 B.C.S.C. 664). A Canadian investor had sought US\$750 million based on an executive order of the governor of California and California regulations on methyl tertiary butyl ether (MTBE) in California gasoline. Among other charges, the investor claimed discrimination (44 I.L.M. 1345). After a hard-fought and lengthy arbitration, the claim ultimately failed (2001 B.C.S.C. 664, notes 86-89). Even though only a handful of NAFTA Chapter 11 claims have succeeded, billions of dollars are and have been at stake.²

Given the substantial potential liability, it came as no surprise that the NAFTA nations attempted to reign in arbitral tribunals by clarifying article 1105(1). In *Mondey International, Ltd. v. United States (Mondey Award)*, the nations were apparently concerned a proven claim that state action was “unfair” or “inequitable” could lead to article 1105(1) “liability” (ICSID Case No. ARB[AF]/99/2, ¶ 103). On July 31, 2001, the NAFTA Free Trade Commission, in accordance with its delegated authority (NAFTA art. 2001[2][c]),³ issued a formal interpretation of NAFTA (“Notes” 2001).

² See <http://www.state.gov/s/1/c3439.htm> (consulted June 30, 2007), setting out the NAFTA Chapter 11 petitions. See also Brower 2002, noting disputes under article 1105(1) have exceeded US\$2 billion.

³ The commission, cabinet-level officials or their designees, “shall ... (c) resolve disputes that may arise regarding [NAFTA’s] interpretation or application.”

The interpretation, which is binding on a Chapter 11 tribunal, stated as follows:

B. Minimum Standard of Treatment in Accordance with International Law.

1. Article 1105(1) prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to investments of investors of another Party.
2. The concepts of 'fair and equitable treatment' and "full protection and security" do not require treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens.
3. A determination that there has been a breach of another provision of the NAFTA, or of a separate international agreement, does not establish that there has been a breach of Article 1105[1] (NAFTA art. 1131[2] note 17, § B).

The interpretation relied on a well-established, yet arguably vague, principle of international law: the customary international law minimum standard of treatment of aliens. Invoking the minimum standard surely did not settle the meaning of article 1105(1) as the minimum standard itself is far from definite. Instead, the interpretation's intent was to limit application of article 1105(1) to a heightened level of alleged state misconduct.

So, what is the content of the now guiding light of article 1105(1), the minimum standard, and has application of the standard helped harmonize the treatment of foreign investment in North America?⁴ The American Society of International Law's founder and former U.S. Secretary of State Elihu Root referred to "a standard of justice, very simple, very fundamental, and of such general acceptance by all civilized countries as to form a part of the international law of the world" (Root, 1910). But Secretary Root's words give little guidance. Even contemporary international law luminaries acknowledge the minimum standard but struggle with its content (Brownlie, 2003). "[Requirements of] international law in [the] field of [foreign investment] ... represent an attempt at accommodation 'between the conflicting interests involved'" without given more clarification" (Jennings and Watts, 1992).

Dancing around the concept of a customary international law minimum standard does little to help investors and states, which would benefit from a more refined sense of the concept. One aspect of the minimum standard, however, has some clarity and this element concerns "denial of justice," or what one NAFTA Chapter 11 tribunal has described as "the standard of treatment of aliens applicable to decisions

⁴ According to Professor David Gantz, "Even if everyone agrees that 'fair and equitable treatment' in Article 1105 means the standard required by 'customary international law,' it still needs to be determined exactly what that means" (Gantz, 2004).

of the host State's courts or tribunals" (Garcia-Amador, 1974; ICSID Case No. ARB[AF]/99/2, note 15, ¶ 96).⁵ Establishing the contours of denial of justice is important as the standard necessarily involves the sensitive issue of an international tribunal's assessment of a state's judicial or quasi-judicial activity.

Certain recent U.S. free trade agreements (FTAs) and bilateral investment treaties (BITs) provide a clearer sense of the minimum standard, including the U.S.-Chile Free Trade Agreement (U.S.-Chile FTA) and the U.S.-Uruguay Treaty Concerning the Encouragement and Reciprocal Protection of Investments (U.S.-Uruguay BIT).⁶ The new U.S. BITs are based on the 2004 U.S. Model BIT ("Treaty" 2004). In the new FTAs and BITs, the United States and its treaty parties, like the NAFTA nations, agree that the customary international law minimum standard applies to foreign investments and the standard includes fair and equitable treatment and full protection and security (U.S.-Chile FTA; 44 I.L.M. 268, 272). Thus, as to these agreements, any doubts about the fact of a minimum standard and its customary international law status have been put to rest.

The new FTAs and BITs are more expansive than NAFTA. In them, the treaty parties "confirm their shared understanding" of customary international law, which they agree "results from a general and consistent practice of States that they follow from a sense of legal obligation" (U.S.-Chile FTA; 44 I.L.M. 268, 272, note 24, annex A). The minimum standard "refers to all customary international law principles that protect the economic rights and interests of aliens" (U.S.-Chile FTA; 44 I.L.M. 268, 272, note 24, annex A). The U.S.-Uruguay BIT, based on the 2004 U.S. Model BIT, explained "fair and equitable treatment" and denial of justice as follows:

"Fair and equitable treatment" includes the obligation not to deny justice in criminal, civil, or administrative adjudicatory proceedings in accordance with the principle of due process embodied in the principal legal systems of the world (44 I.L.M. 268, 272, note 24, art. 5.2).

Denial of justice is thus an element of fair and equitable treatment. Under the U.S.-Uruguay BIT, "full protection and security" requires a party "to provide the level of police protection required under customary international law" (44 I.L.M. 268, 272, note 24, art. 5.2).

⁵ Arguably, this is a narrow definition as, "in a broad sense," denial of justice includes "all the acts or omissions capable of giving rise to international responsibility of the State for injuries caused to the person or property of aliens, independently of the organ which may have been the proximate cause of such injury." See also Paulsson, 2005, discussing the evolution of the duty of a state to provide "decent justice" to foreigners.

⁶ U.S.-Chile Free Trade Agreement, June 6, 2003, available at http://www.ustr.gov/assets/Trade_Agreements/Bilateral/Chile_FTA/Final_Texts/asset_upload_file1_4004.pdf (U.S.-Chile FTA); U.S.-Uruguay Treaty Concerning the Encouragement and Reciprocal Protection of Investments, 2004, art. 5, 44 I.L.M. 268, 272. See Gantz, 2004, discussing the minimum standard under NAFTA and recent free trade agreements.

Accordingly, parties to the new BITS and FTAs and NAFTA agree the minimum standard of treatment is the customary international law minimum standard. The standard includes “fair and equitable treatment” and “full protection and security.” Recent U.S. BITS and certain FTAs have established that one of the subsuming elements, “fair and equitable treatment,” includes the obligation not to deny justice in certain proceedings. Due process, as defined by the world’s principal legal systems, is the governing standard.

The treaty standards have given important guidance on the minimum standard but they have not removed all ambiguities and uncertainty. Furthermore, it was apparently not the intention for the treaties to provide an airtight definition of the minimum standard. The term “justice” has broad implications and, when applied to aliens in the context of a potential claim of state responsibility, the political implications can be substantial. Jan Paulssen has recognized that giving effect to denial of justice requires the “balancing of a number of complex considerations” (Paulssen 2005). As he has further written, “We have learned to live with inherently elastic concerns relating to the international legitimacy of national judicial processes” (Paulssen 2005, 66). The treaties thus authorize arbitral tribunals to resolve investor-state disputes involving the minimum standard and have given some, albeit incomplete, guidance in defining the standard.

THE MINIMUM STANDARD UNDER A MICROSCOPE: ESTABLISHING RELATIVE CONSISTENCY ON DENIAL OF JUSTICE

Introduction

The concept of denial of justice derives from the system of reprisals that emerged before the rise of the modern state (Freeman, 1970). In the context of international trade and investment in the era of the nation-state, alien traders often needed protection when they were in foreign nations and subjected to wrongdoing (Lillich, 1983). Emmerich de Vattel, in *The Law of Nations*, argued the state owed a duty to protect its own subjects who claim an injury by a foreign state (Brownlie, 2003, note 22, 497; Dawson and Head, 1971). Scholars have documented how the developed world’s ideas of justice and fairness became part of an international standard, even though local communities may have had different values (Sornarajah, 2000). As the late Professor Sir Robert Jennings noted:

That so-called “minimum” standard for the treatment of “aliens” was the product of European and North American States wishing to demand a standard of treatment of their nationals in foreign countries, which they called “minimum”, but was nevertheless thought to be higher than the local *national* standard in some defendant countries, and which national standard those countries claimed sufficed for the purposes of international law.⁷

Attempts to refine the concept have met with difficulty. Numerous nations, particularly Latin American ones, had resisted a minimum standard. The UN International Law Commission’s Articles on State Responsibility do not address the substantive content of a state’s obligation (Crawford, 2002). Professor Louis B. Sohn and Professor Richard Baxter, in their “Convention on the International Responsibility of States for Injuries to Aliens,” attempted to clarify the topic, such as denial of access, denial of a fair hearing (adequate preparation time, ability to call witnesses) but their work remained a draft (Sohn and Baxter, note 23, 133).

The decisions of arbitral commissions in the early part of the twentieth century helped advance the concept. For example, in *United States (L.F. Neer) v. Mexico* (U.S.-Mex. General Claims Comm’n, Oct. 15, 1926), a 1920s decision of the United States-Mexico General Claims Commission, the tribunal held that actionable government conduct in the treatment of an alien “should amount to outrage, to bad faith, to willful neglect of duty, or to an insufficiency of governmental action so far short of international standards that every reasonable and impartial man would readily recognize its insufficiency” (4 R.I.A.A. 60, 3 ILR 213 [1927]).⁸ The *Chattin* and *Roberts* cases, also from the United States-Mexico General Claims Commission, addressed denial of justice in the context of criminal matters. These decisions, however, did not consider denial of justice within the context of an investment dispute. Of course, all of these decisions are nearly a century old.

Until recently, international tribunals after the United States-Mexico General Claims Commission gave some attention to the fair and equitable standard and little attention to the customary international law minimum standard (Dolzer, 2005). With NAFTA article 1105(1) and NAFTA’s investor-state arbitration mechanism for resolving disputes however, matters have changed. In the words of some commentators, “The investment arbitration experience of the last five years has turned a drought into a flood” with the fair and equitable standard becoming “a potent tool in the

⁷ *Methanex Corp. v. United States*, Second Opinion of Professor Sir Robert Jennings, Q.C. 1-2, on line at <http://www.naftaclaims.com> (emphasis in original).

⁸ See also Government of Canada Counter-Memorial (Phase 2), *Pope & Talbot, Inc. v. Canada* (Oct. 10, 2000) ¶¶ 212, 238, 266, 309 on line at <http://www.dfait-maeci.gc.ca/tna-nac/documents/B-2.pdf>; and *Mondev* (ICSID Case No. ARB[AF]/99/2, note 15, ¶ 114).

assessment of the adequacy of the judicial and administrative systems of host States” (McLachlan, Shore and Weiniger, 2007).

The NAFTA Chapter 11 Arbitral Awards

NAFTA Chapter 11 arbitral tribunals have limited the contours of denial of justice. An arbitral award under Chapter 11 is not binding beyond the dispute at issue (32 I.L.M. 289, 635, note 1, art. 1136[1]). Yet, awards tend to reflect the views of learned international law scholars and are fairly well-reasoned and thoughtful pronouncements of legal principles. At a minimum, they establish reasonable boundaries on claims that state conduct amounts to a denial of justice.

Establishing some clarity has not been easy. An early NAFTA Chapter 11 award, *Azinian v. Mexico* (39 I.L.M. 537 [2000]), involving a Mexican city’s termination of a U.S. investor’s waste collection and disposal contract, steered matters in the right direction. The Mexican courts had upheld the city’s right to terminate the contract under Mexican law. The claimants did not challenge the decisions of the Mexican courts but argued the city’s annulment of the contract violated NAFTA. The tribunal used the challenge to the city’s conduct, however, to pronounce a limited ability of an arbitration panel to review local judicial decisions:

The possibility of holding a State internationally liable for judicial decisions does not, however, entitle a claimant to seek international review of the national court decisions as though the international jurisdiction seized has plenary appellate jurisdiction. This is not true generally and it is not true for NAFTA. *What must be shown is that the court decision itself constitutes a violation of the treaty* (39 I.L.M. 537 (2000) ¶ 99).⁹

According to the tribunal, “the Claimants must show either a denial of justice, or a pretense of form to achieve an internationally unlawful end” (39 I.L.M. 537 (2000) ¶ 99). A claim of denial of justice, if alleged, would have been recognized “if the relevant courts refuse to entertain a suit, if they subject it to undue delay, or if they administer justice in a seriously inadequate way” (39 I.L.M. 537 (2000) ¶ 102).¹⁰

⁹ Emphasis in the original. Jan Paulsson, the author of the recent definitive work on denial justice, was president of the tribunal in *Azinian*.

¹⁰ The decision also refers to a “fourth type of denial of justice” which is the “clear and malicious misapplication of the law” (39 I.L.M. 537 (2000) ¶ 103). The opinion’s reference to “fourth type” is confusing as international law could be breached based on a misapplication of domestic law, *GAMI Inv. Inc. v. Mexico*, Award (Nov. 15, 2004) ¶ 91, note 57 and accompanying text, on line at <http://naftaclaims.com/Disputes/Mexico/GAMI/GAMIfinalAward.pdf>. (*GAMI* Award). The observation demonstrates that the line

While the *Azinian* tribunal perhaps needlessly addressed denial of justice, its cautionary words set the stage for later decisions. In the meantime, certain tribunals took the debate down a different path.

After *Azinian*, several investor-state NAFTA arbitral tribunals entered the debate on the meaning of article 1105(1). *Metalclad Corp. v. Mexico* pronounced that fair and equitable treatment required that the host state “ensure a transparent and predictable framework” for the investor’s “business planning and investment” (40 I.L.M. 36, note 10, ¶ 99). A “lack of orderly process and timely disposition” of decisions relating to an investment defy the investor’s expectation of treatment “fairly and justly in accordance with the NAFTA” (40 I.L.M. note 10, ¶ 99). As noted, the Supreme Court of British Columbia set aside, in part, the *Metaclad* award (40 I.L.M. 36, note 11, ¶ 99). A few months before the issuance of the interpretation, the tribunal in *Pope & Talbot Inc. v. Canada* announced a broad standard for article 1105(1) as follows:

The Tribunal interprets Article 1105 to require that covered investors and investments receive the benefits of the fairness elements under ordinary standards applied in the NAFTA countries, without any threshold limitation that the conduct complained of be “egregious,” “outrageous” or “shocking” or otherwise extraordinary.¹¹

Infusion of notions of fair and justness without any “threshold limitation” raised a red flag. The floodgates under article 1105(1) could have been open to investors with any complaints about the treatment of their investment.

The interpretation helped ease the tension. The first award on the merits issued after the interpretation, *Mondev International Ltd. v. United States*, discussed denial of justice in the context of the minimum standard (ICSID Case No. ARB[AF]/99/2, note 15). The Canadian investor in *Mondev* alleged that Massachusetts courts’ dismissal of a jury verdict in the investor’s favor violated article 1105(1). The trial court had granted a judgment notwithstanding the verdict (JNOV) on behalf of the Boston Redevelopment Authority due to immunity (the court affirmed the granting of the JNOV) and the Massachusetts Supreme Court reversed the verdict against the City

between domestic and international conduct may not be clear at times. As the tribunal in *GAMI* stated, “a government’s failure to implement or abide by its own law in a manner adversely affecting a foreign investor may but will not necessarily lead to a violation of Article 1105.”

¹¹ *Pope & Talbot Inc. v. Canada*, Award on the Merits of Phase 2 (Apr. 10, 2001), on line at <http://www.investmentclaims.com/decisions/Pope-Canada-Award-10Apr2001.pdf>. After the award was issued and after issuance of the interpretation, the tribunal issued a separate opinion on damages. Applying the standard set forth in the interpretation, which the tribunal assumed was a high one, amounting to “shock and outrage,” it awarded substantial relief to the investor. The conduct concerned Canada Softwood Lumber Division’s “threats and misrepresentations.” See *Pope & Talbot Inc v. Canada*, Award in Respect of Damages (May 31, 2002), on line at <http://www.investmentclaims.com/decisions/Pope-Canada-Damages-31May2002.pdf>.

of Boston due to the investor's failure to take necessary steps to hold the city in breach (ICSID Case No. ARB[AF]/99/2 ¶ 1).

An obvious concern for the tribunal in *Mondev* was that the alleged wrongdoing stemmed from decisions of the Massachusetts courts. As the tribunal noted, "It is one thing to deal with unremedied acts of the local constabulary and another to second-guess the reasoned decisions of the highest courts of a State" (ICSID Case No. ARB[AF]/99/2 ¶ 126). With the cautionary tone set, the tribunal emphasized the minimum standard should be considered as of no earlier than NAFTA's effective date, 1994, and the standard "has evolved and can evolve" (ICSID Case No. ARB[AF]/99/2 ¶ 124). Further, the NAFTA interpretation expressly incorporated international law, "whose content is shaped by the conclusion of more than two thousand bilateral investment treaties, many treaties of friendship and commerce" (ICSID Case No. ARB[AF]/99/2 ¶ 125). The extreme standard of the *Neer* decision, which had issued in the early twentieth century, no longer controlled.

Instead, *Mondev* cited the decision of a chamber of the International Court of Justice in the *ELSI* case, which spoke of "willful disregard of due process of law . . . which shocks, or at least surprises a sense of judicial propriety."¹² It then set forth the following test under article 1105(1):

The test is not whether a particular result is surprising, but whether the shock or surprise occasioned to an impartial tribunal leads, on reflection, to justified concerns as to the judicial propriety of the outcome, bearing in mind on the one hand that international tribunals are not courts of appeal, and on the other hand that Chapter 11 of NAFTA (like other treaties for the protection of investment) is intended to provide a real measure of protection. In the end the question is whether, at an international level and having regard to generally accepted standards of the administration of justice, a tribunal can conclude in the light of all the available facts that the impugned decision was clearly improper and discreditable, with the result that the investment has been subject to unfair and inequitable treatment. This is admittedly a somewhat open-ended standard, but it may be that in practice no more precise formula can be offered to cover the range of possibilities (ICSID Case No. ARB[AF]/99/2 ¶ 127).

The tribunal in *Mondev* easily disposed of the claim of denial of justice. As to each principal complaint, the tribunal held the Massachusetts courts acted consistently with the applicable law. For example, the investor had argued that, under Massachusetts law and practice, issues regarding contract performance should have been

¹² ICSID Case No. ARB(AF)/99/2 ¶ 127, quoting *Elettronica Sicula S.p.A. (ELSI) (United States v. Italy)*, ICJ Reports 1989, 15, 76.

remanded (ICSID Case No. ARB[AF]/99/2 ¶ 135). The tribunal refused to have “quintessentially matters of local procedural practice” become part of article 1105(1), and noted that if the investor’s approach were adopted, “NAFTA tribunals would turn into courts of appeal, which is not their role” (ICSID Case No. ARB[AF]/99/2 ¶ 136). The tribunal’s analysis is consistent with Jan Paulsson’s observation that a national court’s application of national law “does not give rise to an international delict unless there has been a violation of due process as defined by international standards” (Paulsson, 2005, note 23, 7).

Shortly after *Mondev*, the tribunal in the 2003 case *ADF Group, Inc. v. United States* (ICSID Case No. ARB[AF]/00/1) adopted a similarly guarded approach to article 1105(1). ADF, a Canadian entity, had a subcontract to provide structural steel components for a bridge project, and intended to use U.S.-originated steel fabricated, in part, in Canada (ICSID Case No. ARB[AF]/00/1, ¶¶ 45-55). According to U.S. and Virginia authorities, fabricating the steel in Canada violated Buy American requirements, which were part of the subcontract. The standards purportedly required ADF to conduct the manufacturing process, including fabrication, in the United States. The Virginia regulatory authorities refused the general contractor’s request to waive the Buy America requirement.

ADF argued that the Buy America program and the procedures used to implement it violated article 1105(1). Two aspects of the claim caused the NAFTA tribunal to examine decisions of U.S. agencies. First, ADF argued that the Federal Highway Administration (FHWA) of the U.S. Department of Transportation misapplied relevant case law, which ADF claimed gave it a legitimate expectation that some fabrication could occur outside of the United States. The tribunal did “not believe that the FHWA’s refusal ‘to follow prior rulings, judicial or administrative’ is, in itself in the circumstances of this case, grossly unfair or unreasonable” (ICSID Case No. ARB[AF]/00/1, ¶ 189). In fact, the case law arguably was inapplicable to the statutes (ICSID Case No. ARB[AF]/00/1, ¶ 189). Second, ADF argued FHWA “acted *ultra vires* and in disregard” of the applicable law (ICSID Case No. ARB[AF]/00/1, ¶ 190). While the tribunal held the investor had not made a *prima facie* case that the FHWA had acted without authority, even if it had, the tribunal could do nothing as it “has no authority to review the legal validity and standing of the U.S. measures here in question under *U.S. internal administrative law*” (ICSID Case No. ARB[AF]/00/1, ¶ 189).¹³ Indeed, “something more than simple illegality or lack of authority under the domestic law of a State is necessary to render an act or measure inconsistent with the customary international law requirements of article 1105(1)” (ICSID Case No. ARB[AF]/00/1, ¶ 189). ADF’s holding is

¹³ Emphasis in original. As the tribunal further noted, “We do not sit as a court with appellate jurisdiction with respect to the U.S. measures,” (ICSID Case No. ARB[AF]/00/1, ¶ 189).

consistent with the principle of *Azinian* that decisions of municipal courts are not reviewable in absence of a violation of the treaty.

Loewen Group, Inc. v. United States [Loewen Award] is, perhaps, the most notable of the NAFTA Chapter 11 cases. A Canadian funeral home company and its U.S. subsidiary faced a US\$500 million judgment from a Mississippi state court (ICSID Case No. ARB[AF]/98/3). During the trial, the Canadians suffered nationality-based comments and race and class-based discrimination, which the trial judge refused to temper with a cautionary jury instruction. The Mississippi courts later refused to find good cause to reduce or dispense with an appeal bond in excess of the judgment. The Canadian company ultimately settled.

The NAFTA Chapter 11 claim was dismissed due to the Canadian corporation's failure to maintain itself as a Canadian investor.¹⁴ Nevertheless, the tribunal reviewed the conduct of the Mississippi court and pronounced the trial "a disgrace" and noted "the trial judge failed to afford the company the process that was due" (ICSID Case No. ARB[AF]/98/3, note 69, ¶ 119). In fact, the tribunal, after documenting instances of unfairness, observed "the whole trial and its resultant verdict were clearly improper and discreditable and cannot be squared with minimum standards of international law and fair and equitable treatment" (ICSID Case No. ARB[AF]/98/3, ¶ 137). In this situation, it seems a clear violation of article 1105(1) had been established. Even under the interpretation, a denial of justice could be established due to the "manifest injustice in the sense of a lack of due process leading to an outcome which offends a sense of judicial propriety" (ICSID Case No. ARB[AF]/98/3, ¶ 132).¹⁵ Yet, the state court trial was only one aspect of the judicial process in *Loewen*. For the United States to be responsible under international law for denial of justice, the claimants must have exhausted effective, adequate and reasonably available remedies under municipal law (ICSID Case No. ARB[AF]/98/3, ¶¶ 168, 217). As the claimants had settled before all remedies had been exhausted, the system had not denied them justice (ICSID Case No. ARB[AF]/98/3 ¶ 217). Jan Paulsson later would observe that "finality is thus a substantive element of the international delict" (ICSID Case No. ARB[AF]/98/3, note 23 ¶ 100).

Also consistent with *Mondev* is the award in the 2004 decision of *Waste Management, Inc. v. Mexico* (Waste Management Award II) (43 I.L.M. 967). A U.S. investor,

¹⁴ The panel later confirmed its dismissal included a dismissal on the merits as to a Loewen family member, a Canadian, and his claim, ICSID Case No. ARB[AF]/98/3, Decision on Respondent's Request for a Supplementary Decision issued September 13, 2004.

¹⁵ The decision has an interesting analysis of discriminatory treatment and noted that "a decision which is in breach of municipal law and is discriminatory against the foreign litigant amounts to a manifest injustice according to international law," ICSID Case No. ARB[AF]/98/3, ¶ 135.

through a Mexican subsidiary, had entered into an exclusive waste concession agreement with the city of Acapulco (43 I.L.M. 967 ¶¶ 168, 217). The company had also agreed to build and operate a solid waste landfill for Acapulco (43 I.L.M. 967 ¶ 45). A bank provided a letter of credit to secure partial payment for services rendered under the agreement (43 I.L.M. 967 ¶¶ 48-50). The concession agreement provided for arbitration of disputes in Acapulco under the rules of the Mexico City Chamber of Commerce (43 I.L.M. 967 ¶ 45).

The company-city relationship became marred due to the city's difficulty in enforcing the exclusivity provisions and due to local waste practices (43 I.L.M. 967 ¶¶ 54, 56-57). The bank refused to pay the company's full demand under the letter of credit (43 I.L.M. 967 ¶¶ 58-65). The company sued the bank in the Mexican federal courts for non-performance but the claims and their appeals were dismissed (43 I.L.M. 967 ¶ 70). Further, the company sought to arbitrate its dispute against the city under the concession agreement but the arbitration was discontinued when the city refused to pay an amount as a condition for the arbitration to proceed and the company then refused to pay the arbitration fee owed by the city.¹⁶

In the NAFTA Chapter 11 arbitration, the company raised numerous claims, including denial of justice arising from the acts of the city, state, and bank. After reviewing the awards on article 1105(1), the tribunal in *Waste Management II* announced the following standard:

The minimum standard...is infringed by conduct attributable to the State and harmful to the claimant if the conduct is arbitrary, grossly unfair, unjust or idiosyncratic, is discriminatory and exposes the claimant to sectional, or racial prejudice or involves a lack of due process leading to an outcome which offends judicial propriety—as might be the case with a manifest failure of natural justice in judicial proceedings or a complete lack of transparency and candor in an administrative process (43 I.L.M. 967 ¶ 98).

The tribunal dismissed the claim of denial of justice as to the Mexican courts' decision involving the bank as they "were not, either *ex facie* or on closer examination, evidently arbitrary, unjust or idiosyncratic. There is no trace of discrimination on account of the foreign ownership of [the investor], and no evident failure of due process" (43 I.L.M. 967 ¶ 130). The fact that arbitration was not pursued did not give rise to a claim under article 1105(1), as the decision not to proceed with the arbitra-

¹⁶ The city also objected to the arbitration on the ground that the contract, as a public contract, was subject to the jurisdiction of administrative courts, and it had sought to stop the arbitration (43 I.L.M. 967 ¶¶ 120-21).

tion, “a decision made by the Claimant on financial grounds, did not implicate the Respondent in any internationally wrongdoing” (43 I.L.M. 967 ¶ 123).

Recent NAFTA awards reflect a similarly reserved application of the minimum standard. In the 2004 case of *GAMI Investment, Inc. v. Mexico* (GAMI Award), the tribunal summarized *Waste Management II* and noted that mere failure to fulfill objectives of administrative regulations or satisfy national law do not give rise to article 1105(1) violations.¹⁷ In the 2005 case of *Methanex Corp. v. United States* (Methanex Award) the tribunal dismissed a Canadian investor’s claim that California’s ban of MTBE and methanol constituted discriminatory treatment (44 I.L.M. 1345). According to the tribunal, article 1105(1) does not prohibit discriminatory treatment between nationals and aliens.¹⁸ Customary international law allows a state to “differentiate in its treatment of nationals and aliens” (44 I.L.M. 1345 ¶ 25). Also, even under the customary international law minimum standard set forth in *Waste Management II*, which the tribunal did not clearly endorse, the “conduct must have been ‘discriminatory and expose[d] the claimant to sectional or racial prejudice’” (44 I.L.M. 1345 ¶ 26).¹⁹ Finding no discrimination, the investor’s claim under article 1105(1) failed.

The article 1105(1) issues in *International Thunderbird Gaming Corp. v. Mexico*²⁰ (Thunderbird Award) involved Mexico’s Ministry of the Interior allegedly first pronouncing that federal law did not govern certain video game machines which Thunderbird proposed to use in gaming operations in Mexico but, then, closing a gaming facility and preventing the opening of other facilities in which the machines were to be used (Thunderbird ¶¶ 50-78). In the process, the ministry issued an administrative resolution that the machines were prohibited gambling equipment (Thunderbird ¶ 73). In addition, a Mexican administrative body, after a hearing, denied relief to the investor (Thunderbird ¶ 80). Thunderbird alleged denial of justice as to the administrative resolution and manifest arbitrariness in the proceed-

¹⁷ *GAMI Inv. Inc. v. Mexico*, Award (Nov. 15, 2004) ¶ 94, on line at <http://naftaclaims.com/Disputes/Mexico/GAMI/GAMIfinalAward.pdf>. Further, good faith efforts to achieve the law’s objectives could “counter-balance instances of disregard of legal or regulatory requirements” and consideration should be given to “the record as a whole” (GAMI ¶ 94).

¹⁸ Part IV-Chapter C article 1105 NAFTA, ¶ 14, observing “the plain and natural meaning of the text of article 1105 does not support the contention that the ‘minimum standard of treatment’ precludes governmental differentiations as between nationals and aliens,” 44 I.L.M. 1345 ¶ 16.

¹⁹ The opinion in *Methanex* noted the tribunal in *Waste Management* referred to “discriminatory” conduct but required that it be coupled with an exposure “to sectional or racial prejudice,” 44 I.L.M. 1345 ¶ 26. The tribunal in *Methanex* did not tackle the more challenging issue, as in *Waste Management* award’s inclusion of discriminatory conduct as violating the customary international law minimum standard, as it had held there was no discriminatory conduct (44 I.L.M. 1345 ¶ 26).

²⁰ *International Thunderbird Gaming Corp. v. United Mexican States*, Award (Jan. 26, 2006) on line at <http://www.investmentclaims.com/decisions/Thunderbird-Mexico-Award.pdf> (Thunderbird Award).

ings before the ministry. Recognizing that the article 1105(1) standard is not rigid and “should reflect evolving international customary law,” the tribunal pronounced a high threshold:

Acts that would give rise to a breach of the minimum standard prescribed by the NAFTA and customary international law [are] those that, weighed against the given factual context, amount to a gross denial of justice or manifest arbitrariness falling below acceptable international standards (Thunderbird ¶ 194).

Thunderbird had had the “full opportunity to be heard and present evidence at the Administrative Hearing” and had taken advantage of this opportunity (Thunderbird ¶ 198). The 31-page order from the hearing was “adequately detailed and reasoned.” The proceedings before the ministry had “certain regularities” but these were not “grave enough to shock a sense of judicial propriety” (Thunderbird ¶ 200). The tribunal acknowledged the standard for administrative due process is lower than that of judicial process although it provided no authority for this statement (Thunderbird ¶ 200). Further, the tribunal took comfort in that the ministry’s proceedings, including the resolution, were subject to judicial review (Thunderbird ¶ 201). Interestingly, the tribunal did not hold that the investor’s failure to exhaust its remedies barred a claim of denial of justice.

Emerging Principles on Denial of Justice

Since the interpretation, the NAFTA arbitral tribunals have rejected investors’ attempts to convert NAFTA Chapter 11 tribunals into courts of appeal. In the first instance, an aggrieved investor must establish that the conduct violates the NAFTA, which for purposes of article 1105(1) means a violation of the customary international law minimum standard. Mere claims that the municipal court decisions violate municipal law are insufficient. Instead, the allegedly wrongful acts must give rise to violations of “due process” or “generally accepted standards of the administration of justice.”

Yet even these violations may not be enough. For example, the failure to give notice, even if harmful and in violation of principles of due process, may not violate the minimum standard. As one tribunal observed, the result should engender “shock or surprise” which causes one to question the judicial propriety of the result. Also, the mere fact that one is caused to question the result is not enough. The outcome must be clearly improper and discreditable. In other words, the decision must be more than wrong, perhaps clearly wrong.

Further, *Waste Management II* held the conduct must be “arbitrary, grossly unfair, unjust, idiosyncratic” or be “discriminatory and expose the claimant to sectional or racial prejudice.” *GAMI* recognized liability under article 1105 if a NAFTA nation’s “officials fail to implement or implement regulations in a discriminatory or arbitrary fashion” (*GAMI* ¶ 94). The tribunal in *Methanex* held, however, that article 1105(1) did not bar discriminatory conduct and it subtly questioned whether discrimination alone violates customary international law (44 I.L.M. 1345 ¶¶ note 90 25-26). And, as *Loewen* instructs, the complaining party must have taken advantage of all domestic means to exhaust its complaints about the municipal judicial or administrative process.

The NAFTA awards refer to due process, shock, and surprise, which likely means more claims of denial of justice will be raised as enterprising lawyers attempt to deal with adverse decisions from municipal courts and tribunals that affect their investor clients. Further, there is ambiguity in the arbitral awards about the role of discriminatory treatment. While the bar for claims under article 1105(1) is high, with the decisions of the NAFTA arbitral tribunals we have the sense that neutrals are playing the function of assuring that nations are adhering to certain international law minimum standards. For this, all of the investors who venture to foreign lands should be grateful, as the host nations now undergo intense scrutiny when the acts of their respective judicial or administrative bodies are challenged. The effect of this scrutiny, however, is not to guarantee State responsibility under article 1105(1) for mistakes or even lapses in judgment of its actors.

The emergence of a refined concept of at least one aspect of the minimum standard has implications beyond the NAFTA nations. Tribunals resolving investor-state disputes under other treaties have at least referenced NAFTA Chapter 11 awards in assessing claims under various fair and equitable treatment clauses. For example, the 2007 case of *Enron Corp. v. Argentine Republic* involved a claim under the fair and equitable treatment clause of the 1991 Treaty between the United States of America and the Argentine Republic Concerning the Reciprocal Encouragement and Protection of Investments. The tribunal cited various NAFTA Chapter 11 awards (and *Mondey* and *Loewen*, among other awards) in holding that bad faith is not an essential element of fair and equitable treatment (ICSID Case No. ARB/01/3 ¶ 263). Of note, the tribunal further held that fair and equitable treatment under the treaty may require treatment in addition to the minimum standard (ICSID Case No. ARB/01/3 ¶ 258). The tribunal, in the 2005 case of *CMS Gas Transmission Company v. Argentine Republic* (which again involved a claim under the 1991 U.S.-Argentina treaty) referred to the NAFTA Free Trade Commission Interpretation in holding that it need not resolve whether fair and equitable treatment is equated with the minimum standard (ICSID Case No. ARB/01/8 ¶¶ 283-84). The significance of NAFTA and the Chapter 11 awards

in the non-NAFTA cases is not that they establish the relevant legal standard in an absolute sense. Instead, they are factors that non-NAFTA tribunals address, analyze, and distinguish when appropriate.

PROCESS: THE SYSTEM OF *DE FACTO* PRECEDENT

NAFTA recognizes that a tribunal award is only binding “between the disputing parties and in respect of the particular case” (NAFTA art. 1136 (1)).²¹ A tribunal is not required to consider or follow a prior arbitral award. Professor Susan Franck has documented how tribunals in *S.D. Meyers, Metalclad*, and *Pope & Talbot* gave three interpretations of article 1105 (Franck, 2005b)²². The awards in a collective sense were inconsistent (Franck, 2005b, note 109, 1576-1581).²³ According to Professor Franck, the inconsistency “will be a threat to the international legal order and the continued existence of investment treaties” (Franck, 2005b, note 109, 1583).

In fact, NAFTA Chapter 11’s dispute settlement procedure expressly seeks to assure “both equal treatment among investors of the Parties in accordance with the principle of international reciprocity and due process before an impartial tribunal” (NAFTA art. 1115). A predictable and stable legal regime is more likely to promote foreign investment. Further, consistency is a partial measure of due process.²⁴ A dispute settlement regime that lacks a consistent understanding on an essential investment standard (such as the customary international law minimum standard) could undermine the goals of NAFTA.

Each tribunal should render its decision based “on the facts and by application of any governing treaty provisions” (ICSID Case No. ARB[AF]/99/2 note 15, ¶ 118). A tribunal is not free to reach beyond the mandated sources of law, namely, NAFTA and international law. The article 1105(1) experience demonstrates that the NAFTA Free Trade Commission has the authority to interpret NAFTA and its interpretation is binding on a tribunal. The interpretation is the product of a built-in safeguard in NAFTA to

²¹ See also *Grand River Enterprises Six Nations, Ltd. v. United States*, Decision on Objections to Jurisdiction (July 20, 2006) ¶ 36, on line at <http://www.investmentclaims.com/decisions/GRE-USA-Jurisdiction.pdf>, stating that “NAFTA arbitral awards do not constitute binding precedent, and in any event are rooted in their specific facts.”

²² See also *Brower II*, 2003, observing that “incongruity has become the hallmark of decisions involving the minimum standard of treatment set forth in Article 1105(1).”

²³ See also *Brower II*, note 109, at 66-67, establishing the “doctrinal incoherence” of the panels’ decisions interpreting Article 1105(1).

²⁴ See, for example, *Canfor Corp. v. United States*, Order on Consolidation (Sept. 7, 2005), on line at <http://www.state.gov/documents/organization/53113.pdf>, ¶ 131, ordering consolidation to promote the NAFTA goal of avoiding conflicting results.

keep tribunals in check. The tribunals have followed the interpretation and rejected attempts to ignore or undermine it.

In addition, the reasoning in certain recent NAFTA tribunals has been disciplined. Professor Charles Brower has documented how, aside from the confusion surrounding article 1105(1), the panels “have reached a high level of coherence on many issues” (Brower, 2003: 66, note 109).²⁵ The coherence arguably is due to the arbitrators’ sophistication and the depth of their understanding of the international legal issues.

As to claims under article 1105(1), since the interpretation, the arbitral awards have demonstrated relative consistency on denial of justice. *Mondev* acknowledged the tribunal “may not apply its own idiosyncratic standard in lieu of the standard laid down in Article 1105(1)” (ICSID Case No. ARB[AF]/99/2 note 15, ¶ 120). Instead, it is “bound by the minimum standard as established in State practice and in the jurisprudence of arbitral tribunals” (ICSID Case No. ARB[AF]/99/2 ¶ 119). *Mondev* urged tribunals to examine decisions of other arbitral tribunals in refining the minimum standard.

Relying on and quoting *Azinian*, the tribunal in *Mondev* recognized it lacked “‘plenary appellate jurisdiction’” over decisions of national courts (ICSID Case No. ARB[AF]/99/2 ¶ 126). Citing *Mondev*, the tribunal in *ADF* stated that “we do not sit as a court with appellate jurisdiction with respect to U.S. measures” (ICSID Case No. ARB(AF)/00/1 note 62, ¶ 190). The tribunal in *Loewen* likewise recognized that claims of denial of justice are subject to exhaustion requirements.

The tribunal in the 2003 case of *ADF Group, Inc. v. United States* followed the *Mondev* standard of article 1105(1). It acknowledged the standard is “disciplined by being based upon State practice and judicial or arbitral case law or other sources of customary or general international law” (ICSID Case No. ARB[AF]/00/1 ¶ 184). The tribunal in *Waste Management II* cited *Mondev* and *ADF*, along with *S.D. Meyers* and *Loewen*, in noting “a general standard for Article 1105 is emerging” (43 I.L.M. 967 note 77, ¶ 98). The tribunal in *GAMI* relied on the “‘survey’ of standards of review” under article 1105(1) set forth in *Waste Management II* (*GAMI* note 47, ¶ 97). In *International Thunderbird International Gaming Corp. v. United Mexican States* (Thunderbird Award) the tribunal acknowledged the minimum standard is evolving yet subject to a high threshold and relied on “recent international jurisprudence” to reach the conclusion.²⁶

²⁵ See also *Canford Corp. v. United States*, ¶ 64, noting most panels “have developed clear rules that strike a healthy balance between the interests of foreign investors with the regulatory obligations of the host states.”

²⁶ *International Thunderbird Gaming Corp. v. United Mexican States*, Award (Jan. 26, 2006) note 94, ¶ 194, citing *Mondev* Award, *ADF* Award, and *Waste Management II* Award, on line at <http://www.investment-claims.com/decisions/Thunderbird-Mexico-Award.pdf>

Even though NAFTA does not require a tribunal to follow the decision of another tribunal, at least as to article 1105(1) in the post-interpretation environment the tribunals have scrupulously studied and relied on earlier awards. Previous awards, as a former lawyer for the U.S. government in the Chapter 11 cases aptly described, are “persuasive authority” (Bjorklund, 2001). No rules require that the tribunals address and follow or distinguish earlier decisions involving article 1105(1). In practice, however, the tribunals consider prior awards more than “persuasive.” With regard to article 1105(1), they have relied on prior arbitral awards to shape the standard of denial of justice. *ADF* specifically held that arbitral case law disciplines article 1105(1) (ICSID Case No. ARB[AF]/00/1 note 120 and accompanying text; see also ICSID Case No. ARB[AF]/99/2 note 15, ¶¶ 119-20).

The NAFTA tribunals should not be considered as stand-alone institutions that operate in a vacuum. The lawyers appearing before the tribunals on behalf of the NAFTA nations are well-versed in international investment law as they have pleaded and continue to plead a number of cases. Counsel for both sides routinely submit lengthy memorials in which they cite and argue prior decisions. The tribunals address the arguments and the prior arbitral awards. The development illustrates how an important body of investment law has been defined and shaped in a sophisticated and tempered manner.

CONCLUSION

The NAFTA Chapter 11 investor-state arbitration process has jump-started the harmonization of investment standards and dispute resolution practices in North America. The process has occurred outside of the domestic legal systems of the NAFTA nations as the arbitral tribunals are the creature of NAFTA, not domestic law. Tribunals rise above the three domestic systems as they are international institutions. Yet, they are not super-appellate courts. They do not sit in judgment of municipal court decisions or other municipal acts under municipal law. Instead, the tribunals apply relevant substantive investment provisions of the NAFTA and international law in evaluating the challenged state conduct. The NAFTA Chapter 11 tribunals have been fairly consistent in defining the limits of their role.

Tribunals have been cautious in resolving investors’ claims. Aided by NAFTA’s built-in mechanism for clarification, the commission interpretation, the tribunals through their awards have given critical guidance to investors from the NAFTA nations and to the nations themselves on the obligations owing under NAFTA article 1105(1). A signal of the emergence of a maturing system is that tribunals are citing and

addressing earlier arbitral awards, which has resulted in a refined body of law on denial of justice.

The awards' effect on the conduct of the NAFTA nations will be the real measure of harmonization. Will domestic courts and administrative bodies take heed of the NAFTA Chapter 11 awards in their future decisions influencing investment from another NAFTA nation? As more awards are issued and publicized, their effect cannot go unnoticed. Already, judges in the United States have expressed concern that NAFTA Chapter 11 arbitral tribunals are evaluating their judgments and actions (Liptak 2004, quoting Chief Justice Margaret H. Marshall of the Massachusetts Supreme Court and Chief Justice Ronald M. George of the California Supreme Court). The message is being delivered to domestic actors. The financial stakes mean that the NAFTA nations cannot ignore their promises to foreign investors.

In another sense, NAFTA Chapter 11 dispute resolution has already served a useful purpose. Arbitral awards have shed light on the pitfalls of the NAFTA nations' domestic legal systems. The awards offer insight into matters that, in part, the respective NAFTA nations had elected not to address within their domestic systems. The exposure factor should not be underestimated. The world is effectively on notice about practices that cannot be reconciled with accepted notions of justice. The revelations should prompt the NAFTA nations to consider additional measures to assure that disputes resolved in their respective domestic systems are done so in a fair and just manner.

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