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# NAFTA CHAPTER 11: ARE THE DISPUTE RESOLUTION PROCEDURES WORTH THE INVESTMENT?

*Natalie Sears\**

## I. CHAPTER ELEVEN OF NAFTA

IN 1994, the negotiations between Mexico, Canada, and the United States ended as the North American Free Trade Agreement (NAFTA) came into effect.<sup>1</sup> NAFTA, in its act of eliminating most barriers to trade and investment between Mexico, Canada, and the United States, sought to encourage foreign investment by stabilizing economic activity among the three countries.<sup>2</sup> One way NAFTA sought to accomplish such a goal was through its Chapter Eleven provisions, providing rights and protections to investors looking to extend their investment activities into one of the three foreign countries.<sup>3</sup>

Chapter Eleven of NAFTA allows corporations and investors to bring state-investor claims in confidential arbitration tribunals if they believe a country's government issued a conflicting regulation or decision that negatively impacts their investment in that particular country.<sup>4</sup> This particular chapter was designed to protect foreign investment transactions while providing for efficient resolution to investment-related disputes.<sup>5</sup>

Historically, arbitration was favored by industrialized nations and disfavored by developing ones, who usually find themselves coerced and pressured into accepting arbitration as the sole means for resolving disputes.<sup>6</sup> In fact, during initial negotiations for NAFTA, Canada was seeking the more independent dispute resolution body integrated into the Canada United States Free Trade Agreement (CUFTA).<sup>7</sup> But as we see

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1. *North American Free Trade Agreement*, NAFTA NOW.ORG, [http://www.naftanow.org/about/default\\_en.asp](http://www.naftanow.org/about/default_en.asp) (last visited June 8, 2014).

2. *Id.*

3. *NAFTA Chapter 11: Corporate Cases*, PUB. CITIZEN, <http://www.citizen.org/Page.aspx?pid=1218> (last visited June 8, 2014).

4. *Id.*

5. *NAFTA Investor-State Arbitrations*, U.S. DEPARTMENT OF STATE, [www.state.gov/s/l/c3439.htm](http://www.state.gov/s/l/c3439.htm) (last visited June 8, 2014).

6. Jennifer A. Heindl, *Toward a History of NAFTA's Chapter Eleven*, 24 BERKELEY J. INT'L LAW. 672, 673 (2006), available at <http://scholarship.law.berkeley.edu/bjil/vol24/iss2/11>.

7. *Id.*

the chapter in practice today, Canadian officials believe that Chapter Eleven provisions have been applied even more broadly than they intended.<sup>8</sup>

Chapter Eleven covers all disputes arising between investors of other countries, including claims such as expropriation, discrimination, and unfair treatment.<sup>9</sup> Originally, arbitration was thought of as a forum that could settle international disputes in a neutral way, reducing the so-called “home-court” advantage.<sup>10</sup> Particularly in the business realm, companies and investors alike are weary towards litigation, where procedural and substantive unfairness can play a huge part in a case’s outcome. Within Chapter Eleven of NAFTA, arbitration was specifically selected for investments because foreign investors fear having to resolve disputes in a court that might be predisposed to ruling for the other side every time, thereby inhibiting their decision to send their investment money internationally.<sup>11</sup> In creating a mandatory arbitration procedure, NAFTA sought to encourage investors to cross borders and invest in activity without adding fear to the already high cost of investing there.<sup>12</sup>

Within Chapter Eleven, investors may choose between three arbitration methods: ICSID Convention, Additional Facility Rules of ICSID, and UNCITRAL Arbitration Rules.<sup>13</sup> In normal practice, because of the underlying policy in favor of fairness, the two disputing parties will normally hold the arbitration in the third NAFTA country not involved in the dispute in order to create an additional neutrality safeguard.<sup>14</sup> If a foreign investor initiates an investor-state case, the claim will be brought to a binding arbitration process of the World Bank and the United Nations, which are “closed to public participation, observation and input.”<sup>15</sup>

## II. MODERN CRITICISM OF THE AGE-OLD PRACTICE OF ARBITRATION

Although arbitration has been a method used for centuries, many scholars claim that investor arbitration for claims arising out of Chapter Eleven do not work as well in practice as the drafters of NAFTA initially hoped they would. One criticism is that the investment arbitration provided for under Chapter Eleven is evidence of a possible double standard by the United States.<sup>16</sup> Similar to the way Canada initially predicted Chapter Eleven would be applied more narrowly, the United States, as well, believed the investment arbitration provisions would be used a dif-

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8. 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 (2002).

9. WILLIAM W. PARK, *ARBITRATION OF INTERNATIONAL BUSINESS DISPUTES* 701–26 (2d ed. 2012).

10. *Id.* at 704.

11. *Id.*

12. *Id.*

13. Jones, *supra* note 8, at 533–34.

14. *Id.*

15. NAFTA Chapter 11, *supra* note 3.

16. PARK, *supra* note 9, at 703–04.

ferent way than has played out.<sup>17</sup> Some legal scholars note that the United States looks highly upon investment arbitration when it corrects misbehavior by foreign states, but it is not favored when used to attack its own country's governmental decision-making.<sup>18</sup>

Broader criticisms include concerns about the confidentiality and overall secrecy of the arbitration process and uncertainty in their outcomes and decisions. Others question the absence of accountability of domestic constituents.<sup>19</sup> This concern is particularly noteworthy and troublesome because it was one of the primary reasons for implementing arbitration, rather than permitting litigation, in Chapter Eleven of NAFTA.<sup>20</sup> It is also commonly tied to a violation found in section A of Chapter Eleven, which prohibits discrimination against foreign investors and requires "fair and equitable" treatment.<sup>21</sup> In addition, some claim that the cases brought to arbitral tribunals under Chapter Eleven constitute a "regulatory taking," rather than issues of Mexico seizing property from U.S. and Canadian companies, which was the originally anticipated scenario sought to be prevented by Chapter Eleven.<sup>22</sup>

Other opponents claim that Chapter Eleven acts as a "sword" for investors, allowing them to attack the NAFTA countries, rather than the "shield" it was intended to be.<sup>23</sup> This occurs because investors citing Chapter Eleven claims can use their leverage of such arbitration to sway governmental agencies into certain law-making decisions.<sup>24</sup> In addition, because Chapter Eleven requires full evaluation of each case on the merits, whether seemingly frivolous or not, governments recognize the cost and time burdens such arbitration will take if they pass certain litigation, and could thus likely be persuaded to act in accordance with the demands of foreign investors.<sup>25</sup>

### III. INVESTOR-TO-STATE CLAIMS IN RECENT YEARS

Although Chapter Eleven was designed so as to minimize the number of investor-to-state disputes and increase their outcomes' predictability, the arbitration provision in and of itself has proven troublesome for many. Many of the cases heard through arbitration within recent years under Chapter Eleven involve disputes caused by the ambiguous language contained in the provision and others involve struggles of power between a foreign investor and a country's government.

Article 1105(1) of NAFTA requires each country to "accord investments of investors of another Party treatment in accordance with interna-

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17. *Id.*

18. *Id.*

19. *Id.* at 705.

20. *See id.* at 704.

21. *Id.* at 706.

22. Jones, *supra* note 8, at 541.

23. *Id.* at 541-42.

24. *Id.* at 543.

25. *Id.*

tional law, including fair and equitable treatment and full protection and security."<sup>26</sup> These terms represent some of those most in dispute between investors and countries, especially the meaning of "international law" and "full protection and security."<sup>27</sup> The latter term has been interpreted to hold a nation liable for failure to use due diligence when trying to prevent third parties from injuring foreign investors covered under NAFTA.<sup>28</sup> In some cases, even where governmental actions have been found to be non-discriminatory in nature, arbitration decisions have still found a breach of this NAFTA provision.<sup>29</sup>

In the past, many arbitration decisions have portrayed how closely foreign investors scrutinize governmental, and very often environmental, action, and expect remedial action to be taken to maintain and protect their investments abroad. For example, in *Methanex Corp. v. U.S.A.*, a California governor banned gasoline with an additive called "MTBE" because of concerns that it would penetrate into the state's drinking water supply.<sup>30</sup> What is noteworthy about this case is that the claimant, Methanex, is a Canadian corporation producing feedstock, not the actual MTBE.<sup>31</sup> But it still filed an investor-to-state claim arguing expropriation, discrimination, and denial of the minimum standard of treatment.<sup>32</sup> This claim incited environmental protests based on accusations that NAFTA Chapter Eleven favored foreign investors' profits over the local governmental authority to regulate its own sovereign.<sup>33</sup>

Many disputes arise because of the power struggle and threat of arbitration proceedings brought by investors under Chapter Eleven claims. One of the most illustrative cases of this particular issue is *Ethyl v. Canada*, which occurred only a matter of years after NAFTA was signed.<sup>34</sup> Ethyl Corporation is a chemical company based in Virginia and a very large methylcyclopentadienyl manganese tricarbonyl (MMT) producer.<sup>35</sup> Ethyl Corporation exported this chemical to its subsidiary in Canada, Ethyl Canada, who then sold it to refineries until April 1997 when the Canadian Parliament imposed a ban on MMT's importation into Canada.<sup>36</sup> Even before the Canadian Parliament passed the law, Ethyl Corporation threatened a Chapter Eleven suit, claiming the ban would amount to expropriation.<sup>37</sup> Ethyl Corporation's position stated that they were entitled to due compensation for losing the right to export to the

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26. North American Free Trade Agreement, U.S.-Can.-Mex., Dec. 17, 1992, 32 I.L.M. 289, art. 1105(1) (1993), available at <http://www.sice.oas.org/trade/nafta/chap-11.asp>.

27. Park, *supra* note 6 at 709.

28. *Id.*

29. *Id.*

30. *Id.* at 711.

31. *Id.* at 711-12.

32. *Id.* at 712.

33. *Id.*

34. Jones, *supra* note 8 at 538-39.

35. *Id.*

36. *Id.*

37. *Id.* at 538.

corporation's Canadian subsidiary.<sup>38</sup> The Canadian Parliament followed through with the law and Ethyl followed through with its threat, and subsequently filed a Chapter Eleven suit seeking \$251 million.<sup>39</sup> Even though Ethyl Corporation did not follow the timing procedure laid out in article 1120.72, the tribunal allowed the suit. But before it came to fruition, Canada rescinded its law, allowing Ethyl to continue exporting into Canada.<sup>40</sup>

Ethyl's argument was that Canada violated article 1102, requiring national treatment for foreign investors, because Canada's law banned the import of MMT. But it did not interfere or object to the production of MMT within its own country.<sup>41</sup> Ethyl also claimed Canada committed "expropriation" by their actions to ban importation of MMT.<sup>42</sup> This term has also been disputed among arbitration proceedings because it is not defined within Chapter Eleven.<sup>43</sup> This concept is similar to that of eminent domain in the United States and means that a country may take measures, such as banning MMT importation, only if the measures are not discriminatory.<sup>44</sup> Even when carried out in a fair way, a country must compensate their investors for any loss suffered because of the new regulation.<sup>45</sup> What amounts to expropriation can be an entirely separate issue. Chapter Eleven claimants, not surprisingly, utilize the most expansive definition under article 1110 to hold that any "measure" used by the country can amount to such expropriation.<sup>46</sup>

#### IV. DOES CHAPTER ELEVEN NEED REVISING?

Legal scholars are divided on the question of whether Chapter Eleven, which was deemed a very important and fairly groundbreaking section in NAFTA, has proven successful, or whether it has become a nuisance of power struggles. Certainly, the results are not what the countries originally anticipated. Upon signing in 1992, Canada and the United States expected to be the investor-claimants filing Chapter Eleven suits, but most often have found themselves placed in the respondent chair to Mexico's lawsuits.<sup>47</sup>

The result most concerning since NAFTA was signed twelve years ago is the idea that expensive litigation might deter legitimate governmental regulation that could potentially be in conflict, financially and politically,

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38. *Id.* at 539.

39. *Id.* at 538.

40. *Id.* at 538-39.

41. PUBLIC CITIZENS GLOBAL TRADE WATCH, NAFTA CHAPTER 11 INVESTOR-STATE CASES, LESSONS FOR THE CENTRAL AMERICAN FREE TRADE AGREEMENT 21, 22 (2005), available at [http://www.citizen.org/documents/NAFTAReport\\_Final.pdf](http://www.citizen.org/documents/NAFTAReport_Final.pdf).

42. *Id.* at 22.

43. Jones, *supra* note 8 at 550.

44. *Id.* at 551.

45. *Id.* at 550-51.

46. *Id.*

47. PARK, *supra*, note 9 at 724.

with foreign investors' activity.<sup>48</sup> Especially in the case of a situation similar to *Ethyl v. Canada*, if a company like Ethyl can manage to change the Canadian government's decision to ban a particular substance's importation, their country's policy-making ability is greatly hindered.<sup>49</sup> Outcomes such as this will also have a ripple effect when other foreign investors watch and see how much influence and power they can have over a governmental body simply because of fear of Chapter Eleven claims.<sup>50</sup> It has been noted that arbitration under NAFTA is thought of as "investor-biased" and has only catapulted the number of investor-state claims and disputes filed under Chapter Eleven in the past twenty years.<sup>51</sup>

So, if Chapter Eleven is full of problems, what could be a solution? Certainly, one possibility will be to revise the language, providing more specificity to the investment arbitration language. But this may be hard to accomplish because many arbitrators actually lobby to prevent reform in the wording of investment protection clauses.<sup>52</sup> Vague language, however, has been recognized as an invitation to litigation and disputes. The United Nations Conference on Trade and Development has stated "an expansive interpretation of minimalist treaty language can give rise to a lack of predictability in the application of the standard. This, in turn, may lead to the undermining of legitimate State intervention for economic, social, environmental and other developmental ends."<sup>53</sup> Another option is to create a preliminary evaluation or screening tool to weed out frivolous and meritless claims.<sup>54</sup> This option might be particularly successful because article 1121 removes the local remedies rule; thus, any obstacle investors have to go through it in order to submit a Chapter Eleven claim—regardless if the claim is meritless.<sup>55</sup> This option could also help reduce the number of Chapter Eleven claims, and as a result, governments would not have to be so cautious in their law-making abilities.

Although many have argued that NAFTA Chapter Eleven needs to undergo several changes to make it as beneficial as the United States, Canada, and Mexico originally intended it to be, others argue that the arbitration provision is good just the way it is.<sup>56</sup> While critics claim the chapter's procedures can deprive U.S. citizens of certain procedural rights guaranteed to them under the Constitution, proponents of the provision argue that it has served its purpose in achieving the goals found in article

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48. Jones, *supra* note 8 at 545.

49. *Id.* at 543.

50. *See id.*

51. Cecilia Olivet & Pia Eberhardt, *Arbitrators' Role in the Recent Investment Arbitration Boom*, INVESTMENT TREATY NEWS (March 25, 2013), <http://www.iisd.org/itn/2013/03/25/arbitrators-role-in-the-recent-investment-arbitration-boom/>.

52. *See id.*

53. *Id.*

54. Jones, *supra* note 8 at 546.

55. *See* North American Free Trade Agreement, U.S.-Can.-Mex., Dec. 17, 1992, 32 I.L.M. 289, art. 1121 (1993), available at <http://www.sice.oas.org/trade/nafta/chap-112.asp>.

56. Jones, *supra* note 8, at 542.

102 and the preamble of the NAFTA Agreement.<sup>57</sup>

## V. CONCLUSION

Although this year marks the twenty-year anniversary of NAFTA's implementation, the path has not gone unscathed. With regards to Chapter Eleven, the provision that allows for investment arbitration over foreign disputes, scholars remain divided as to whether it has been successful, will be successful, or whether it needs to be changed in order to get on the right path. The most obvious choice for reconstructing Chapter Eleven would be to add specificity to the language so as to reduce frivolous investor-state claims with the hopes that such action would resolve the big-picture issue.

Throughout the past twenty years, the most troublesome cases have been those that challenge governmental decision-making even before the decision has been made. Investors are using Chapter Eleven as a way to entice governments to act in certain ways, which was never the purpose of Chapter Eleven. In order to end the power struggles occurring between wealthy investors and governments after Chapter Eleven threats have been made, Chapter Eleven must allow for some type of screening device so as to weed out meritless claims. Under NAFTA, governments are allowed to exercise their power reasonably, even if it interferes with foreign investment activity. But under the current regime, a government may still be taken to arbitration under a Chapter Eleven claim because NAFTA requires full hearing on all claims—whether frivolous or not. NAFTA needs a provision to filter out such claims so that governments won't be threatened and dragged into each and every claim an investor makes. It is the only way for governments to assert their power over their sovereign and to ensure that investors don't interfere with such decisions.

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57. *Id.* at 546.





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