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NAFTA Chapter 11: Investment and Investment Disputes

Richard C. Levin and Susan Erickson Marin

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I. Introduction.

Chapter Eleven of the North American Free Trade Agreement ("NAFTA" or "the Agreement") deals with investment and investment disputes. The provisions of this chapter represent great progress toward the creation of a truly open and nondiscriminatory environment for investment in the United States, Canadian, and Mexican economies by investors of the NAFTA Parties. Moreover, Chapter 11 constitutes to date the most comprehensive investment accord to which the United States is a party. Generally speaking, it applies to all economic sectors and industries addressed by the NAFTA except the financial services industry, which is separately governed by Chapter 15 of the Agreement.

Chapter 11 sets forth the standards of nondiscriminatory treatment that the NAFTA Parties have agreed to extend to investors and investments of one another. In addition, it establishes a dispute settlement framework that allows NAFTA investors, at their option, to seek monetary damages through international arbitration in lieu of seeking redress through the host country's courts or administrative tribunals. The creation of this dispute resolution mechanism responds directly to one of the most significant concerns of foreign investors: to what extent will the investors be able to seek redress before an impartial tribunal, and be accorded due process for claims against the country in which they have invested. The provisions of the investment chapter are intended to create a fairer, more transparent, and more predictable environment in which NAFTA investors may establish a local presence in Mexico, Canada, or the United States. Because establishing a local presence is often a critical element of securing market access in a foreign country, particularly for the service industries, the provisions of Chapter 11 are crucial to the expansion of the economic relationship among the NAFTA Parties, as intended by the Agreement as a whole.

This article examines the content and the practical effect of Chapter 11, through the use of a hypothetical investment dispute arising under the NAFTA. Section II of the article provides a descriptive overview of the chapter's substantive provisions. The basic facts of our hypothetical investment dispute are set forth in Section III. The third section also contains an in-depth discussion of issues that are likely to be central to the resolution of an investment dispute under the NAFTA, including whether the dispute was caused by an unlawful expropriation by the host NAFTA Party and what monetary damages or other remedies should be awarded in the event of an unlawful expropriation.

II. NAFTA Chapter Eleven: Investment and Investment Disputes.

For U.S. negotiators, the primary objectives for the investment chapter of the NAFTA were to liberalize Mexican restrictions on foreign investment and to solidify legal protections for investors in Mexico. The chapter expands upon recent bilateral investment treaties the United States has entered into with developing countries. The chapter is also based on the investment provisions of the U.S.-Canada Free Trade Agreement (CFTA). It

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imposes relatively few changes with respect to the investment regime established between the United States and Canada under the CFTA. Liberalizations between the two that were implemented under the CFTA are basically maintained under the NAFTA. Similarly, the obligations of Chapter 11 do not represent great changes to the foreign investment regime of the United States. The United States has traditionally been relatively open to foreign investment. It maintains few formal restrictions on foreign investment, except in a few specific sectors considered sensitive for national security reasons. These sectors include air transportation services, atomic energy, and certain mining activities.

The greatest degree of positive change engendered by the investment provisions clearly is with respect to Mexico. Prior to the NAFTA negotiations, Mexico had maintained a severely restricted and regulated foreign investment regime. The Mexican Government reserved numerous activities for the state, screened most investment proposals, and imposed substantial performance requirements and price controls. A wide range of economic sectors, from petroleum-related activities to telecommunications and cargo transportation services, were closed to foreign ownership. Until December 1993, Mexico maintained the “Law to Promote Mexican Investment and to Regulate Foreign Investment,” under which foreign investors could not own more than 49% of a Mexican enterprise without government approval. Substantial authority over investments was vested in the National Foreign Investment Commission.3

The NAFTA’s liberalizations expand upon changes that were commenced in Mexico in the mid-1980s. Those changes culminated in December 1993, when, in anticipation of the NAFTA’s entry into force, the government of President Carlos Salinas de Gortari enacted a new foreign investment law.4 The new law incorporates the principles of national treatment, Most-Favored Nation (“MFN”) treatment, and the minimum standard of treatment agreed to in the NAFTA. Under this law, any foreign investor (from a NAFTA Party or other country) may invest in the shares of a Mexican enterprise, acquire the assets of a Mexican company, establish a new business in Mexico or expand its current business, subject to narrower restrictions than in the past.5 In the NAFTA treaty itself, Mexico’s commitments in Chapter 11 represent substantial progress in opening up its economy to foreign investment from U.S. and Canadian investors. The extent of the reservations and exceptions Mexico has taken in the annexes to the chapter indicates, however, that more progress remains to be made.

Chapter 11 is divided into two parts. Section A sets forth the basic protections each NAFTA Party is obligated to extend to the investors of another NAFTA Party or to the investments of such investors in the territory of the Party. The protections apply equally to investments already in existence at the NAFTA’s January 1, 1994 entry into force and to those made after that date. Among the general principles encompassed in the chapter are the following: national treatment, most-favored nation treatment, nondiscriminatory treatment, freedom from performance requirements, free transferability of investment-related capital, and expropriation only in conformity with international standards. The annexes to the chapter, found in Volume II of the NAFTA, detail each Party’s reservations

and exceptions to the obligations imposed by Chapter 11. Section B establishes a mechanism that allows parties to go to international arbitration to resolve investment disputes, in lieu of local judicial or administrative proceedings.

The scope of the chapter is broad. The term "investment," as defined by Article 1139 of the NAFTA, includes not only enterprises and equity and debt securities of an enterprise, but also real estate, certain contracts and concessions, and intangible property such as goodwill and intellectual property. A NAFTA "investor" is defined as "a Party or state enterprise thereof, or a national or an enterprise of such Party, that seeks to make, is making or has made a investment." Qualification as a NAFTA "investor" is based on a residency test. The term thus includes firms that are established in a NAFTA country and have substantial business activity there, even if they are owned or controlled by non-Party nationals. Finally, the chapter binds not only the Governments of Canada, Mexico, and the United States (the "NAFTA Parties" or the "Parties") but also state enterprises, such as Petroleos Mexicanos in Mexico or the Crown corporations in Canada.

A. BASIC OBLIGATIONS OF THE INVESTMENT CHAPTER (SECTION A).

Chapter 11 first sets forth the guiding principles that are to protect NAFTA investors and their investments. Pursuant to Article 1102, NAFTA Parties must extend national treatment to investors (and investments) of another Party, meaning treatment no less favorable than that which it accords its own investors in like circumstances, with respect to the establishment, acquisition, management, operation, or disposition of such investments. In addition, the treatment accorded by a state or province of a NAFTA Party must be no less favorable than the most favorable treatment it accords to investors and investments of the NAFTA Party of which it forms a part. NAFTA Parties must also extend to one another most-favored nation treatment, or treatment no less favorable than that which they extend to investors or investments of any other Party or non-Party in like circumstances. Pursuant to Article 1104, NAFTA Parties must extend "non-discriminatory" treatment to investors or investments of another Party, meaning the better of national or most-favored nation treatment. Finally, NAFTA Parties must extend to the investments of other Parties a "minimum" standard of treatment, which must meet international law standards of "fair and equitable treatment" and "full protection and security." This minimum standard of treatment is to be extended to investors and investments of other NAFTA Parties regardless of whether nationals of that Party receive such treatment by their own government.

Chapter 11 provides investors with substantial freedom from performance requirements. Article 1106 of the Agreement sets forth seven performance requirements that a NAFTA Party may not impose or enforce in connection with the establishment, acquisition, management or operation of an investment of an investor from a NAFTA Party or

6. NAFTA, Supra note 1, art. 1139.
7. Id., art. 1102(3).
8. Id., art. 1103.
9. Id., art. 1105.
10. Id., art. 1105.
from a non-Party.\textsuperscript{11} The elimination of these performance requirements thus applies equally to Japanese, Korean, and other non-NAFTA investors as it does to NAFTA investors. With a few exceptions, a NAFTA Party may not impose any of the first five of the seven prohibited performance requirements as a condition to receive any advantage it provides, such as a tax concession or other investment incentive. The Parties are, however, permitted to condition the receipt of an investment-related advantage on compliance with requirements to locate production, provide a service, train or employ workers, construct or expand facilities, or carry out research and development, in their territories.\textsuperscript{12}

In addition, with respect to enterprises of other NAFTA Parties that have been established in its territory, a Party may not require that senior management positions be filled with individuals of any particular nationality. A Party may, however, require that a majority of the board of directors, or any committee thereof, be of a particular nationality, or resident in the territory of the Party, provided that the requirement does not materially impair the ability of the NAFTA investors to exercise control over their investments.\textsuperscript{13}

Under Article 1109, each Party is obligated to permit all transfers and international payments, related to an investment of an investor of another Party, to be made freely and without delay into or out of that Party. Such transfers include profits, dividends, interest, capital gains, proceeds from the sale or liquidation of the investment, loan repayments, and payments arising out of an investment dispute. This prohibition on most transfer restrictions is important to investors who are evaluating and attempting to mitigate the risks of investing in developing countries such as Mexico.\textsuperscript{14} Pursuant to this provision, the Parties must permit transfers to be made in a freely usable currency at the market rate of exchange. The Parties are permitted, however, to prevent transfers through the non-discriminatory and good-faith application of specified laws, such as bankruptcy laws or securities regulations.

\textsuperscript{11} Article 1106 prohibits Parties from requiring that an investment in their territories: (a) to export a given level or percentage of goods or services; (b) to achieve a given level or percentage of domestic content; (c) to purchase, use or accord a preference to goods produced or services provided in its territory, or purchase goods or services from persons in its territory; (d) to relate in any way the volume or value of imports to the volume or value of exports or to the amount of foreign exchange inflows associated with such investment; (e) to restrict sales of goods or services in its territory that such investment produces or provides by relating such sales in any way to the volume or value of its exports or foreign exchange earnings; (f) to transfer technology, a production process or other proprietary knowledge to a person in their territory, except when the requirement is imposed or the commitment or undertaking is enforced by a court, administrative tribunal, or competition authority to remedy an alleged violation of competition laws or to act in a manner not inconsistent with other provisions of the NAFTA; or, (g) to act as the exclusive supplier of the goods it produces or services it provides to a specific region or world market. \textit{Id.}, art. 1106.

\textsuperscript{12} \textit{Id.}, art. 1106 (3)-(4).

\textsuperscript{13} \textit{Id.}, art. 1107.

Chapter 11 also provides protection to investors of a NAFTA Party in the event of the nationalization or expropriation of their investments by another Party. Article 1110 prohibits uncompensated nationalization or expropriation of a foreign investment. The article states, "No Party shall directly or indirectly nationalize or expropriate an investment of an investor of another Party in its territory or take a measure tantamount to nationalization or expropriation of such an investment..." Article 1110 of the NAFTA would only allow a Party to "take" an investment where it is done (1) for a public purpose; (2) on a non-discriminatory basis; (3) in accordance with due process of law and international law; and, (4) on payment of adequate compensation. Actions taken by a local or state government of a NAFTA Party are not exempted from this general prohibition. Compensation is to be equivalent to the fair market value of the expropriated investment immediately before the expropriation took place, plus any applicable interest. Among the criteria to be used in determining the fair market value are going concern value and asset value, including the declared tax value of tangible property. Compensation is to be paid without delay and is to be fully realizable. In addition, an investor may challenge certain taxation measures as being tantamount to an expropriation. Such a challenge is to be referred to the tax authorities of the relevant NAFTA country. If the tax authorities fail to consider the dispute, or fail to agree within six months that the taxation measure was not an expropriation, the investor may invoke the investment dispute resolution provisions of Chapter 11.

The investment chapter also provides that no Party shall be prevented from adopting, maintaining, or enforcing any measure otherwise consistent with the chapter that it considers appropriate to ensure that investment activity in its territory is conducted in a manner sensitive to environmental concerns. The Parties acknowledge that it is inappropriate to encourage investment by relaxing health, safety or environmental measures, and they agree to engage in bilateral consultations if one Party believes that another Party has offered such an encouragement.

1. Reservations and Exceptions to Obligations Under Chapter 11.

Article 1108, in conjunction with Annexes I, II, III, and IV of Volume II of the Agreement, sets forth the reservations and exceptions the Parties have agreed to establish with respect to the investment chapter. In most cases, the reservations and exceptions taken by the Parties exempt certain non-conforming measures from the obligations of

15. NAFTA, Supra note 1, art. 1110 (2) and (4).
16. Id., art. 1110 (2).
17. Id., art. 1110 (3).
18. GAO Report, Supra note 2 at 23.
19. Id.
20. Id.
21. NAFTA, Supra note 1, art. 1114.
22. The reservations taken in Annexes I and II also pertain to Chapter 12 on Cross-Border Trade in Services and Chapter 14 on Financial Services.
Articles 1102 (National Treatment), 1103 (Most-Favored Nation Treatment), 1106 (Performance Requirements), and 1107 (Senior Management/Boards of Directors). At the federal level, each NAFTA Party is allowed to maintain and renew non-conforming measures that it has set out in its Annex I schedule. Reservations found in Annex I relate to, for example, the acquisition of property rights over certain areas of land and water (Mexico), the distribution, storage, or sale of liquified petroleum gas (Mexico), the acquisition of rights-of-way for oil or gas pipelines (the United States), and the provision of domestic air service (the United States). Each Party's Annex I schedule also contains the Party's liberalization commitments relating to the phase-out (over a ten-year period, for example) of certain of its reservations. The reservations listed in Annex I are subject to the so-called "ratchet rule," meaning that any change or amendment to these non-conforming measures may increase, but not decrease, their conformity with NAFTA obligations.

Among the most significant of the Annex I reservations — and the most vexing to U.S. negotiators — are those that relate to Canada's and Mexico's laws for the screening of foreign investments. These reservations follow precedent set in the CFTA. Pursuant to its Annex I schedule, Mexico reserves the right to review direct or indirect acquisitions by U.S. or Canadian investors of more than 49 percent of the ownership interest in a Mexican enterprise, when the gross assets of the Mexican enterprise exceed a specified threshold.

Under the Investment Canada Act, investments above a certain monetary threshold by "non-Canadians" are subject to review, including all direct acquisitions of Canadian businesses with assets of C$5 million or more and all indirect acquisitions of Canadian businesses with assets of C$50 million or more.

Annex II lists additional reservations taken by each NAFTA Party, for which the Party may maintain existing, or may adopt new or more restrictive, measures that fail to conform with the obligations of the investment chapter. These reservations are thus not subject to the "ratchet rule" of Annex I. Sectors reserved under Annex II include basic telecommunications, air traffic control, and maritime transportation services.

Annex III lists Mexico's constitutionally based exceptions to the investment chapter, in which private equity investment is prohibited under Mexican law. In this Annex, Mexico has reserved the right to perform exclusively, and to refuse to permit the establishment of investments in, eleven general categories of activities. These include exploration and exploitation of crude oil and natural gas, the generation of nuclear energy, and the operation and control of traffic within the Mexican railway system. Annex III reservations are subject to the "ratchet rule." Moreover, when Mexico privatizes its state companies, it is obligated under the NAFTA to sell such assets on a non-discriminatory basis to investors.

23. Because the NAFTA does not provide for any new liberalization commitments between the United States and Canada, the investment restrictions protected under the CFTA are continued under the NAFTA.

24. For investors and investments from Canada or the United States, the applicable threshold increases, for most sectors, from $25 million to $150 million over the course of 10 years.

25. For U.S. and Mexican investors, the screening is limited, as under the CFTA, to direct acquisitions in excess of C$150 million. That threshold increases over time according to a formula set out in Annex I. No review is required for indirect acquisitions of Canadian businesses by U.S. or Mexican investors. Investments subject to review under the Investment Canada Act must be found to be of likely "net benefit" to Canada in order to be approved.
from NAFTA Parties, subject to a maximum three-year reservation.26

Annex IV provides a schedule of the exceptions each NAFTA Party takes with respect to its Most-Favored Nation obligation for treatment accorded under all bilateral or multilateral international agreements in force or signed prior to the NAFTA’s entry into force. For subsequent international agreements, the Parties have taken an exception from Most-Favored Nation obligations for treatment accorded under agreements involving aviation, fisheries, maritime matters, and telecommunications transport networks and services.

Under Article 1108, non-conforming measures maintained by state or provincial governments are grandfathered for two years following the entry into force of the Agreement. Upon the expiration of that period, they must be specifically identified and set out in the Schedules to Annex I in order to maintain their grandfathered status, subject to the ratchet rule. All existing, non-conforming measures of local governments are grandfathered, meaning they are exempted from the obligations of Chapter 11 on a permanent basis, subject to the ratchet rule.

The national treatment and Most-Favored Nation obligations of the investment chapter do not apply to government procurements by NAFTA Parties or their state enterprises or to subsidies or grants provided by a NAFTA Party or state enterprise.27 In addition, some of the restrictions on performance requirements do not apply with respect to export promotion and foreign aid programs or to government procurement.

Finally, at the insistence of U.S. negotiators, the NAFTA includes a national security exemption that enables each Party to restrict investments for national security reasons.28 This exception allows the United States to continue to investigate and prohibit or suspend foreign acquisitions or mergers because of their possible impact on U.S. national security, pursuant to the Exon-Florio Amendment to the Omnibus Trade and Competitiveness Act of 1988.29 At the insistence of Canadian negotiators, Canada maintains its CFTA exemption for “cultural industries,” as set forth in Chapter 21 of the NAFTA. Canada’s cultural industries exception provides that any investment by a non-Canadian, by establishment of a new business or by acquisition of an existing business, in a cultural industry may be reviewed by the Investment Canada Agency.30

B. INVESTMENT DISPUTE SETTLEMENT (SECTION B).

Chapter Eleven, Section B establishes a mechanism for the settlement, via international arbitration, of disputes arising from an alleged breach of the investment provisions of the NAFTA. U.S. participants in the NAFTA negotiations were eager to secure access to international arbitration for investor disputes under the Agreement.31 Inclusion of the

26. NAFTA, supra note 1, annex III (c). This rule applies to activities reserved to the state on January 1, 1992 but not specifically reserved under the NAFTA. If Mexican law is amended to allow private equity investment in activities set forth in Annex III, Mexico may impose restrictions on foreign investment participation and describe them in Annex I. See Annex III(B).
27. Id., art. 1108 (7).
28. Id., art. 2102.
29. GAO Report, supra note 2 at 25.
30. Cultural” industries include filmmaking, television production, and magazine publishing.
Chapter 11 mechanism is regarded as an important accomplishment in light of Mexico's historic opposition to international arbitration for investment disputes. Foreign investors' worries about Mexico have long been exacerbated by the presence of the so-called "Calvo Clause" in Mexico's Constitution, which has precluded foreign investors from invoking the assistance of their home governments in presenting any international claim on their behalf. The Calvo Clause has worked to prevent foreign investors in Mexico from seeking help from their own governments, at the risk of forfeiting their investments to the Mexican Government. Their only avenue for redress was before local Mexican courts. With the establishment of the Chapter 11 dispute settlement mechanism, the NAFTA Parties effectively nullified the Calvo Clause with respect to U.S. and Canadian investors in Mexico.

Unlike the dispute settlement provisions of NAFTA Chapters 19 and 20, under which only a Party may bring a claim, the dispute settlement mechanism of Chapter 11 creates private rights that can be invoked by NAFTA investors or enterprises. An investor acting on behalf of himself or on behalf of an enterprise may submit a claim for dispute settlement under this chapter. Claims submitted to arbitration under Chapter 11 may thus be based on allegations of direct injury to an investor or of indirect injury to an investor caused by injury to an enterprise or other investment owned or controlled by the investor. The investments that are the basis of a claim for relief under this dispute settlement mechanism must be owned or controlled directly or indirectly by an investor of a NAFTA Party. Claims may be submitted to arbitration under the Convention on the Settlement of Investment Disputes between States and Nationals of other States (the ICSID Convention), if both the disputing Party and the Party of the investor are parties to the ICSID Convention; the Additional Facility Rules of ICSID, if either the disputing Party or the Party of the investor, but not both, is a party to the ICSID Convention; or, the UNCITRAL Arbitration Rules. Although the United States and Canada are parties to the ICSID Convention, Mexico is not a party. Accordingly, only the latter two options would be available for an arbitration involving Mexico.

1. Standing and Jurisdiction.

Under this mechanism, an investor of a NAFTA Party may submit to arbitration a claim that another Party has breached its obligations under Chapter 11 and that the investor has incurred loss or damage because of that breach. Investors must submit claims, on behalf of themselves or their enterprise, within three years of the date they first acquired, or should have acquired, knowledge of the alleged breach and resulting loss or damages. The dispute resolution mechanism applies to disputes involving actions taken

33. (Mexican Constitution) Constitucion Politica de los Estados Unidos Mexicanos, art. 27. See also GAO Report, supra note 2 at 24; Torres Landa, Juan Francisco, "The Changing Times: Foreign Investment in Mexico," 23 N.Y.U. J. INT'L L. & POL. 801, 808 (1991) (explaining that "a Calvo Clause considers a foreign investor as a national with respect to his investment, thereby denying him recourse to the protection of his state of nationality.").
34. NAFTA, Supra note 1, art. 1116, 1117.
35. Id., art. 1120.
36. Id., arts. 1116, 1117.
by political subdivisions of a NAFTA Party. It does not apply, however, to disputes that an investor from one Party may have with private parties in the NAFTA country in which it invests. Such disputes must be adjudicated in local court or administrative proceedings or before such courts or tribunals as agreed upon by the parties.

Pursuant to Article 1118, disputing parties (i.e., the investor(s) and the NAFTA Party alleged to have breached its Chapter 11 obligations) should attempt to settle a claim through consultations or negotiations before submitting it to arbitration. The disputing investor must deliver to the disputing NAFTA Party written notice of its intent to submit a claim to arbitration at least 90 days before doing so. In addition, the dispute settlement provisions include a built-in six-month conciliation time, whereby a disputing investor must let at least six months elapse between the events giving rise to a claim and submission of the claim to arbitration.

Disputing investors must comply with several other conditions before they may submit a claim to arbitration. Investors must first provide their written consent to arbitration. Investors must also waive their right to initiate or continue before any administrative tribunal or court under the law of any Party or any other proceedings with respect to the alleged breach of that Party's NAFTA obligations. However, investors may initiate or continue to pursue injunctive, declaratory, or other relief not involving the payment of damages. Both the consent and waiver must be in writing, must be delivered to the disputing Party, and must be included in the submission of the claim to arbitration.

Access to arbitration under Chapter 11 is strictly precluded under certain circumstances. Pursuant to Annex 1120.1, investors from the United States or Canada may not allege that Mexico has breached its Chapter 11 obligations both in a Chapter 11 arbitration and in proceedings before a Mexican court or administrative tribunal. Therefore, if U.S. investors have claimed in a Mexican court proceeding that Mexico expropriated their investment, they may not submit the same claim to arbitration under the NAFTA Chapter 11. Investors may not make use of both fora; taking "two bites of the apple" to gain relief is not allowed.

In addition, decisions by the Canadian Government, following a review of a potential acquisition under the Investment Canada Act, are not subject to the dispute settlement

37. Id., art. 105.
38. Id., art. 1119.
39. Id., art. 1120.
40. Id., art. 1121.
41. Id. Providing written consent and submitting the claim to arbitration satisfies the requirements of: (1) Chapter 11 of the ICSID Convention (Jurisdiction of the Centre) and the Additional Facility Rules for written consent of the parties; (2) Article II of the New York Convention for an agreement in writing; and, (3) Article I of the Inter-American Convention for an agreement. Art. 1122.
42. The international law principle of lex mercatoria supports the argument that arbitration under Chapter 11 is precluded when allegations of expropriation have been previously raised before a Mexican court. In simple terms, lex mercatoria is defined as the system of laws adopted by all commercial nations, which becomes part of common law. Black's Law Dictionary (6th ed. 1990) at 911. As discussed previously, the Parties expressly agreed that they "shall interpret and apply the provisions of this Agreement ... in accordance with applicable rules of international law." Id., art. 102(2).
provisions of NAFTA Chapter 11 or Chapter 20. Decisions by Mexico's National Commission on Foreign Investment, with respect to potential acquisitions in Mexico, are similarly excluded from NAFTA's dispute settlement provisions.  

2. Structure of the Panel and the Proceedings.

In most cases, arbitration panels are to comprise three arbitrators — one appointed by each of the disputing parties and the third, who will serve as the presiding arbitrator, appointed by agreement of the disputing parties. If the parties fail to appoint the arbitrators, or fail to agree on a presiding arbitrator, the Secretary-General of ICSID shall appoint any arbitrators not yet appointed. The Secretary-General will make appointments from a roster of 45 persons chosen by consensus of the NAFTA Parties. If no presiding arbitrator is available from that roster, the Secretary-General will appoint from the ICSID Panel of Arbitrators a presiding arbitrator who is not a national of any of the Parties. The arbitration tribunal is to decide the issues in dispute in accordance with the NAFTA and the applicable rules of international law.

The dispute settlement mechanism also provides for the consolidation of claims. A disputing party may request that the Secretary-General of ICSID establish a tribunal comprised of three arbitrators who shall determine, under the UNCITRAL Arbitration Rules, whether claims submitted to arbitration have common questions of law or fact such that, "in the interests of fair and efficient resolution of claims," the tribunal shall assume jurisdiction over, and hear and determine together, all or part of the claims. The tribunal may also decide to assume jurisdiction over and decide one or more claims that it believes would assist in the resolution of the others.

There may be a question as to whether Chapter 11, in conjunction with the relevant international arbitration rules, would permit a disputing party to submit a counterclaim for resolution in the course of the arbitration. Nothing in Chapter 11 appears expressly to preclude a counterclaim by a Party against a disputing investor, and Article 1126(2) seems to contemplate the consolidation of claims and counterclaims if they arise from the same facts. Further, section 2 of Article 1120 states, "[t]he applicable arbitration rules shall govern the arbitration except to the extent modified by this Section." In a dispute involving Mexico, Article 1120 of the NAFTA would thus incorporate either the Additional Facility Rules of ICSID or the UNCITRAL Arbitration Rules, because Mexico is not a party to the ICSID Convention. In turn, Article 48 of the Additional Facility Rules of ICSID and Article 19, Section 3 of the UNCITRAL rules specifically allow for a respondent to make a counterclaim if the counterclaim relates to the principal claim.

Another feature of the dispute settlement mechanism allows NAFTA Parties to make submissions, similar to amicus curiae briefs, to an arbitration tribunal on a question of interpretation of the NAFTA. Under this provision, the U.S. Government, for example,
could make a submission to a tribunal hearing a dispute between the Government of Mexico and U.S. investors. In addition, an arbitration panel may appoint experts to report to it in writing on any factual issue concerning environmental, health, safety, or other scientific matters raised by a disputing party in an arbitration proceeding.\textsuperscript{49}

3. \textit{Final Awards.}

An arbitration tribunal deciding a Chapter 11 dispute may award monetary damages, including applicable interest, and/or the restitution of property to the prevailing party.\textsuperscript{50} In the latter case, the disputing Party may pay monetary damages and any applicable interest in lieu of restitution.\textsuperscript{51} For arbitration claims made by an investor on behalf of an enterprise, a final award of restitution of property must provide that restitution be made to the enterprise and that an award of monetary damages be paid to the enterprise.\textsuperscript{52} For any type of arbitration, the tribunal may award costs, but it may not order a Party to pay punitive damages.\textsuperscript{53}

In the case of arbitrations conducted pursuant to the ICSID Rules, a party may "appeal" the tribunal's finding by filing an application for annulment of the award with the Secretary-General. Upon receipt of the application, the Secretary-General will request that an ad hoc Committee of three persons (other than those who heard the original case) be appointed from the Panel of Arbitrators.\textsuperscript{54} The Committee may annul part or all of an award; in this event, either party may request the resubmission of the dispute to a new arbitral tribunal.\textsuperscript{55} The new tribunal may consider only those parts of an award that were annulled by the ad hoc Committee.\textsuperscript{56}

Pursuant to the ICSID Additional Facility Arbitration Rules, parties may, within 45 days after the date of the award, request the arbitral tribunal to decide any question that had been submitted to it but that was omitted from its original award.\textsuperscript{57} Parties may also request, within 45 days of the award, the Secretary-General to obtain from the tribunal an interpretation of the award.\textsuperscript{58}

Under the UNCITRAL Arbitration Rules, parties may, within 30 days after the receipt of the award, request the arbitral tribunal to make an additional award as to claims presented in the arbitral proceedings but omitted from the award.\textsuperscript{59} If the arbitral tribunal considers the request to be justified, it will complete its award within 60 days of receiving the request.\textsuperscript{60}

\textsuperscript{49} NAFTA, supra note 1, \textit{Id.}, art. 1128.
\textsuperscript{50} \textit{Id.}, art. 1135(1).
\textsuperscript{51} \textit{Id.}, art. 1135(1)(b).
\textsuperscript{52} \textit{Id.}, art. 1135(2).
\textsuperscript{53} \textit{Id.}, art. 1135(3).
\textsuperscript{54} ICSID Rules of Procedure for Arbitration Proceedings, rule 52.
\textsuperscript{55} \textit{Id.}, rule 55.
\textsuperscript{56} \textit{Id.}, rule 55(3).
\textsuperscript{57} ICSID Additional Facility Arbitration Rules, art. 58.
\textsuperscript{58} ICSID Additional Facility Arbitration Rules, art. 56.
\textsuperscript{59} UNCITRAL Arbitration Rules, art. 37(1).
\textsuperscript{60} \textit{Id.}, art. 37(2).
Tribunal awards have binding force only between the disputing parties and with respect to that particular case.\textsuperscript{61} If a Party fails to abide by the terms of a final award, the Party of the investor who prevailed in the arbitration may request the establishment of a panel under Chapter 20 of the NAFTA.\textsuperscript{62} This panel may determine that the former Party's failure to comply with the terms of the final award is inconsistent with NAFTA obligations and may recommend that Party comply with the terms of the award. Failure to do so may trigger the right of the investor's Party to suspend benefits it provides pursuant to the NAFTA.

In the case of a final award made under the ICSID Convention, a disputing party may not seek enforcement of a final award until 120 days have elapsed from the date of the award and no party has requested revision or annulment of the award, or revision or annulment proceedings have been completed.\textsuperscript{63} In the case of a final award under the ICSID Additional Facility Rules or the UNCITRAL Arbitration Rules, enforcement may not be sought until three months have elapsed and no disputing party has commenced a proceeding to revise, set aside or annul the award, or a court has dismissed or allowed an application to revise, set aside or annul the award and there is no further appeal.\textsuperscript{64} Article 1136(4) requires each Party to provide for the enforcement of an award in its territory. In addition, Article 1136 allows a disputing investor to seek enforcement of an arbitration award under the New York Convention (United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards, June 10, 1958), which, in effect, allows the investor to go to court to get the arbitration award enforced.

III. Hypothetical Investment Dispute Arising Under the NAFTA.

A. Basic Fact Scenario.

Thinking about Chapter 11 in terms of a hypothetical investment dispute is useful in understanding how the chapter is expected to function. Of the various types of investment disputes that might arise and make use of the dispute settlement mechanism of Chapter 11, the hypothetical scenario we have developed concerns an investment in Mexico by a group of U.S. investors. The type of investment contemplated is a concession.

The NAFTA defines a concession as "an authorization provided by the State to a person to exploit a natural resource or provide a service, for which Mexican nationals and Mexican enterprises are granted priority over foreigners."\textsuperscript{65} Concession agreements typi-
cally authorize the provision of a public service, for consumption by the general public, in return for agreed-upon compensation by a government entity. These contracts are not regarded as government procurements but rather are classified as investments under the NAFTA.\textsuperscript{66}

Also, while the fact pattern surrounding an equity investment in, or an acquisition of, a private Mexican company, for example, would be different in certain ways from this hypothetical, a dispute with the Mexican Government concerning those types of investments would similarly give rise to many of the basic issues that are discussed in this article.

1. \textit{Sequence of Events Surrounding the Hypothetical Investment Dispute.}

The first stage, which actually occurs prior to the making of the investment, begins when the Government of Mexico, or a state or local level government in Mexico, issues a request for proposal or otherwise announces that an investment opportunity, via a concession agreement, is available. The concession might be for the provision of such services to the local citizenry as computer outsourcing in the health industry, garbage collection or recycling, or public construction and transportation.

Once the Mexican governmental entity (federal, state, county, or municipal—the “Entity”) has granted the concession to the hypothetical U.S. investor group, the appropriate contracts are signed. After being granted a concession for the provision of services to the Entity’s residents, the U.S. investors incorporate and capitalize a Mexican company to perform their obligations under the concession. The investors incur start-up expenses, such as those related to hiring employees and paying their salaries, purchasing equipment and supplies, and renting office space. The investors make initial capital investments in the company to which the concession was granted. The investors’ Mexican enterprise will enter into contracts to procure the goods and services it needs to perform under the concession. In addition, the U.S. investors must become informed about the provisions of Mexican law that will affect the operation of their business. The investors will have to concern themselves, for example, with applicable tax laws, labor laws, and importing and other licensing requirements in Mexico, subject to any applicable protections in the NAFTA. Taking initial steps such as these may be considered a sign of the company’s intent to perform under the concession.

Once the preparatory steps have been taken, the investors, acting through their Mexican enterprise, begin to perform under the concession. The pace and breadth of the services they provide under the concession may be subject to an agreed-upon phase-in schedule. As the U.S. investors performance gets underway, the Entity becomes obligated to compensate the company as provided under their concession agreement.

Let us assume now that some time after performance begins under the concession, the hypothetical Mexican Entity elects new members to its governing body.\textsuperscript{67} Following its

\textsuperscript{66} As defined in Article 1139, the term “investment” includes “interests arising from the commitment of capital or other resources in the territory of a Party to economic activity in such territory, such as under: (i) contracts involving the presence of an investor’s property in the territory of the Party (including turnkey or construction contracts, or concessions) . . . ”

\textsuperscript{67} Alternatively, of course, a shift in policy views may occur within the existing Entity government, causing the members to reexamine any existing concession agreements.
entry into power, the new Entity's government would assess the status of various concession agreements to which the Entity is a party. It determines that the U.S. investors in our hypothetical are not in compliance with their concession contracts. The Entity's conclusion that the U.S. investors are not performing as required may be based on their failure to provide the specified services to Entity residents, a failure to make agreed-to capital investments in the company or otherwise in relation to the investment, or a failure to meet commitments to bring Mexican investors into their enterprise. The new government might also determine that the previous government entered into the agreement in some unauthorized manner or was duped into entering into it by fraudulent conduct or misrepresentations made by the U.S. investors. The law of the Mexican Entity, may provide that any government act done on the basis of mistake, error or bad faith may be voided by the government. The Entity may also point out that it has incurred expenses to provide the very services the U.S. investors were supposed to, but failed to, provide under the concession.

In our hypothetical sequence of events, the Mexican Entity next gives notice of its intent to nullify the concession, citing performance problems as its reason. The nullification would likely be based, in part, on what the Entity considers an "emergency situation," where important services are not being provided to citizens because of the investors' non-performance. The Entity then takes the legal actions necessary to nullify the concession. It may be required to institute certain administrative procedures, such as issuing written allegations and interrogatories to the U.S. investors for their response. The outcome of the administrative proceeding may or may not support the Entity's decision to nullify the concession. Depending on the circumstances, the Entity may shortly thereafter announce that it has reopened the concession to competitive bidding to grant a concession to another company to perform the same services.

Upon learning of the nullification, the U.S. investors may choose to dispute it by proceeding to litigation in a local court. The investors could seek the equivalent of a declaratory judgment that the nullification was improper because the Entity acted outside its powers to nullify the concession or had "expropriated" their investment, allegedly in favor of a local company. A court proceeding may result in a finding that the concession was properly nullified and that the investors have failed to prove their allegation of wrongdoing. The court may affirm the validity of the Entity's action and recognize the validity of the nullification of the concession. On the other hand, the court may hold that the Entity had an inadequate legal basis on which to nullify the concession.

As an alternative to proceeding in local courts, the U.S. investors may pursue arbitration under the dispute settlement mechanism of Chapter 11. In order to do so, the investors must give the requisite notice of intent to submit a claim to arbitration and must engage in a period of consultation and negotiation with Mexico. The dispute settlement mechanism described above then comes into play.

B. Key Issues That May Arise

1. Expropriation.

The overriding issue, and the one on which an arbitration would likely be based, is whether the Mexican Entity's nullification of the concession constituted an unlawful
expropriation or was simply the Entity's commercially reasonable response to a breach of contract by the U.S. investors. As indicated above, Chapter 11 was designed to address discriminatory expropriations, including those that are politically motivated, but not ordinary breach of contract disputes. The idea that the NAFTA's use of the term "expropriation" was intended to reach ordinary breaches of contract would be directly contrary to conventional international law, which as stated above, governs the interpretation of the treaty. Historically, a mere breach of contract is not considered redressable under international law. Commercially motivated cancellations are controlled by municipal law unless the state's actions discriminate or constitute a taking within the meaning of expropriation law.

Traditionally, expropriation has been thought of as a state's unanticipated and arbitrary deprivation of rights unaccompanied by any invocation of legal rules or any justification under a particular contractual clause. The decision to expropriate an investment is typically rooted in shifts in government policy or political power. If, instead, an investor's defaults in performance compel the government to abandon the contract, it becomes more difficult to characterize the government's actions as expropriatory. The primary distinction between an expropriatory act and a commercial breach of contract, therefore, is the "role" the government was in at the time of the allegedly expropriatory act: sovereign or commercial participant. If the government was acting as a sovereign, the act is more likely to be considered expropriatory.

Legal definitions of expropriation expressly assume the absence of any fault on the part of or provocation by the investor. Section 238 of the Foreign Assistance Act of 1961, as amended in 1969 (the enabling statute for the Overseas Private Investment Corporation, "OPIC"), for example, states that:

the term "expropriation" includes, but is not limited to, any abrogation, repudiation, or impairment by a foreign government of its own contract with an investor with respect to a project, where such abrogation, repudiation or impairment is not caused by the investor's own fault or misconduct, and materially adversely affects the continued operation of the project[.]

Many of the leading international law cases concerning expropriation have involved concession agreements. In Kuwait v. American Independent Oil Co., for example, an arbitral tribunal examined whether a Kuwaiti government decree terminating American Independent Oil Co.'s 1948 concession for the exploration and exploitation of petroleum and natural gas constituted an unlawful taking of property interests. In Texaco Overseas Petroleum Co. & California Asiatic Oil Co. (TOPCO) v. Government of the Libyan Arab Republic, the sole arbitrator determined that Libya's 1974 nationalization of the property

69. NAFTA, supra note 1, art. 1131.
72. 21 Int'l Leg. Mat. 976 (1982).
rights held by Texaco and California Asiatic Oil Co. under numerous long-term concession agreements was unlawful. The arbitrator ordered Libya to resume performance under those agreements.75

Not all terminations of concession agreements constitute a violation of international law, as provided for by NAFTA Article 1110. International tribunals and legal commentators have recognized the right of a state to revoke a concession for non-fulfillment of the alien investors' obligations thereunder, without running afoul of international law.76 Section 712 of the Restatement (Third) of the Foreign Relations Law of the United States (1986) treats separately expropriations and breaches of contract. A state is responsible under international law for injury resulting from:

(2) a repudiation or a breach by the state of contract with a national of another state
(a) where the repudiation or breach is (i) discriminatory; or (ii) motivated by non-commercial considerations, and compensatory damages are not paid; or
(b) where the foreign national is not given an adequate forum to determine his claim of repudiation or breach, or is not compensated for any repudiation or breach determined to have occurred.

Whether the Entity's termination of the concession in our hypothetical investment dispute violates the NAFTA and international principles of expropriation will depend greatly on whether the Entity was motivated primarily by political or commercial considerations. According to comment (h) to § 712 of the Restatement (Third), a state's repudiation is not a violation of the international law of expropriation if it is based on a "bona fide dispute" about the parties' obligations or performance. Reporter's Note 8 to § 712 further states that "international law is not implicated if a state repudiates or breaches a commercial contract with a foreign national for commercial reasons as a private contractor might, e.g., . . . because of controversy about the contractor's performance." Pursuant to the Restatement, therefore, the Mexican Entity's nullification of a concession would not violate international law if its action was based on legitimate concerns regarding the investors' performance, and if the investors were given a fair opportunity to contest the Entity's assertions. A government is not required by international law to stay wedded to a defaulting contractor.

The fact that a government has a colorable claim that the investors breached their obligations under the concession, however, is not dispositive on the issue of expropriation. In Liberian Eastern Timber Corp. (LETCO) v. The Government of the Republic of Liberia, for example, the Liberian government asserted a series of breaches by LETCO of its obligations under a concession agreement for the processing of forest products.77 Nevertheless, the arbitration tribunal determined that the allegations were not supported by the evi-

75. Under the NAFTA, an arbitral tribunal may award, separately or in combination, monetary damages, with any applicable interest, and restitution of property. NAFTA, Supra note 1, art. 1135(1). If restitution of property is awarded, the award must provide, however, that the disputing Party may pay monetary damages with any applicable interest in lieu of restitution. NAFTA, Supra note 1, art. 1135(1)(b).
76. See, e.g., Libyan American Oil Co. (LIAMCO) v. The Government of the Libyan Arab Republic, 20 Int'l Leg. Mat. 1 (1982). See also Mann, State Contracts and State Responsibility, 54 Am. J. Int'l Law 572, 574-75 (1960) (where state raises a genuine dispute as to its legal obligations under the contract, the state's "breach of contract" is unlikely to give rise to a claim in international law).
idence, that Liberia had not given LETCO proper notice of any alleged breaches pursuant to the terms of the contract, and that Liberia, therefore, was responsible for damages caused by its improper revocation of the concession. Similarly, in Valentine Petroleum & Chem. Corp. v. AID, an arbitral panel found that an unlawful expropriation had occurred, regardless of the Haitian Government’s arguments that a dispute existed as to the date of expected performance. Thus, arbitral tribunals are willing to look at the underlying facts of a dispute to determine if they support government assertions that the cancellation of a concession was caused and justified by the investor’s breach of performance obligations. Further, statements issued by a government may be a pretext for an underlying arbitrary motive. Tribunals scrutinize whether the government was acting within, or outside, its role as a commercial participant. If the authority the government relied upon to void a concession was its inherent power to act in the public interest, the action is more likely to be considered expropriatory. If, on the other hand, the government raised serious performance issues that any private contracting party legitimately would be concerned about, the argument will be stronger that the cancellation — whether or not justified under municipal law — is not expropriatory under international law principles. Such principles become operative only if there is a denial of justice or some arbitrary or discriminatory element in the state’s conduct. Therefore, for a claim to be meritorious under the NAFTA, the investors must show, at a minimum, discriminatory or arbitrary actions by the NAFTA government.

As stated above, arbitration tribunals look to circumstantial evidence in determining whether the government’s cancellation was politically, and therefore likely discriminatorily, motivated. Judging from past cases, it can be difficult to predict how a decision-maker will rule on the issue of a party’s intent. Several key factors in the analysis can be identified, however, from previous agency and arbitral panel decisions.

• The subsequent, immediate award of the concession to a government insider, for example, has been cited in support of a finding of expropriatory intent. In Georgia Pacific International, Ecuador cancelled a concession and immediately granted it to a third party who was the nephew of the president of Ecuador. The government’s protests that the foreign investor had not met the deadline by which a mill facility was to be constructed were rejected because the evidence showed that the investor had been denied possession of the site.

• The presence of unusually harsh business conditions has also been cited as an indication of political motivation. The decision to avoid a concession is likely to be ruled an expropriation if the cancellation is accompanied by aggravating circumstances such as harassment. In the case of Fearn International, Inc., for example, the Government of Somalia had arrested key employees and blocked access to the plant site. The government’s appointment of an intervenor may also be considered a

80. See, e.g., Agricola Metals Corp., Contract No. 8636, Memorandum of Determination (OPIC May 3, 1979) (expropriation found even though government had colorable claim of investor breach).
form of harassment that suggests expropriatory action. In *Northern Indiana Brass Co.*, OPIC found that the government's reliance on a company's failure to obtain government approval for a shutdown was merely a pretext and that an intervenor had been appointed to force the American company into bankruptcy.  

- While it is no longer necessary to show that a decision to terminate a concession was made in the midst of political upheaval, it may still be relevant that a new regime, announcing new economic policies, has come into power since the concession was awarded. The facts surrounding the arbitration of *Revere Copper and Brass, Inc. and Overseas Private Investment Corp.*, for example, involved a newly elected Jamaican Prime Minister who had announced an economic policy that included national economic primacy in the aluminum and bauxite industries. At the same time, the new Prime Minister had passed additional taxes in violation of the stabilization clause of the investment agreement. In awarding *Revere Copper and Brass, Inc.* compensation under its contract with OPIC, the arbitral panel found that the actions of the new Jamaican government had "effectively put an end" to the investment agreement and had directly prevented the company from "exercising effective control over the use or disposition of its property."  

Even if an arbitral tribunal rejects the government's arguments that the investor's defaults justified an avoidance of the concession, the government may be successful in asserting that at worst, it is guilty of a repudiation or breach of a contract, which should not be scrutinized under international law principles. In *International Fisheries Co. (U.S.A.) v. United Mexican States*, for example, the United States-Mexican Claims Commission addressed the issue of whether the "Calvo Clause" of a concession agreement precluded an investigation of a claim arising from the cancellation of that agreement. As indicated above, under the Calvo doctrine as it operated prior to the passage of the NAFTA, Mexico maintained that foreign investors should have the same recourse as Mexican nationals in settling disputes: Disputes were to be determined in local Mexican courts under local law. In upholding the Calvo clause and ruling that the claim could not properly be brought before it, the Commission noted that the cancellation in question "was not an arbitrary act, a violation of a duty abhorrent to the contract and which in itself might be considered as a violation of some rule or principle of international law." The Commission asserted that such conditions must be present for it to examine a claim on the basis of international law, even in the absence of a Calvo clause. Annulments of a contract done in accordance with the contract's express terms do not give rise to a claim for settlement under international law. The Commission concluded, "[I]f every non-fulfillment of a contract on the part of a government were to create at once the presumption of an arbitrary act, which should therefore be avoided, governments would be in a worse situation than that of any private person, a party to any contract."  

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84. 4 R. Int'l Arb. Awards 691 (1931).  
85. *Id.* at 699.  
86. *Id.* at 700.
a. The Government’s Perspective.

Returning now to our hypothetical, we can examine the arguments that the Mexican government might provide with respect to why its actions nullifying the concession do not constitute an unlawful expropriation. In whatever forum — a local court or administrative body or an international arbitration pursuant to NAFTA Chapter 11 — in which the investors lodge their protest, the Mexican government is likely to justify its actions with one of two principal arguments: The government was justified in voiding the concession on contractual grounds because the investors lacked the technical or financial capacity to perform under the agreement and were in fact not meeting their performance obligations, or because the concession agreement was procured by mistake, error, or bad faith.

That the investors have failed to perform under the contract provides perhaps the most sound basis for nullifying the concession because, as illustrated in international case law, governments are allowed to make decisions on contractual grounds and are allowed to act as reasonable commercial participants in the marketplace. A government’s nullification of a contract on purely commercial grounds, because of a breach of performance obligations by the other party, is unlikely to be considered expropriatory. To protect itself from allegations of expropriation, therefore, it is crucially important that the government have solid commercial reasons for repudiating a concession and not appear by its actions to be favoring domestic investors.

A wide range of performance issues might arise that cause the Mexican Entity to conclude that the U.S. investors lacked the ability or the willingness to perform under the concession agreement. The investors might fall behind on the agreed-upon production schedule or the schedule for the delivery of certain services. They may fail to use the materials or implement the technology agreed to in the concession. The services they do provide may not be up to expected standards as set forth in the agreement. The failure to deliver the agreed-upon goods or services, of the expected quality and by the expected time, would likely constitute a breach of the investors’ performance obligations under the concession. Because the investors chosen to provide a particular service to the public under a concession are typically taking the place of the government, which many times has provided the service in the past, ensuring that the service is provided in a timely manner and meets certain standards is very important to the government. Making sure that the investors perform under the concession is necessary to avoid potentially massive public outcry and discontent, particularly when the concession pertains to such vital and visible public services as, for example, water purification, highway construction or garbage collection.

The U.S. investors might also breach their performance obligations by failing to make promised capital investments in the Mexican company formed to perform under the concession. The concession agreement might include corollary investment obligations on the U.S. investors, such as to make investments in people — by committing to hire a certain number of people or to pay for training and education for workers — or in infrastructure or other resources — by committing to clean up and protect certain water sources from pollution by the investors’ manufacturing or to build a waste processing facility in conjunction with the investors’ operations, for example. In some cases, the investors’ failure to adequately capitalize the project may cause the Entity government to incur expenses to provide the services that should, under the concession, be provided by the U.S. investors. The investors’ failure to adequately capitalize their venture could place in financial jeopardy the Mexican and other creditors of the company formed by the investors pursuant to
the concession. The decision to award a concession is based in part on the investors' commitment to capitalize the project at a certain level and is based on the government's analysis of the investment's financial strength and feasibility. Under most circumstances, the failure to meet such capitalization commitments, therefore, constitutes a breach of the concession by the investors.

The government's nullification of the concession might also be based on commercial grounds of another sort. The Entity may claim that the contract between it and the investors was entered into improperly through the fault of the investors. The government may argue that, under general contract law, an agreement entered into because of fraud or misrepresentation by one party may be voided, and it is not binding on the innocent party, a fraud in the inducement type of theory. The government may discover that dishonest or misleading representations by the investors, particularly as to their capability and capacity to perform, convinced the government to award the concession to that party. Fraudulent misrepresentations as to the identity of the investors may also provide a commercial basis for voiding the concession. The possibility also exists that acts of bribery led to the granting of the concession. A subsequent government administration may "justify" its nullification of the concession by reference to the underhanded or illegal means by which it was obtained. However, termination of this concession by the new government may still be regarded as an unlawful expropriation, even if the concession were obtained by illegal means.

In the event that the government's nullification of a concession is challenged, the government's position will be strengthened if the government can show evidence of its intent to reestablish a concession with some other private investor or investor group, such as by reopening the concession for public bidding. If, on the other hand, the government resumes provision of the service itself or awards the concession to a predetermined private party, a finding of expropriation would be more likely. The Mexican Government should be sure that it follows the proper local procedures and rules in nullifying the concession and that it provides the investors with an adequate forum to adjudicate the claims they may bring with respect to their investment. Taking these actions will lessen the likelihood that the government's nullification of the concession will be deemed expropriatory.

87. Previous bad acts by the government, such as accepting or inducing bribes, do not necessarily exonerate subsequent administrations, whose behavior is held to the standards required under trade agreements and under international law in general. As a general rule under the law of contracts, a party with "unclean hands" may not be released unilaterally from its contract obligations to the detriment of the other party for reasons related to its own wrongdoing. McKeehan v. McDermott, 595 F. Supp. 672, 676 (N.D. Ind. 1984) ("A plaintiff cannot seek relief against the wrong of another where he himself was engaged in the same wrong or a wrong with reference to the same matter."); Assoc. Business Telephone Systems Corp. v. Greater Capital Corp., 729 F. Supp. 1488 (D. N.J. 1990) (holding that the doctrine of unclean hands is not limited to suits in equity and is equally applicable to damage actions.). This rule would apply even where the individuals directly responsible for the wrongdoing have been replaced by new government representatives.

88. See, e.g., Georgia Pacific International, supra note 80.
b. The Investors' Perspective.

Investors who allege that their investment under a concession agreement has been unlawfully expropriated are likely to argue that the government's allegations of defects in the investors' performance are a mere pretext designed to disguise an expropriatory intent. They may argue that the Mexican Government's intent is in fact expropriatory even if some plausible claim can be made that the investor was in technical breach of the concession. As illustrated by several of the cases cited above, an unlawful expropriation clearly can be, and has been, found despite the availability of technical grounds to terminate the concession. The critical consideration in such instances appears to be whether the concession was cancelled due to political, as opposed to commercial, considerations. If pronouncements by the government, for example, suggest a policy or an overall strategy that would be furthered by cancellation of the concession, the termination is likely to be viewed as expropriatory despite the presence of some evidence that the investor may have been in technical default.

To back up their allegations that the government had an underlying political motive, the U.S. investors may argue that the concession agreement was too new — had been implemented too recently — for judgments to be made about the investors' performance. They may claim that the Mexican Government's "premature" decision to declare the investors incapable of performing and in breach of their performance obligations indicates that the government had no desire to see the investment succeed. They may also claim that the government interfered with their ability to perform and thereby caused the investors to default.

In the alternative, the investors may argue that the nullification of the concession constitutes an unlawful expropriation because the government denied the investors an adequate forum to determine whether the government's action was expropriatory. The investors may assert that they were not given adequate notice of the alleged deficiencies in their performance or time to prepare for or present their side in an administrative or court proceeding. They might claim they were denied access to documents crucial to their appearance at that proceeding. The investors might also cite to any failure by the government to comply with termination provisions in the concession agreement as evidence of the government's haste in nullifying the concession and as evidence of its expropriatory intent. Finally, if the government attempts to support its nullification by pointing to mere technical irregularities in its granting of the concession, the investors may use that attempt as evidence of expropriatory intent, arguing that any irregularities in the contract's language or execution are equally the fault of the government and could be grounds for reformulation, but not for nullification, of the concession.

In sum, in order to prevail on a claim that the government's nullification of a concession was expropriatory, in either a local administrative or court proceeding or in an international arbitration, the investors must show that (1) the government's action was discriminatory in nature or was motivated by non-commercial considerations, and compensatory damages were not paid, or (2) the government failed to provide an adequate forum to determine the claim for repudiation or breach or failed to provide adequate notice, and compensatory damages were not paid.

89. See, e.g., Agricola Metals Corp., supra note 81.
90. Restatement (Third), 712 (2)(b) supra note 71.
The issue of what damages the investors might claim or be entitled to will be a major component of nearly every investment dispute under the NAFTA. The parties' ability to agree on the measure and amount of any damages to be paid will be a critical factor in determining whether the dispute ever reaches the arbitration stage or is instead resolved in settlement. Thus, while the issue of damages will almost always have to be resolved before the dispute can be settled, it is possible that the question of whether an unlawful expropriation in fact occurred may never be formally determined in a given dispute.

Just as in domestic litigation, it can be anticipated that the measure of damages relied upon by the investors will differ from that used by the NAFTA Party. Although Chapter 11 contains its own specific provision regarding the compensation to be paid for an unlawful expropriation, it borrows heavily from U.S. and international legal standards for calculating damages. Understanding how wronged investors are intended to be compensated under Chapter 11 thus requires an understanding of how these standards and measures have been applied in the past.

Over the years, international tribunals and commentators have offered different formulations for the compensation standard that should be used in cases of expropriation. In the large majority of cases, economic damages constitute the compensation awarded to investors or property owners who have suffered an unlawful expropriation of their property rights. The primary source of debate in international law has been whether the expropriating state is required to give "full compensation" for the property owner's loss or whether the state may employ a standard allowing less than full compensation, such as "appropriate" or "equitable" compensation. Gann's study of international tribunal decisions, conducted in the mid-1980s, illustrates the variety of standards that have been adopted by international arbitrators, including those providing "appropriate," "equitable," and "fair" compensation.

In real-life terms, these standards will be incorporated into damage claims that take several forms. In attempting to settle our hypothetical investment dispute, for example, the investors are likely to put one or both of the following demands on the table: (1) that the concession agreement be reinstated and the investors be compensated for economic damages for the period since the agreement was nullified; or, (2) that the parties agree to terminate their relationship, and the investors receive fair market value for their interests under the concession agreement. Under this second settlement option, the investors' claim for damages will most likely be calculated to include compensation for (1) capital expendi-

91. Restatement (Third) § 712, Reporter's Note 2, supra note 71. For detailed discussions of the international law standards that have been used to determine the compensation owed to owners of property expropriated by foreign governments, see, e.g., Patrick Norton, A Law of the Future or a Law of the Past? Modern Tribunals and the International Law of Expropriation, 85 AM. J. INT'L L. 474 (1991); Pamela Gann, Compensation Standard for Expropriation, 23 COLUM. J. INT'L L. 615 (1985).

92. A rare exception can be found in Texaco Overseas Petroleum Co. v. Libya, supra note 75, where the arbitrator ordered Libya to resume performance under its concession agreement with TOPCO. Notwithstanding the Texaco decision, the remedies of restitution of property rights or specific performance have been awarded only very rarely in the second half of this century.

93. See Gann, supra note 92 at 648-49.
tures and investments, (2) out-of-pocket expenses, and (3) lost profits. Out-of-pocket expenses, including legal counsel and consultants' fees, obviously require solid proof of these expenses. The investors should be required to substantiate their claimed expenses with adequate documentation. Lost profits can be even more difficult to estimate and can be a more serious source of contention between the parties that are attempting to settle the dispute. This issue of lost profits is discussed more fully below.


The standard that has been incorporated into the investment chapter of the NAFTA requires the payment of "fair market value." Article 1110(2) states the relevant standard: Compensation shall be equivalent to the fair market value of the expropriated investment immediately before the expropriation took place ("date of expropriation"), and shall not reflect any change in value occurring because the intended expropriation had become known earlier. Valuation criteria shall include going concern value, asset value including declared tax value of tangible property, and other criteria, as appropriate, to determine fair market value.

Despite the seeming clarity of this standard, prior international case law remains relevant to an investment dispute under the NAFTA to the extent it provides guidance as to the interpretation or application of the meaning of "fair market value." Furthermore, several international decisions are helpful in their discussion and application of "going concern value" and "asset value" as criteria for determining the fair market value of expropriated property.

Particularly helpful for this analysis is the line of cases that was determined by the Iran-U.S. Claims Tribunal (the "Tribunal"). The Tribunal was established in the wake of the Iranian Islamic revolution of 1979 to adjudicate disputes concerning, inter alia, the nationalization of various American-owned assets and businesses in Iran. The Tribunal's awards generally were based upon the compensation standard set forth in the U.S.-Iran Treaty of Amity, Economic Relations and Consular Rights (the "Treaty of Amity"), which provided for compensation that represented the "full equivalent of the property taken."

b. Fair Market Value.

In determining fair market value, international tribunals have generally first examined whether there existed an established market price for the expropriated property. In Amer. Int'l Group, Inc. v. Iran, for example, the Tribunal indicated that the claimant's compensation should equal the fair market value of the expropriated property, which consisted of shares in an Iranian corporation. The Tribunal indicated that such value should be determined according to the actual market price of such shares, but because no active market existed, the Tribunal determined their market value by estimating the value of the company as a going concern, including such factors as future business prospects and goodwill. Similarly, in L.N.A. Corporation v. Iran, the Tribunal determined that the best evidence of

94. NAFTA, supra note, arts. 102(2), 1131(1).
95. See Aug. 15, 1955, 8 UST 900, TIAS No. 3853, 284 UNTS 93.
the fair market value of the claimant's 20% holding in an Iranian company was the actual price that the claimant had paid for its shares one year prior to the nationalization of the company. The Tribunal defined "fair market value" as "the amount which a willing buyer would have paid a willing seller for the shares of a going concern, disregarding any diminution of value due to the nationalisation itself or the anticipation thereof, and excluding consideration of events thereafter that might have increased or decreased the value of the shares."98

Fair market valuations can be made according to different accounting methodologies, including an income approach (discounted cash flow), which considers the expected earnings and future cash flows of the business entity. Valuation analyses may be conducted to produce a range of fair market values for the concession agreement, which are designed for use in settlement negotiations. It is important for the parties to the dispute to agree upon a valuation date from which calculations can be made. Valuation analyses will look at such factors as: (1) performance estimates; (2) risk factors, which could affect the investors' ability to perform; (3) analysis of other service providers in the industry, as a basis of comparison; and, (4) assumptions underlying the investors' budget estimates. The investors should be expected to be able to substantiate the customer totals, sales volume, and growth expectations with which they establish their expected earnings figures. Expense calculations should consider depreciation, profit sharing, income tax rates, and capital expenditures.

To arrive at a damage figure, the expenses the investors saved from not performing should be deducted from the expected gross revenue so that what is claimed is lost profit, not lost revenue. The Mexican Government will likely object to compensation claims from investors if, for a multi-phase concession arrangement that was nullified in its early stages, the calculations assume that all investments required over the life of the agreement have been made and that the company is operating at full capacity. If the investors do not have the assets and working capital completely in place, with its work force established and its business operating on a going concern basis, the Mexican Government should oppose demands to pay the investors the same amount it might to a fully operational, going concern business. The government will assert that lost profits should not be awarded for phases of the investment that the investors have shown no ability to perform. Any profit that the investors claim they would have made from some future activity they had not yet begun or shown the ability to do would arguably be wholly speculative.99

c. Another standard: Just Compensation under the Restatement.

Section 712 of the Restatement (Third) of the Foreign Relations Law of the United States (entitled, "State Responsibility for Economic Injury to Nationals of Other States") employs the standard of "just compensation" for victims of expropriation. The Section provides that "[f]or compensation to be just . . ., it must, in the absence of exceptional circum-

98. Id.
99. For a discussion of this principle as set forth in common law, see, e.g., National Controls v. National Semiconductor, 833 F. 2d 491, 495 (3rd Cir. 1987); Deauville Corp. v. Federated Dept. Stores, Inc., 756 F. 2d 1183, 1194 n. 8 (5th Cir. 1985).
stances, be in an amount equivalent to the value of the property taken and be paid at the time of taking, or within a reasonable time thereafter with interest from the date of taking, and in a form economically usable by the foreign national...” Comment (d) to § 712 explains that, where it can be determined, the compensation to be paid should equal the fair market value of the expropriated property, taking into account any going concern value that exists. Reporters’ Note 3 to § 712 states that, in instances where the expropriated property is unique and it is thus difficult to calculate a market value, it may also be acceptable to capture going concern value by calculating the present value of the future earnings of the investment. As under U.S. domestic law, the Restatement provides that if compensation is delayed pending administrative, judicial, or legislative processes for establishing the appropriate compensation, interest must be paid from the time the taking occurred. In addition, the compensation should be paid in a freely convertible currency with no restriction on its repatriation. According to Reporter’s Note 2, payments meeting this obligation include deferred payments, such as bonds, as long as they bear interest that is “realistically related to market rates.”

According to Reporters’ Note 2 to § 712, “The Executive Branch and the Congress of the United States have held resolutely to the view that international law requires compensation that is ‘prompt, adequate and effective.'” This formula was first asserted by Secretary of State Hull in 1938. The same standard has been incorporated into various aspects of domestic law. Under 19 U.S.C. § 2462(b)(4), for example, the United States may deny the benefits of the generalized system of tariff preferences for least-developed countries that expropriate property and fail to compensate in accordance with this standard. Professor Gann concludes in her study that, although international tribunals have not typically employed the precise wording of the “prompt, adequate, and effective” compensation standard favored by the United States, the valuation methods that have been used have often been very consistent with this standard.

On the other hand, Latin American countries, including Mexico, have traditionally asserted that “appropriate compensation” was provided for expropriation as long as aliens were compensated to the same extent as their nationals would be.

100. Restatement (Third) §712 comment(d), supra note 71. Comment (d) to § 712 of the Restatement provides that in exceptional circumstances, such as war, parties may be justified in deviating from the “just compensation” standard. Comment (d) also states, however, that “a departure from the general rule on the ground of such exceptional circumstances is unwarranted if (i) the property taken had been used in a business enterprise that was specifically authorized or encouraged by the state....”


102. Restatement (Third) § 712, Reporter’s Note 2 supra note 71. It is interesting to note that The United Nations Charter of Economic Rights and Duties of States employs the standard of “appropriate” compensation, to be paid according to the laws of the expropriating state, not pursuant to international law standards for compensation. The relevant part of Chapter 2, Art. II of this resolution states that each State has the right to “...nationalize, expropriate or transfer ownership of foreign property, in which case appropriate compensation should be paid by the State adopting such measures, taking into account its relevant laws and regulations and all circumstance that the State considers pertinent.” G.A. Res. 3281 (XXIX), 29 U.N. GAOR Supp. (No. 31) at 50, U.N. Doc. A/9631 (1974), reprinted in 14 Int’l Leg. Mat. 251, 255 (1975). Most Western states, however, have not embraced, or have in fact outwardly rejected, the Charter. Gann’s analysis of international tribunal awards showed that, up to the time of her study, no international tribunal had yet adopted the Charter’s viewpoint that the expropriating state has the right to apply its own laws in determining the appropriate amount of compensation to be paid. (Gann, supra note 92 at 648-49.)
d. Going Concern Value.

As seen above, in some cases there is little or no evidence of an actual market price of the expropriated property. The fair market value must then be determined by the use of other criteria, including the "going concern value" of the asset. In evaluating the "going concern value" to determine the compensation due, international tribunals have attempted to calculate the prospective profits of the enterprise in question. One author has described the going concern approach as one that "attempts to measure earnings power (and so encompasses elements such as loss of future profits which may be based on projections of past earnings or estimates of future earnings)." In American Int'l Group, for example, the Tribunal evaluated the expropriated corporation as a going concern and stated that "the most important element of the compensation claimed by the Claimants... is the loss of prospective earnings." In another case, Phillips Petroleum Co. v. Iran, the Tribunal determined the compensation due Phillips for Iran's repudiation of an oil concession agreement. After determining that Phillips' enterprise should be evaluated as a going concern, the Tribunal estimated the profits Phillips would have earned during the duration of the concession, discounting such amounts to the date of expropriation, and awarded the company $55 million for Iran's breach.

e. Circumstances in which Lost Profits are not Recoverable.

International tribunals and scholars have recognized however, that, under some circumstances, recovery of lost profits may be inappropriate. In some situations, lost profits are not recoverable because they are too speculative to be fairly estimated. In Phelps Dodge Corp. and OPIC and Iran, for example, claimants sought damages for the nationalization of an ownership interest in an Iranian company, SICAB, which was established for the purpose of manufacturing wire and cable products. However, before SICAB completed

104. American Int'l Group, supra note 97, at 107.
106. In the majority of international law cases applying the going concern approach, the property expropriated was an ownership interest in an ongoing business. In some cases, however, the issue has arisen as to whether the investor's contractual rights may be evaluated as a going concern. The Iran-U.S. Claims Tribunal decided this issue in the Phillips Petroleum case, concluding that Phillips' contractual rights were part of a going concern and that Phillips was entitled to be compensated for the fair market value of those rights. Id. at 119.
107. See also AMCO Asia Corporation et al. and Indonesia, 24 Int'l Leg. Mat. 1022, 1037 (1984) (an ICSID arbitral tribunal awarded compensation by valuing the investment as a going concern, for which it established the "net present value of the business, based on a reasonable projection of the foreseeable net cash flow during the period to be considered, said net cash flow being then discounted in order to take into account the assessment of the damages at the date of the prejudice.").
construction of its manufacturing facilities, the Iranian revolution forced the departure of American personnel, and the Iranian government subsequently assumed control of the facilities. Phelps Dodge Corp. participated in arbitration before the Tribunal and sought recovery of its prospective earnings based upon a valuation of SICAB as a going concern. In evaluating the fair market value of the company as of the date of expropriation, the Tribunal determined that the company had not yet become a going concern and that any conclusions as to SICAB’s goodwill or future profits were “highly speculative.” Accordingly, the Tribunal refused to estimate such earnings, and it awarded SICAB an amount equal to the claimant’s actual investment in the Company.

A similar result was reached by the Tribunal in *Sola Tiles, Inc. v. Iran*,\(^\text{109}\) which also involved the nationalization of an American-owned corporation. After determining the fair market value of the company’s tangible assets, including physical property, accounts receivable and expropriated cash, the Tribunal declined to award compensation for lost goodwill or future profits. The Tribunal questioned the value of Sola Tile’s goodwill in light of the changes in the Iranian political and economic environment. Further, the Tribunal found that the company’s brief operating history, during which it operated at a loss in its first year and showed only a small profit the following year, provided an insufficient basis upon which to award future profits.

The United States Department of State has also acknowledged that application of the going concern approach may be impracticable or unfair in situations where expropriation occurs before the investment has begun to generate revenue.\(^\text{110}\) In general, the three standards recognized by the State Department as indirect methods of approximating the fair market value of expropriated property are (1) going concern value, (2) replacement cost, and (3) book value.\(^\text{111}\) The going concern approach, which measures earnings power based on past earnings or estimates of future earnings, has been regarded by the State Department as generally providing the best approximation of fair market value (although, as just stated, inappropriate in some circumstances). The second method calculates the replacement cost of the property at the time it was expropriated, less actual depreciation. This calculation does not consider earning capacity. The book value approach values the investors’ assets at their acquisition cost, less depreciation. This approach is not regarded as favorably as the other two because it is thought to yield figures that have little relationship to the actual value of the expropriated property.\(^\text{112}\) As an overarching rule, the State Department policy regarding valuation methods has recognized that the method most likely to provide just compensation depends on the particular circumstances of the investment at issue, as well as on non-monetary aspect of the settlement that may be negotiated between the parties.\(^\text{113}\)

Accordingly, if, as in our hypothetical investment scenario, the investors have been performing (or under the obligation to perform) under the concession agreement for only a short period of time with no track record of operations or profits, an arbitral tribunal


\(^{110}\) See Smith, *supra* note 104 at 519 (stating that, where an investment has a limited history of operating results or expropriation occurs before a revenue-generating stage is reached, the going concern approach may not operate fairly).

\(^{111}\) Id. at 519.

\(^{112}\) Id.

\(^{113}\) Id.
may find it improper to evaluate the concession as a going concern. Clearly, the NAFTA itself allows compensation for the consideration of an investment’s going concern value. Article 1110’s endorsement of the going concern approach indicates that an investor’s lost profits may be recoverable in the event of an expropriation of property in violation of the NAFTA Agreement. The body of international law that may be consulted to interpret the meaning of the NAFTA standard, however, shows that evaluation of an investment as a going concern and calculation of its potential lost profits are not appropriate to all situations. Faced with a situation like the one described in our hypothetical, the Mexican Government would want to argue that the investment had not yet become a going concern when the concession was terminated and that there was no operating history upon which to estimate future earnings. The investors might tend to counter that, although the particular Mexican venture did not yet have a track record of profits, that was the fault of the Mexican parties in terminating the concession. Moreover, the investors might show that other businesses in which they are involved have been successful, so as to establish their own track record and credibility.\textsuperscript{114}

\section{Annex 1120.1: No two bites of the apple.}

A third issue that is likely to arise in our hypothetical and in a number of investment disputes involving Mexico relates to the forum in which the investors choose to bring their claim against the Mexican government. Annex 1120.1 of the NAFTA provides that an investor of another Party may not allege that Mexico has breached an obligation under NAFTA Chapter 11 (e.g., by expropriating an investment) both in a NAFTA arbitration and in proceedings before a Mexican court or administrative tribunal.\textsuperscript{115} U.S. or Canadian investors must choose one forum or the other, therefore, because once allegations of expropriation or any other violation of Chapter 11 have been made in one forum, access to the other is denied. This restriction applies solely to allegations made in Mexican court or administrative proceedings. NAFTA investors in Canada or the United States are not similarly restricted by Annex 1120.1. This annex precludes NAFTA investors in Mexico from, in effect, taking “two bites of the same apple.” Interpreted according to its plain meaning, the Annex prohibits investors from first bringing a claim before a Mexican court or administrative body and later, especially if they are unhappy with the judicial or administrative determination, bringing the same claim before an arbitral panel pursuant

\textsuperscript{114} Cf. McDermott v. Middle East Carpet Co. Associated, 811 F. 2d 1422, 1427-28 (11th Cir. 1987).

\textsuperscript{115} NAFTA \textit{supra} note 1, annex 1120.1 provides as follows: With respect to the submission of a claim to arbitration: (a) a provision of subChapter A (I) An investor of another Party may not allege that Mexico has breached: (i) Section A [of Chapter 11] or Article 1503(2) (State Enterprises), or (ii) Article 1502(3)(a) (Monopolies and State Enterprises) where the monopoly has acted in a manner inconsistent with the Party’s obligations under Section A (Chapter 11), both in an arbitration under this subchapter and in proceedings before a Mexican court or administrative tribunal; and (b) where an enterprise of Mexico that is a juridical person that an investor of another Party owns or controls directly or indirectly alleges in proceedings before a Mexican court or administrative tribunal that Mexico has breached an obligation under: (i) Section A [Chapter 11] or Article 1503(2) (State Enterprises), or (ii) Article 1502(3)(a) (Monopolies and State Enterprises) where the monopoly has acted in a manner inconsistent with the Party’s obligations under Section A, the investor may not allege the breach in an arbitration under this Section.
to Chapter 11. If a claim has previously been brought before a local court or administra-
tive body in Mexico, the Mexican Government can invoke Annex 1120.1 to prevent a claim
from going to arbitration.

In evaluating whether the Government of Mexico could successfully invoke the appli-
cation of the Annex, two factors come into play. First, for the restriction to be effective, the
allegations made before any local court or administrative body must in some form address
the issue of the Mexican government having breached its Chapter 11 obligations with
respect to the concession. If an allegation of expropriation is not addressed in the Mexican
courts, it is doubtful that access to a Chapter 11 arbitration on the expropriation claim
would be precluded by Annex 1120.1.

Second, the Government of Mexico must determine how and when to advance the
argument that the investors' arbitration claim is precluded by Annex 1120.1. One option is
to raise this argument with the arbitration panel itself. It has been well established that
arbitrators may determine their own jurisdiction.\(^{116}\) Having the arbitral panel determine
whether the arbitration was barred by Annex 1120.1 may be advantageous to the Mexican
government. Because the determination would be made in an arbitration proceeding
rather than in a courtroom, the arbitrators' decision would be confidential.\(^{117}\) Having the
arbitrators resolve the issue before the actual arbitration began could avoid an expensive
and potentially lengthy arbitration, saving both sides money and possibly negative publi-
city. However, the mere existence of an arbitration would obviously leave some observers
with the impression, however inaccurate, that Mexico is hostile to foreign investment.

In the alternative, Mexico might consider initiating litigation immediately in the
United States in an effort to preclude arbitration on the basis of Annex 1120.1. Mexico
could file a motion to enjoin the U.S. investors from proceeding with arbitration. As an
analogue, courts have held in numerous cases, citing the Federal Arbitration Act,\(^{118}\) that
they have the authority to determine whether a valid agreement to arbitrate exists in a par-
ticular situation and, if it does exist, the scope of that agreement.\(^ {119}\) Of course, the possi-

\(^{116}\) See, e.g., AT&T Technologies, Inc. V. Communications Workers of America et al., 475 U.S. 643, 106 S.Ct. 1415 (1986) (holding that, although the question of whether both parties have agreed to submit a dispute to arbitration is a question for the judiciary, the arbitrators are to decide whether particular aspects of a claim preclude arbitration in that instance.); Smith Barney Shearson, Inc. v. Boone, 47 F. 3d 750 (5th Cir. 1995) (holding that the judiciary is to decide whether the subject matter of a particular dispute was included in an arbitration clause, but the arbitrators are to decide whether procedural circumstances preclude the use of arbitration in a particular case); First Options of Chicago v. Kaplan, 115 S.Ct. 1920 (1995) (discussing whether the parties agreed to submit the question of the arbitrability of their underlying dispute to arbitration or to the court.).

\(^{117}\) For a discussion of the confidentiality accorded to alternative dispute resolution, see generally, Smith v. Smith et al., 154 F.R.D. 661 (N.D. Tex. 1994).

\(^{118}\) 9 U.S.C.A. § 1 et seq. (1995). The Act empowers U.S. courts to stay judicial proceedings when the issues involved are referable to arbitration pursuant to a written agreement.

bility exists that a U.S. court would rule against Mexico's request, perhaps acting on a general policy of deferring to arbitration. On the other hand, the clarity of the language of Annex 1120.1 makes it seem likely that a U.S. court would be bound to enjoin arbitration on a finding that the U.S. investors had previously made their claim of expropriation in proceedings before a Mexican judicial or administrative body.

A third alternative would be to submit the Annex 1120.1 issue to the Free Trade Commission set up under Chapter 20 of the NAFTA ("Institutional Arrangements and Dispute Settlement Procedures"). The Free Trade Commission (the "Commission") is charged with, inter alia, resolving disputes that may arise regarding the interpretation or application of NAFTA provisions. Chapter 20 establishes a mechanism by which Parties may request the establishment of an arbitral panel "to examine, in the light of the relevant provisions of the Agreement, the matter referred to the Commission...and to make findings, determinations and recommendations..." In addition, Article 1132 provides that, where a disputing Party asserts as a defense that the measure alleged to be a breach is within the scope of a reservation or exception set out in Annexes I-IV of the Agreement, the arbitral Tribunal may request the interpretation of the Free Trade Commission on the issue. Commission interpretations are to be issued within 60 days and are binding on the Tribunal. The intentional and direct overlap between Chapter 11 and Chapter 20 makes a submission to the Free Trade Commission a viable alternate approach to the Annex 1120.1 issue.

Whatever the forum in which the Government of Mexico chooses to advance its argument that arbitration is precluded by Annex 1120.1, the Annex's prohibition on taking "two bites of the apples" seems clear-cut. Until NAFTA investors in Mexico become familiar with it, Annex 1120.1 is likely to deny access to international arbitration for at least some investment disputes.

120. See, e.g., Moses H. Cone Memorial Hospital v. Mercury Construction Corp., 460 U.S. 1, 24-25, 103 S.Ct. 927, 941 (1983) ("the Arbitration Act establishes that, as a matter of federal law, any doubts concerning the scope of arbitrable issues should be resolved in favor of arbitration, whether the problem at hand is the construction of the contract language itself or an allegation of waiver, delay, or a like defense to arbitrability.").

121. This could be analogized to a party waiving its rights to arbitrate by participating in litigation before the courts. See, e.g. Price v. Drexel Burnham Lambert, Inc., 791 F. 2d 1156, 1158 (5th Cir. 1986); Miller Brewing Company v. Fort Worth Distributing Co., 781 F. 2d 494, 498 (5th Cir. 1986) (holding that, like any other contract right, the right to arbitration may be waived, and that waiver may be found when the party seeking arbitration has substantially invoked the judicial process to the detriment or prejudice of the other party.).

122. Art. 2001. In addition, Article 2020 of the NAFTA provides that Parties may request the Free Trade Commission's response on the interpretation or application of any provision of the NAFTA that has arisen in any domestic judicial or administrative proceedings of a NAFTA party. Upon receipt of such a request, the Free Trade Commission "shall endeavor to agree on an appropriate response as expeditiously as possible." The Party in whose territory the court or administrative body is located is responsible for submitting any agreed interpretation of the Commission to the appropriate court or administrative body.

123. NAFTA, supra note 1 art. 2012.

124. Id., art 1132(2).
C. Political Component.

Any investment dispute that arises between one NAFTA Party and investors of another Party will necessarily also involve a strong political component. The political climate and relationship between the governments of the disputing NAFTA Party and the Party of the investors at the time of the dispute will have a role, whether subtle or less-than-subtle, in the manner in which the dispute is resolved. Political factors may be used as a strategic tool, or even as a weapon, by the parties as they engage in the consultations, negotiations or arbitration that is held pursuant to Chapter 11. The degree of political pressure involved may, in effect, determine whether a dispute ever gets to the arbitration stage or whether it is resolved more quietly in consultations, and, of course, it can also determine for what sum of money or other compensation the parties ultimately decide to settle their dispute.

Disputing parties will quickly seek to gain political advantage at the local and the federal levels, and at the administrative and the executive branches, of government. In addition to any other legal counsel they may have engaged with respect to the investment dispute, particularly for their litigation skills, the parties are likely find themselves in need of counsel who know the ins and outs of setting up meetings and lobbying with the appropriate government officials and policymakers. The politics undeniably will play an important role.

For example, in the hypothetical investment dispute we described above, involving U.S. investors who entered into a concession agreement with the government in Mexico, the investors' lobbying efforts would most likely center on one message, however outdated or inaccurate it might be. The investors would launch a lobbying campaign that would most likely portray Mexico as being hostile to foreign investment and unreasonable in its dealing with U.S. business people. They may attempt to paint a picture of less than honest government officials who deliberately interfered with the investors' performance so as to turn over the concession to favored Mexican investors, raising the time-worn fears that it is "impossible" to do business in Mexico (or at least to do it honestly).

The U.S. investors' lobbying efforts will be aimed at certain members of the U.S. Congress (from their home state, for example), the U.S. Commerce Department, the Office of the United States Trade Representative, as well as the U.S. Embassy in Mexico City and the Mexican Secretariat of Commerce and Industrial Development (SECOFI). Embassy representatives would be relied upon to relay information about the facts of the investment and the dispute to government officials in the United States, including Members of Congress and their staff. Members of Congress and their staff rely heavily on the Embassy for information and opinions of events occurring in Mexico.

The investors may attempt to gain a windfall by intensifying their lobbying efforts when other issues affecting U.S.-Mexico relations, such as monetary aid to Mexico or immigration and border patrol problems, are being debated within Congress or the Administration. Their tactic in this regard would be to pressure the Mexican Government, such as by raising fears of a threatened relationship with the U.S. Government, so that Mexico would feel obligated to enter into a settlement agreement with the U.S. investors to avoid the negative connotations that might arise from an arbitration. Because Mexico has taken great strides in the past decade to improve its foreign investment climate, the Mexican Government would be sensitive to public accusations of having violated the NAFTA's investment provisions. To place further pressure on Mexico, the investors may try to convince the U.S. Government to submit an "amicus curae" brief on their behalf to the arbitration tribunal, pursuant to Article 1128 of the NAFTA. This provision allows...
Parties to make submissions to an arbitration tribunal on a question of interpretation of the NAFTA. All of these tactics would be aimed at persuading Mexico to settle the investors’ claim to avoid going to arbitration.

Of course, the Mexican Government would also want to engage in lobbying efforts, to counteract political damage being done by the U.S. investors and as a dispute settlement strategy of its own. Mexico would want to convey its side of the story to Members of the U.S. Congress, Administration officials, and Embassy officials. Its initial goal would be to remove any U.S. Government pressure on it that might result from the investors getting a head start in conveying their side of the story. Mexico would want to “level the playing field” in terms of public and official sentiment about the dispute in order to improve its chances of obtaining realistic and reasonable settlement offers from the investors. Another goal would be to persuade the U.S. Government to make an Article 1128 submission to the tribunal on Mexico’s behalf, rather than on behalf of the U.S. investors, or, alternatively, to persuade the United States not to make a submission on behalf of either party. Without the backing of the U.S. Government in the form of such a submission, the U.S. investors would be more likely to be reasonable in settlement negotiations. Mexico would want to avoid political pressure by the U.S. Government that is perverted by reason of factual distortions, which could force Mexico into a settlement that is unrealistic or unfair. So as not to mar the country’s improving reputation as a place to do business, Mexico would want to make clear to U.S. Government officials and policymakers that the concession was cancelled for performance issues and breach of contract problems, not by any expropriatory act on its part. By getting their side of the story across to the U.S. Government, Mexico might be able to diffuse the political weapon that the investors were attempting to craft out of the arbitration provisions of Chapter 11.

Moreover, Mexico’s message could also be that this investment dispute is one for which the applicable laws and international agreements have contemplated use of a particular dispute resolution procedure. That procedure should be allowed to run its course outside the political arena; the NAFTA should be allowed to work.

IV. Conclusion.

Examining the content and practical effect of NAFTA Chapter 11 through the perspective of a hypothetical investment dispute provides several lessons for operating in a NAFTA environment. It teaches, for example, that the NAFTA Parties should take steps to ensure that all local and state or provincial government bodies are thoroughly familiar with their obligations under Chapter 11. The NAFTA Parties would also be wise to establish sound mechanisms to review carefully (to the extent allowed under the NAFTA) the financial and personal backgrounds of potential investors to identify possible performance problems once an investment has been made. The NAFTA Parties should also make certain that any government action that has the effect of terminating an investment, such as the nullification of a concession agreement, be done for commercial, and not political, reasons. Finally, the NAFTA Parties must ensure that all enforceable procedures and rules of law are followed in any judicial or administrative hearing relating to an investment dispute under the NAFTA, in order to avoid investors’ claims of a denial of due process.

To better their position in the event of an investment dispute, NAFTA investors in Mexico should remain aware of the restriction on standing imposed by Annex 1120.1. The investors should thus decide carefully whether to pursue remedies before a Mexican court
or administrative body or via an international arbitration under Chapter 11. The investors should also be prepared to document and substantiate any damages they claim in an investment dispute. As a preventative measure, the NAFTA investors should, of course, be fully aware of the performance obligations they are undertaking when they enter into an investment deal and should perform as required under the concession or other type of investment.

As we have seen, a downside to Chapter 11 can be said to exist in the potential for investors to abuse the dispute settlement provisions by using political pressure and the threat of public humiliation — such as by labelling the host government as hostile to foreign investment— to gain an advantage in settlement negotiations. Despite that potential, the investment provisions of the NAFTA should be regarded as overwhelmingly positive for U.S., Canadian, and Mexican investors in the NAFTA territory. Perhaps most significantly, Chapter 11 contains Mexico’s first commitment to submit investment disputes to international arbitration. The process provided by Chapter 11 to bypass local court or administrative systems and instead to invoke an international arbitration mechanism is enormously positive news for investors, given the considerable differences between the legal systems of the NAFTA Parties. Only experience will show what the practical effects of implementation of the NAFTA investment provisions will be. There should be no doubt, however, that the foundation for a fair and nondiscriminatory investment climate for and among the NAFTA Parties has been laid.