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CHAPTER 11 – PRIVATE PARTY VS. GOVERNMENT,  
INVESTOR-STATE DISPUTE SETTLEMENT:  
FRANKENSTEIN OR SAFETY VALVE?

*Daniel M. Price*\*

As we heard this morning, there have always been both tensions and joys in the cross-border relationship. These came as somewhat of a surprise to me when I first joined the United State Trade Representative (USTR). I came from the office of the legal advisor at the State Department, where I was dealing with what I thought were the truly difficult countries of Iran or Cuba or the Soviet Union. So I was somewhat surprised when I joined the USTR during the Bush Administration to learn that one of the most challenging trade relationships to manage was that between the United States and Canada. That was certainly borne out during my tenure as a North American Free Trade Agreement (NAFTA) negotiator.<sup>1</sup>

I remember during the NAFTA negotiations, a political cartoon appeared in the *Globe & Mail*, and somebody brought it in. Picture a graphic of North America; the outline of North America. There is Canada, the United States, and Mexico. Well, this particular political cartoon had the phrase “manufacturing zone” in the area outlining Mexico. In the landmass that was the United States, it said “shopping zone.” In the landmass that was Canada, it said “skiing zone.” Not a single Canadian member of the delegation thought that was funny.

It was quite a challenging series of negotiations, but what was produced in Chapter 11 was, in my view,<sup>2</sup> actually nothing terribly novel. We hear a lot of criticisms of Chapter 11, in particular the dispute settlement mechanism, suggesting that it is unprecedented. In fact, it is heavily preceded. I want to take a minute to talk about a number of the features that can help us understand some of these criticisms a little more clearly.

From the U.S. perspective, Chapter 11 grew out of a long tradition of negotiating first treaties of friendship, commerce, and navigation, or treaties of amity, and later, bilateral investment treaties. This was not a trend peculiar to the United States. In fact, looking from the vantage point of the year 2000,

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<sup>1</sup> *North American Free Trade Agreement Between the Government of Canada, the Government of Mexico and the Government of the United States*, Dec. 17, 1992, Can. T.S. 1994 No. 2, 32 I.L.M. 289 (entered in force Jan. 1, 1994) [hereafter NAFTA].

<sup>2</sup> *Id.* at Ch.11.

there are now more than 1500 bilateral investment treaties in force. Most of them have provisions nearly identical to those one finds in NAFTA Chapter 11, including the feature of investor-state dispute settlement.

Canada also launched a program of negotiating foreign investment protection agreements. I remember at one point during the negotiation, when Canada was seeming to resist particular provisions that the United States and Mexico were urging, and it was discovered that these very same provisions appeared in Canada's bilateral investment treaty with the then-Soviet Union. The question raised by the Ministers to the Canadian Minister was, is it really your position that you will treat investors from the Soviet Union more favorably than you will treat investors from either the United States or Mexico?

The end of the story is that the provisions were ultimately included in Chapter 11. Perhaps one of the reasons that Chapter 11 and the dispute settlement mechanism have attracted so much attention is that, usually the relations between the countries were defined by their trade agreements, or their relations in the WTO. Now, there are significant differences between the way trade is traditionally handled in international agreements and the way investment is typically handled. The outlook is different. The philosophy is different, starting from the basics. Goods have origin. Investments have nationality. Trade agreements typically protect flows, not traders in particular.

Investment agreements by contrast protect individual, specific enterprises or investors. Relief under trade agreements is typically prospective only. If there is a dispute under the WTO, there is no order to pay compensation. Rather there is an order or a determination to bring its measure into compliance with the obligation, but no retrospective relief. I do not know what is going to happen.

In any event, the point of dispute settlement, under an investment agreement, is to make the investor whole. The concepts underlying an investment agreement stem from rather classical categories of public international law. They are informed by state responsibility for injury to aliens, or injury to the property of aliens. They come out of the world of diplomatic espousal, or diplomatic protection, the concept being that an investor, or the investment, carries with it a little piece of the crown, a little piece of the sovereign. So that injury to an alien or its property, if unremedied, is an injury to the state of that investor, or the sending state of the investment, so to speak. These concepts do not inform – or did not inform NAFTA, and I do not believe they inform the WTO agreements, at least insofar as they relate to trade and goods.

These distinctions prove to be important. The political systems of all three countries were prepared to deal with and scrutinize trade agreements. They were perhaps less prepared to deal with the linkages between trade and investment as occurred for the first time multi-laterally in NAFTA. Importantly, NAFTA was also the first time that two developed countries demanded of themselves on investment protection the same high level of standards that they had traditionally demanded of developing countries. And that, when we come to talk about disputes, will prove to be quite important.

Now, if we want to assess the cases under NAFTA, or we want to analyze is whether Chapter 11 is a success, or whether the tribunals are overreaching, we first need to understand the essential features of Chapter 11. I would like to take a look for a few moments at the scope of Chapter 11, what is included within it, and the disciplines or the substantive rules that it contains. The starting point is the definition. If you look at the definition of investment, you will see that it is enormously broad. I invite your attention to subparagraph H, first of all. Investment means – and in this sense we need to say “includes” – “interests arising from the commitment of capital or other resources in the territory of a part to economic activity in such territory.” That is an enormously broad definition, enormously broad.<sup>3</sup>

When one works backwards up the definition, there are some more concrete examples. But one would be hard-pressed to think of what we classically think of as an investment, or as a commitment of capital to another territory, and not have that brought within the scope of the NAFTA Chapter 11. Recalling not only the explicit reference to contracts and concessions, but also that, under international law, contractual rights, or property rights, we find that we have included within the definition of investment contractual rights by reference to all property, tangible or intangible, acquired in the expectation or used for the purpose of economic benefit or other business purpose, so all property, tangible or intangible, including intellectual property, used for economic activity. So you can see how NAFTA treats various ownership interests, as well.

My point here is that the scope of Chapter 11, as is the case with most bilateral investment treaties, is enormously broad. This is not an accident. The parties did not stumble into this. The parties did not inadvertently do this. This was a carefully crafted definition. Where parties wanted to carve something out, such as public debt, they did. The carve-out is there. Where they wanted to exclude receivables or other interests arriving merely from the cross-border sale of goods, they did. That exclusion is there. So the breadth of this chapter is not inadvertent.

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<sup>3</sup> *Id.* at art. 1139 (Defining investment).

Given the scope of the Chapter, let us take a look at some of the obligations that are essentially two-fold.

The disciplines of Chapter 11 track those of bilateral investment treaties and really involve two categories; one, a set of comparative or relative obligations in the form of a nondiscrimination discipline. The first is national treatment, the obligation to accord investments and investors, treatment no less favorable than that accorded to your own investors.<sup>4</sup> The second is most favored nation (MFN), the obligation to accord investors and investment, treatment no less favorable than that accorded to third parties. You will also see in Chapter 11, lest there be any doubt, something that says "Standard of treatment." It says, "You owe the better of national treatment, or MFN." So it is, whichever is more favorable, that is what you owe.<sup>5</sup>

Coupled with the nondiscrimination obligations are a series of substantive and absolute promises, not qualified by reference to domestic legislation or to how a host government may treat its own nationals. There are quite a few of these, and they are really very, very significant. The first is a prohibition on so-called performance requirements. These are export, local content, trade balancing, and tech transfer requirements.<sup>6</sup> Those of you who have counseled foreign investors or have negotiated investment agreements with host governments, you will have experienced the irresistible impulse of those host governments to shape and turn the investment to what they consider to be their own advantage by requiring you to employ a degree of local content or have the enterprise satisfy its own needs for foreign exchange. All of those are prohibited under Chapter 11.

The second absolute guarantee concerns financial transfers, that is the right of the investor to remit profits, dividends, to obtain foreign currency, or hard currency, as the case may be, for payment of interests or principal, or service contract payments.

The last two guarantees are really quite critical and have been the subject of the most controversy. The first is the so-called international minimum standard. The NAFTA, as every other investment agreement with which I am familiar, incorporates explicitly a customary international law floor. Sometimes you will see the words, "[e]ach party shall accord to investments of the other party fair and equitable treatment" or "[f]ull protection and security," or "[t]reatment in accordance with international law," which I believe is the formulation of NAFTA. NAFTA actually says, "[t]reatment in accordance with international law."<sup>7</sup>

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<sup>4</sup> *Id.* at art. 1102.

<sup>5</sup> *Id.* at art. 1106.

<sup>6</sup> *Id.* at art. 1109.

<sup>7</sup> *Id.* at art. 1105.

The effect of this should not be underestimated. It incorporates into NAFTA the evolving standard of customary international law. It also sets a floor against which all domestic measures of a government can be tested. It also serves a very useful institutional purpose in dispute settlement. The negotiators were very careful to say a decision from one NAFTA Chapter 11 panel has no precedential effect on any other panel. It only relates to what is in front of the panel. True enough, there is no *stare decisis*, but part of the incorporation of the customary international law reference is to bring within the body of interpretive law state practice, decisions of other tribunals, and the other sources of international law mentioned in the statute of the International Court of Justice. So, while there is no direct *stare decisis* effect, you will see cited in NAFTA reports, as you see cited in the International Convention on the Settlement of Disputes decisions, or the decisions of the Iran-U.S. claims tribunal, the awards of other arbitral tribunals.

The last absolute guarantee, so to speak, deals with expropriation.<sup>8</sup> In NAFTA, the parties used the classic international law formulation, which is that property is not to be expropriated or nationalized directly or indirectly, except through due process of law, in a nondiscriminatory fashion, and against payment of prompt, adequate, and effective compensation.

There is another phrase in this article which says, “[o]r subjected to measures tantamount to its appropriation,” which some have sinisterly read as broadening the international law standard and suggesting that the parties intended to go beyond the classic international law formulation. I think that is incorrect. I do not read that into it.

Having said that, I do believe that under the NAFTA formulation, as under public international law, so-called regulatory takings are addressable under the expropriation norm. That is to say, a measure that diminishes the value of an investment and does not necessarily transfer ownership to a third party is still treated under the rubric of expropriation. The negotiators tried for some time to consider putting a line in the text that would distinguish between legitimate regulation on the one hand, *bona fide* and nondiscriminatory, and a taking on the other hand.

We quickly gave up that enterprise. If the U.S. Supreme Court could not do it in over 150 years, it was unlikely that we were going to do it in a matter of weeks with one exception. We wished to make clear that a measure, generally applicable, which merely had the effect of lessening the economic fortunes of a particular enterprise, such that that enterprise could not repay a debt and therefore it could not be argued to be an expropriation. Loans are covered as investment. I am a lender. I am the creditor. I cannot assert a

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<sup>8</sup> *Id.* at art. 1110.

claim that a generally applicable measure which raised the costs of doing business for all businesses, and that incremental cost put my debtor over the line so that he could not repay the debt to me, I cannot allege that that is an expropriation. The parties were not able to agree upon more clarification than that.

Let us turn to disputes and ask first, why investor-state dispute settlement? In my view, one of the single advances of bilateral investment treaties over the early version of such treaties, the treaties of amity, or friendship, commerce, and navigation (FCNs),<sup>9</sup> was to introduce the concept of investor-state. Under the FCNs and treaties of amity, dispute settlement was state-to-state. That is, if a party was expropriated or subjected to measures inconsistent with the treaty obligations, that party had to go to its host government, its home government, and say, "Please bring my claim before the International Court of Justice." The state might choose to do that, or it might not choose to do that; the decision was purely political. The prospect was that an investor who suffered significant economic harm had its redress contingent upon the political will and the political calculation of its own government. That government may choose not to bring a claim for a variety of reasons. It might have a comparable practice, or it might need the vote in the U.N. of the punitive defendant.

The bilateral investment treaties<sup>10</sup> for the first time, and NAFTA following that tradition, empowered the investor to seek redress itself against the host government. This had the effect, or the intent, of depoliticizing these disputes. The idea was to take them out of the political realm and put them more into the realm of commercial arbitration. The idea was that the investor, by having the avenue of bringing the dispute itself, could resolve the dispute in a way that did not engage the political organs of the two governments. I have to say that, as a matter of practice, when an investment dispute arises, the first thing that happens is not a filing of a request for arbitration. But the investor still has to go to its own government and complain about the nasty thing this other government has done and ask if the could please get them to stop or compensate them or do something to make the harm go away.

But the point is, the decision to go forward now rests in the hands of the private investor. I should say that the cases that have been brought, and the questions that have been raised, are not really being raised on a blank slate. There is a rich body of jurisprudence in the Iran-U.S. claims tribunal in the practice of claims settlement tribunals in the earlier part of this century, as

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<sup>9</sup> See generally, Treaty of Friendship, Commerce and Navigation, Oct. 29, 1954, U.S.-F.R.G., 7 U.S.T. 1839

<sup>10</sup> See generally, Treaty Concerning the Reciprocal Encouragement and Protection of Investment, May 28, 1992, U.S.-Rom., S. Treaty Doc. No. 102, 36 (1992).

well as in ad hoc tribunals that deal with issues of expropriation or takings or violations of the minimum standard.

Just as a kind of schematic of the disputes, there have been fourteen disputes to date under NAFTA Chapter 11. Three of those are Canadian claims against the United States. Five of those are U.S. claims against Canada. It has been suggested that these disputes somehow represent a threat to sovereignty, or a threat to democracy. How can we let private arbitrators decide whether or not a law adopted by the Congress of the United States, or the legislature of a state, is fair and equitable or constitutes an expropriation?

There is a very easy answer to that question. We can do that because we agreed to do that. That is what the treaty says. Treaties are a restriction on sovereignty. All treaties, all international agreements, are a compromise of sovereignty. They are first an exercise of sovereignty. But they represent agreements by the state parties to do or not to do certain things. A promise not to conduct oneself in a particular way is a restriction on one's future action. So to that extent, yes, NAFTA and every other international agreement does represent a restriction on the exercise of sovereignty. But I would say, 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.

Part of the furor arises because states that have traditionally been claimants are now defendants. Remember, most of these BITs were concluded with developing countries that have very little investment either in the United States or Canada. All of a sudden, from the perspective of the United States, NAFTA tells it, you can be a defendant. The United States can be a defendant. My only advice is, get over it. It is true. Argue the cases. Defend the cases. These are sensible arbitrators. If the United States is right and the investor is wrong, it is likely that the tribunal will so find. But – and I say this to both governments who may be represented here – we have to guard against letting the exigencies of defending a particular case cause the sacrifice of important principles.

I refer in this regard to the *Loewen* case.<sup>11</sup> It is a claim against the United States by a funeral home consolidator arising out of certain actions of the judiciary in the State of Mississippi. The United States has argued at the jurisdictional phase that actions of courts should not be considered measures for purposes of NAFTA. I make no comment on the merits of this claim, or really any other aspect of it, other than this one. It is U.S. investors that are influenced by the whims of the arbitrary exercises of judicial authority. It is

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<sup>11</sup> *Loewen Group, Inc. v. United States*, Notice of Claim, Oct. 31, 1998; see also Harmonization Project, Briefing Paper, *Loewen Group, Inc. v. United States* (visited July 28, 2000) <<http://www.harmonizationalert.org/NAFTA/loewen.htm>>.

the United States, which has been a champion of establishing the international law tort, so to speak, of denial of justice. It is the United States that has benefited disproportionately from this norm in claim settlement tribunals. It would be unfortunate if, in defending this particular case, the United States did so in such a way as to cast doubt on whether a claim, sounding in denial of justice, could be raised under NAFTA.

At the same time that I urge caution on the part of the government defenders, I would also urge caution on the part of counsel bringing claims. This is, at the moment anyway, a somewhat fragile institutional arrangement. It grows out of a more than 100 year tradition, but at present, it is somewhat fragile. I would urge caution on the part of counsel in fashioning their claims and in pushing these norms too far. If counsel does not exercise the caution, the tribunal and the panel members certainly will.

Is it possible that frivolous claims will be brought? Absolutely. Frivolous claims are brought every day in our national judicial systems. Does our democracy or sovereignty melt? No. Is it possible that there may be an incorrect or an erroneous decision? Absolutely. But I do not think that, speaking from a U.S. perspective, our policy or judicial system or legal system is so frail or fragile that it cannot withstand an erroneous decision. For the critics who suggest that environmental measures should not be challenged in international arbitration in this fashion, or other measures should not be challenged, I would say simply this: any measure can be challenged against these international law norms.

The critics cannot have it both ways. They cannot simultaneously argue that NAFTA and the WTO are bad because they can issue rulings that overturn food safety or environmental regulations, and at the same time argue that these agreements should legislate or incorporate substantive environmental and labor provisions, meaning the WTO cannot be evil both for touching upon environmental measures and at the same time not having substantive rules.

I will conclude by saying I do not think Chapter 11, in particular the dispute settlement mechanism, is either a monster or a safety valve. It is an important feature on the dispute settlement landscape. I think fears or hysteria about overreaching panels are quite premature.