NAFTA DISPUTE RESOLUTION: SECRET CORPORATE WEAPON?

LYDIA LAZAR EXAMINES THE ARBITRATION MECHANISM UNDER NAFTA, WHICH GIVES CORPORATIONS UNPRECENDENTED POWERS TO CHALLENGE THE AUTHORITY OF SOVEREIGN, SIGNATORY STATES

BY LYDIA LAZAR

With the recent decision by an international arbitral tribunal that Mexico must pay nearly $17 million in compensatory damages to a U.S. hazardous waste treatment company, a little noticed provision of the North American Free Trade Agreement (Nafta) has leapt into the limelight. Nafta's Chapter 11 empowers companies to force the U.S., Mexico, and Canada into arbitration whenever a company believes that it has not been treated "fairly and equitably," as those terms are defined in Nafta.

The practical result of Nafta's Chapter 11 is a strategic windfall for companies unhappy with actions taken by local or federal governments, actions that impede or thwart their corporate ambitions. The financial services industry needs to be aware of the increased use of arbitration to resolve disputes between corporations and governments. Why? Because the use of arbitration to resolve disputes between sovereign nations and private parties is a leading indicator of the increased legal and economic leverage that companies and investors—including investors in the financial services industry—will have in the new millennium. This new leverage

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results directly from Nafta's diminishing, and in some ways breaching, traditional concepts of sovereignty.

Nafta treats investors in financial services differently from investors in other industries. To understand how Nafta governs disputes between financial services investors and the U.S., Canada, and Mexico, one must read Nafta's Chapter 14 alongside Chapter 11. Recourse to the Chapter 11 dispute resolution process can be viewed as protection from arbitrary and nontransparent governmental actions, while Chapter 14 addresses the fairness of governmental policies themselves. This article discusses the implications of the Chapter 11 dispute resolution process for those investors, including financial services investors, doing business in the Nafta-created "free trading zone," and for the three nations that currently comprise that zone.

Nafta is considered a prototype global trade pact, and its provisions for dispute resolution are consistent with World Trade Organization (WTO) procedures. The Nafta countries are actively pursuing expansion of their free trade area, and Canada has already signed a separate bilateral agreement with Chile intended to serve as a bridge to Chile's accession to Nafta. Negotiations are well underway for a Free Trade Area of the Americas (FTAA), which would be the world's largest free trade area, uniting 34 countries and almost 800 million people and "stretching from Point Barrow to Patagonia, Hawaii to Recife, Easter Island to Newfoundland."[1] Thus, we can expect the use of arbitration by investors in disputes with governments to increase substantially.

The fact that Nafta mandated the use of arbitration to resolve such sovereign/investor disputes has had a profound impact on the balance of power between private economic interests and sovereign states, one that deserves to be more fully debated. That impact can be seen when considering the recent arbitral award against Mexico, which will soon take on the force of a legal judgment. When it does, a sea change in the balance of power between corporations and sovereign states will have occurred.

To understand why, consider how our judicial system handles arbitral awards. It is comparatively difficult to convince a U.S. court to overturn an arbitral award, and U.S. courts have traditionally accorded deference to foreign arbitral awards. Now, however, when just the threat of a Chapter 11 action may suffice to wrest a financial settlement from a government, investors have unprecedented leverage against states. As international arbitration becomes the *de facto* global legal regime between economic entities and sovereign states, widespread notions about "global governance without global government" need to be critically re-evaluated.

NAFTA'S IMPACT ON STATE SOVEREIGNTY

Historically, sovereign states have asserted rights that were absolute in nature. Black's Law Dictionary defines sovereignty as:

> "The supreme, absolute, and uncontrollable power by which any independent state is governed ... By 'sovereignty' in its largest sense is meant supreme, absolute power, the absolute right to govern."

The 20th Century has seen a gradual shift away from the historical concepts of absolute sovereignty and toward a modified theory of sovereignty that acknowledges limits on state rights. The fiercest defenders of state sovereignty are reluctant to accept any limitations, however, and in principle reject constraints on sovereign power. To these stalwarts, the concessions that states make when they sign treaties are seen as expressions of state sovereignty, not limitations on it.

An extension of the idea of sovereignty is the concept of "sovereign immunity." This judicial doctrine holds that a state cannot be sued without its consent. Over the course of the last century, sovereign states have become less immune to legal process by their creditors through the emergence and acceptance of the so-called "restrictive" theory of sovereign immunity, which states "accept" by signing international conventions, implementing statutes, or through case law decisions. This theory is based on the idea that a sovereign can either explicitly waive its immunity to being sued without its consent (for example, in a contract or a treaty) or implicitly waive its immunity when engaging in commercial activity.

Nafta added a new wrinkle to the restrictive theory of sovereign immunity because it altered the longstanding presumption that, apart from the two exceptions noted above, only states and state-based international organizations had legal standing to pursue non-contractual claims against one another under international law. Under Nafta, a corporation (referred to throughout Nafta as an 'investor') is now empowered to force the signatory countries into arbitration[2] when it believes it has been economically harmed by any governmental activity, whether or not commercial.

Although the investor must meet certain "national" criteria (spelled out in Nafta's Chapters 3, 4, and 11) to bring its claim, because virtually any corporation doing business in the United States, Mexico, or Canada could conceivably meet those criteria, there is now an "open class" of potential "legal equals" to the Nafta signatory states. Unlike the rights granted to a particular entity under an individual contract, the rights granted under Nafta are non-assigned. They are new rights, out there for any entity to access, albeit limited to those "qualified" under Nafta's terms.

The traditional defense of sovereign immunity has been waived by each country agreeing to Nafta's terms, and when seeking to enforce an arbitral award, a winning corporation will be able to target the losing state's assets to pay the award.

Thus by signing Nafta, the United States, Mexico and Canada have done more than merely express their sovereignty; as a direct result of the treaty's unprecedented bestowal of international legal personality on an open class of private investors, Nafta has significantly contributed to the erosion of these three states' (and possibly all states') sovereignty. This change in the access to international dispute resolution mechanisms represents the most important, far reaching, least understood, *and possibly unintended* dimension of the new Nafta regime.

DISPUTE RESOLUTION UNDER NAFTA

Instead of creating new legal institutions, Nafta has mandated the use of an "alternative" dispute resolution mechanism for private parties to bring claims against Canada, Mexico and the United States. Specifically, Nafta empowered investors to compel those states to arbitrate under certain circumstances. Those circumstances were delineated in Nafta's Chapter 11, which details treaty-based justifications for claims of economic loss due to state actions (see Treaty Language, below). In sum, under Chapter 11, the signatory states made commitments guaranteeing foreign investors certain economic rights and guaranteeing access to international arbitration as the means for enforcing breaches of those rights.

Companies now have standing to bring claims for economic loss due to a state's implementing its own environmental or other domestic laws, and *there are now nearly a dozen such claims pending*, against all three Nafta states. With the recent ruling against Mexico in the *Metalclad* case (detailed below), unless Mexico complies voluntarily, and assuming that its appeals fail, we will soon see a U.S. court enforcing a Nafta arbitral award.

COMPANIES ALREADY IN ARBITRATION AGAINST STATES

Investors wasted no time in bringing claims for economic loss they attributed to the actions of Nafta states. By mid-2000 there was a wide range of cases pending. For example, Loewen Group, Inc., a Canadian company, is seeking damages of $725 million from the U.S. on a claim that Mississippi law improperly prevents it from appealing a civil judgment. Pope & Talbott, a U.S. forestry company, is seeking $500 million (Canadian), claiming damages for the way that Canada has administered the 1996 Softwood Lumber Agreement with the U.S. And at least one case has been settled to date: in 1998, Canada agreed to pay U.S.-based Ethyl Corp. $13 million and also to reverse a ban on imports of the gasoline additive MMT.

There are several cases challenging environmental regulations under Nafta's Chapter 11 provisions, to the surprise (and dismay) of those who anticipated that the provisions of the environmental side agreement would govern those disputes. The first of these cases to be decided involves Metalclad Corp., a California-based hazardous waste disposal and asbestos contractor, just awarded $16.7 million by the arbitral tribunal convened to hear its claim.

METALCLAD CORP.

In 1993, Metalclad purchased a landfill in San Luis Potosi, Mexico with the permission of the Mexican government. The company cleaned up the site (removing 20,000 tons of waste that the previous owner had illegally dumped there) and brought it into compliance with U.S. hazardous waste landfill standards, all with the explicit permission of the Mexican government that had granted the necessary permits for waste removal, landfill construction, etc.

Metalclad had approval from Mexican federal environmental authorities and a letter of invitation from then-Governor Sanchez of San Luis Potosi. After the contentious Mexican presidential elections of 1994 and the collapse of the Mexican peso, opposition parties in Mexico were strengthened, and one target of those in opposition in San Luis Potosi was the Metalclad landfill.

With the emergence of strong citizens groups and an environmental impact assessment revealing that the site was located above subterranean streams supplying water to the local community, then-Governor Sanchez also turned against the project and designated the Metalclad site (a $22 million project covering 600,000 acres) as part of an ecological preserve, effectively stopping the project.

After extended but ultimately fruitless negotiations with the Mexican government, Metalclad filed its Nafta claim in 1997, asserting expropriation of its property. Metalclad argued that the landfill was a legally authorized project that had been impermissibly prevented from operating. Metalclad contended its property had been illegally taken by the Mexican government, which, therefore, should pay fair compensation under Nafta. An outside valuation done on behalf of Metalclad found that the fair market value of the landfill business was $90 million.

The tribunal selected by Metalclad and Mexico convened in July 1997 and heard oral arguments in the case in September 1999. In the interim, both parties filed expensive and detailed legal documents. Metalclad incurred nearly $4,000,000 in expenses for legal and other expert assistance, and it is believed that Mexico's expenditures were significantly higher.

With the August decision in its behalf, Metalclad now faces the prospect of trying to enforce the award if Mexico does not comply voluntarily. (See discussion of enforcement, below.) Meanwhile, Mexico has asked the Supreme Court of British Colombia to overturn the original tribunal's award. This court, based in Vancouver, was designated by the first arbitral tribunal as arbiter of any disputes over the outcome of the first arbitration.

Mexico's Deputy Commerce Secretary said recently that Mexico would base its challenge on arguments asserting the constitutional right of municipalities to require permission for what happens in their territory, an argument that the United States will likely take great interest in, given, as discussed below, Vancouver-based Methanex' challenge to California's legislation banning the gasoline additive MTBE.

METHANEX

Following the passage of the U.S. Clean Air Act in 1990, use of a methanol-based gasoline additive, MTBE (Methyl Tertiary Butyl Ether), became popular as a means to combat air pollution. Methanex, a Vancouver-based company, is the world's largest methanol producer and it sells methanol to MTBE producers. In 1999, Governor Gray Davis of California issued an executive order mandating the removal of MTBE from gasoline supplies by 2003 (as a way to protect water supplies after a University of California study found that MTBE had affected at least 10,000 groundwater sites throughout California.) Other studies have shown that MTBE may cause cancer as well as neurological, dermatological, and other problems in humans.

Other states have banned or proposed banning MTBE, and the United States Senate Environment and Public Works Committee voted recently to ban MTBE across the United States.

Methanex filed a notice of intent to arbitrate on June 15, 1999, and an international tribunal has now been convened to consider the case. Methanex is claiming $970 million in damages (described as expropriation of their expected business profits). Methanex has also filed a complaint with the Commission for Environmental Cooperation, established under the Nafta side agreement for environmental concerns, alleging that any groundwater contamination in California results from California's failure to enforce its own environmental laws.

The Metalclad decision really raised the profile of the Nafta provisions permitting claims against the U.S., Canada and Mexico, and the Methanex case demonstrates even more clearly the challenge that these treaty provisions pose to constitutional governments. Because arbitration is a private mechanism under Nafta, there is no requirement for public access to the decision-making process. Although two environmental organizations have formally requested that the arbitrators consider *amicus* (friend of the court) briefs, Methanex has opposed these requests, and the U.S. government has not yet responded.

WHY IT MATTERS: STANDING TO PURSUE A CLAIM

In the past, when private parties doing business with or in foreign states ended up in disputes with those states, there were practical and legal limitations on their ability to seek redress. If it was a contract dispute, an investor could pursue judicial or administrative remedies in the courts of the foreign state (generally considered to be "prejudiced" against the foreign investor) or in its own home state (if the foreign state acceded to the restrictive theory of sovereign immunity). An aggrieved investor could also petition its home government to take up the claim as a state-to-state dispute before the International Court of Justice (ICJ).

Persuading an investor's home state to take up the claim was difficult, uncertain, and time consuming, but if the investor succeeded in convincing its own government to take up its cause, that state might pursue traditional customary international law self-help remedies of retorsion (implementing equivalent bad treatment—similar severe and stringent regulations or harsh treatment—to citizens of the other state located within the investor's home state), countermeasures (against the other state as opposed to its citizens), or suspension or termination of treaties. However, even if the investor succeeded in convincing its government to pursue its cause, because such traditional remedies require lengthy and drawn out processes, they were unlikely to serve the aggrieved investor's immediate, financial interests.

Nafta's Chapter 11 has essentially created an "open class" of "legal equals" whose strategic position in relation to the United States, Mexico, and Canada has improved profoundly.

Now, with Nafta, the legal situation has changed. Investors can now bring claims against the United States, Canada and Mexico "at will," without first consulting their own governments, and can exert unprecedented control over the adjudicative processes that their claims will engender. As parties to an arbitration—unlike litigants in a judicial system of courts, assigned judges, and governing law—aggrieved investors themselves will now select the arbitrators, the substantive law, and the procedural rules governing the adjudication of their dispute.

Also unprecedented is the fact that Nafta authorizes investors to bring these claims without first exhausting all other domestic legal avenues. In fact, once an investor brings a claim for arbitration, it is barred from litigating domestically, except to enforce an arbitral award.

Traditionally, the right to bring an action and have standing (*locus standi*) in a legal dispute has been a cornerstone of legal personality, bestowal of which was viewed as dependent on the will of a sovereign state. When we consider the historical record of *locus standi*, we see that states have jealously guarded the perquisites and prerogatives of international legal standing. What is most remarkable about Nafta's bestowal of this enhanced legal standing on private parties is its stealth nature: almost without public debate,[3] the ground has shifted from underneath those legal traditionalists who refuse to accept the idea that non-state-based entities could ever be "international persons" without the express action of states.

Although this new right to bring a non-contractually based claim against a Nafta signatory state apparently resembles a standard, state-based conferral of legal standing, there is a critical distinction. Because the private party need not have been in a contractual relationship with the state, and because international arbitration is the means for pursuing the claim, Nafta's Chapter 11 has essentially created an "open class" of "legal equals" whose strategic position in relation to the United States, Mexico, and Canada has improved profoundly.

CONCLUSION

The incorporation of arbitration as a dispute resolution mechanism in Nafta has created a challenging paradox when seen through the lens of evolving international law, namely, that the growing use of international arbitration both strengthens and weakens international law and the rule of law.

Through the unprecedented expansion of the legal standing of a defined (but open) group of private parties, Nafta has significantly contributed to the erosion of the idea that international legal standing depends on the will of a sovereign. Even though this standing is still state-based (and is formally conferred via a treaty), there now exists an "open class" of private parties who are potential "legal equals" to the United States, Mexico and Canada. As the Free Trade Area is expanded to include other countries, and as corporations learn about this new "right," we can expect more and more arbitration claims to be brought. Over time, the number of private parties exercising this right could well number in the thousands.

There are now innumerable non-state-based international legal persons, acting more or less as equals when dealing with larger states, and more or less dominating business transactions with smaller states. With the institutionalization of arbitration as a de facto dispute resolution regime, there is a risk that the global trading regime will provide financial interests with an unprecedented and decidedly undemocratic opportunity to challenge restrictions and regulations that they believe hinder their ability to do business.

To the extent that reliance on international arbitration supports the emergence of a "global awareness" generally, and helps create increasing acceptance of the idea that one set of rules should govern international business activities, then increased arbitration can strengthen international law and the idea of the rule of law. But the dark side of arbitration looks like a private legal order, a system of private justice. To many, such a system actually de-legitimizes international law and weakens the nascent consensus in support of international legal regimes.

The essence of arbitration is its confidential nature, its evolving quality, and its responsiveness to changing business priorities. Unlike court decisions, arbitration does not produce law as most people understand law and its decisions have no precedential value (though paradoxically they help create international custom and usage). Unlike domestic legislation and treaties, international custom and usage (a/k/a the 'law merchant') is not fixed, is not written, and is not the product of a judicial or legislative process of debate over different parties' concerns and interests.

Substantively, arbitral decisions reflect the economic interests of businesses. Arbitrators do not explicitly incorporate any other interests, such as environmental, social, or political concerns. Yet through its incorporation into the Nafta regime, arbitration will continue to become, substantively, one of the leading legal mechanisms governing international commercial disputes. Should this occur, those whose interests are not represented are even less likely to support global institutions and less likely to see international law as a positive tool for resolving problems. In the end, disaffected groups will support policies that challenge or obstruct efforts to integrate national economies into global trading regimes.

Nafta's critics charge that international corporations are "on the offensive" and are deliberately using Nafta to promote their own commercial interests, which the critics characterize as inconsistent with environmental and health regulations. But without the hazardous waste disposal facility that Metalclad developed there, the toxic residue from the industrial development in San Luis Potosi would go where it has always gone: onto the land and into the water. Was the facility located in an ideal spot? Probably not, but isn't some treatment of hazardous wastes better than none? There aren't any easy answers when it comes to weighing environmental risks, but one thing is certain: arbitral tribunals are not designed to be forums for balancing competing social, economic, environmental, and political concerns.

The treaty language in Nafta is like an embedded computer virus, stealthily weakening the sovereign state while at the same time acting like yeast, fermenting a robust increase in international trade. Whether one believes global trade is a villain or a savior, Nafta's provisions concerning dispute resolution between corporations and countries raise important issues about the international legal norms citizens want governing transnational corporate behavior. Thanks to Nafta, corporations now share governance of their own disputes—via arbitration—with their former masters, the "sovereign" states. If that was *not* the plan, we had better come up with a new global governance regime.

Background Data File

NAFTA Dispute resolution: Secret Corporate Weapon?

WHAT IS NAFTA?

Nafta is a treaty between the United States, Canada, and Mexico designed to promote economic growth through increased trade and investment. Signed in late 1992, the treaty became effective in January, 1994, and was intended to stimulate a process of gradual and comprehensive elimination of trade barriers between the member countries. Nafta calls for: (1) the full, phased elimination of import tariffs; (2) the elimination or fullest possible reduction of non-tariff trade barriers, such as import quotas, licenses, and technical trade barriers; and (3) the establishment of clear, binding protection for intellectual property rights. Additionally, Nafta calls for the implementation of fair and expeditious dispute settlement procedures, and various other measures to improve and expand the flow of goods, services, and investment between the United States, Canada and Mexico.

To stimulate and support further economic growth, the treaty envisions the fair and equal treatment of all qualified investors and investments within its trading sphere ("qualified" in the sense that either the investor or the goods themselves meet treaty criteria for "national" origin.[4]) Nafta uses the concepts of National Treatment and Most-Favored-Nation Treatment, which were previously established in the Global Agreement on Tariffs and Trade (GATT), as the means for assuring this level playing field.

Nafta governs disputes arising between the United States, Mexico and Canada, and it may govern the resolution of disputes arising between private parties doing business within the Free Trade Area, depending on their contractual provisions. Finally, and most significantly, it governs the resolution of disputes arising between the U.S., Mexico and Canada and private parties doing business in the Free Trade Area who believe they have been harmed by the actions of one of these three states.

Nafta provides three different dispute resolution mechanisms, depending on who the disputing parties are. Chapter 20 addresses state-to-state disputes, while Chapter 19 addresses disputes alleging dumping or countervailing duties (generally brought by a government on behalf of a private party). Chapter 11 governs disputes arising when private parties claim harm due to governmental action (or inaction) that violates the provisions of Nafta.

Disputes over the implementation of National Treatment and Most-Favored-Nation Treatment are governed by Nafta's Chapter 11, which prescribes arbitration as the means for resolving those disputes. In Section B, "Settlement of Disputes Between A Party and an Investor of Another Party,"[5] the treaty explicitly accords investors the right to submit disputes with a treaty Party to arbitration. Article 1116 addresses claims by investors "on their own behalf," while Article 1117 concerns claims by an investor "on behalf of an enterprise."

CHAPTER 11'S IMPACT ON FINANCIAL SERVICES INDUSTRY

All of Nafta's provisions, including Chapter 11, apply to financial services providers and investors in banking, insurance, and other financial services. However, the liability of the U.S., Canada, and Mexico to investors' demands for National Treatment and Most-Favored-Nation Treatment (on issues like market access, cross-border trade, and transparency of regulatory actions) is subject to exceptions carved out in Article 1410 and a separate, state-to-state dispute resolution process mandated in Chapter 20.

These Article 1410 exceptions mean that the Nafta countries may prevent or limit transfers by financial institutions or cross-border financial services providers through the "equitable, non-discriminatory and good faith application of measures relating to maintenance of the safety, soundness, integrity or financial responsibility" of those institutions or providers.

When an investor submits a claim for arbitration under Chapter 11 and the disputing party invokes Article 1410 as its defense, the arbitral tribunal hearing the claim must refer the matter to a financial services committee, comprised of representatives of each country's authority responsible for financial services. (For the U.S., this is the Department of the Treasury for banking and other financial services, and the Department of Commerce for insurance services; for Mexico this is the Secretaria de Hacienda y Credito Publico; for Canada, the Department of Finance of Canada.)

Once a matter is referred to the financial services committee, the arbitral tribunal that was convened under Chapter 11 cannot proceed until it receives a decision or a report from the committee. The committee decides whether the Article 1410 defense is valid or not, and if it is deemed valid, the investor's claim is defeated. If the defense is denied, the arbitral tribunal can proceed to decide the case. The committee's decision is binding on the tribunal and there is no provision for appeal. This ability to bypass the Chapter 11 dispute resolution provisions may fairly be described as a last gasp of traditional sovereignty; a treaty-based "backstop" to what used to be considered, in essence, absolute rights.

WHY IS ACCESS TO INTERNATIONAL ARBITRATION SO IMPORTANT?

By mandating an arbitration-based dispute resolution system and giving private parties essentially free access to it, Nafta has caused serious structural damage to the traditional state-based system of international legal standing and legal personality for non-state actors. Because arbitration has traditionally been used in dispute resolution between states and private parties when they have a contractual relationship, (for example, under the terms of Bilateral Investment Treaties), this aspect of Nafta went largely unquestioned in the otherwise robust debate over the treaty. Also generally unexamined (in the rush to enshrine arbitration as a better dispute resolution mechanism than traditional litigation) have been the implications of the use of arbitration generally on the development of international law.

Businesses like arbitration because it is perceived to be less time consuming and, therefore, less expensive than traditional litigation. It is done privately, with fewer legal formalities, and little or no publicity. Under Nafta, for example, the parties to a dispute can choose not to make the dispute public. Parties seeking to arbitrate their disputes usually agree to submit their cases to an established arbitration regime, such as the one administered by the International Chamber of Commerce (ICC). Whatever regime they choose, the parties are bound to follow its rules regarding appeals, which are generally quite limited.

There is no jury in an arbitration, so no chance for unexpected jury awards. And the arbitrators are chosen by the parties, often specifically for their expertise and, in the case of international disputes, their nationality. International arbitration is seen as a way to avoid litigating in an inconvenient, possibly hostile judicial forum, and as a way to maximize control over the dispute resolution process.

Arbitral tribunals are NOT courts, and one of their most interesting features is that the parties to the dispute decide who will hear their claims and which laws will govern its resolution. It is not widely known that those 'laws' may be no more than what the arbitrators believe to be the prevailing international custom in the industry, since the arbitrators may be empowered to decide a case on the basis of *Lex Mercatoria*, also known interchangeably as "the law merchant," "international custom and usage" and "internationally accepted principles of law."

Even more interesting, no matter what substantive or procedural law they apply to a case, arbitrators are not bound by past decisions or precedent—indeed, due to the confidentiality of arbitration, they may even be unaware of prior decisions relating to the same issues. If the arbitrators use *Lex Mercatoria* as their substantive law, this in and of itself implies reliance on past practice, which it might be argued is a sort of precedent. However, reliance on "international custom and usage" is by definition *ad hoc* and not bound—in a legal sense—by precedent.

THE TREATY LANGUAGE ITSELF

Section B of Chapter 11 is entitled "Settlement of Disputes Between a Party and an Investor of Another Party." This part details the steps that an aggrieved investor must take to press its claim. The section first prescribes arbitration as the proper dispute resolution mechanism, justifying this choice as "assur[ing] both equal treatment among investors of the Parties in accordance with the principle of international reciprocity and due process before an impartial tribunal."[6]

Next, the treaty specifies who may submit claims for arbitration and under what circumstances. In articles 1116(1) and 1117(1), the treaty gives qualified investors and investments of the U.S., Canada and Mexico the right to arbitrate disputes over the implementation of their "rights" to National Treatment and Most-Favored-Nation treatment (rights that were granted in Section A of the treaty).[7]

These two articles reference Section A of Chapter 11, where the signatory states promised to provide all investors meeting certain criteria what is called National Treatment (Article 1102) and also what is termed Most-Favored-Nation Treatment (Article 1103). In substance, National Treatment means that a Nafta government must treat products and producers from the other Nafta countries in the same way as it treats its own products and producers.[8] Most-Favored-Nation treatment means that each Nafta government must give the products and producers of other Nafta countries at least the same treatment that it gives to the products and producers of any non-Nafta country.[9]

To claim the protections of Article 1102 and 1103, private parties must meet the Nafta "national" criteria. The criteria and definitions of national origin for goods under Nafta are established in Nafta Part Two, Chapters 3 and 4.[10] These criteria involve percentages of ownership, ratios of domestic (U.S., Mexican or Canadian) to "foreign" materials in the composition of goods, and other closely-defined elements.

Article 1139 provides definitions of investor, enterprise, and investment entitled to receive National Treatment and Most-Favored-Nation treatment. For example, the definition of "investor of a Party" is "a Party or state enterprise thereof, or a national or an enterprise of such Party, that seeks to make, is making or has made an investment."

PERFORMANCE REQUIREMENTS PROHIBITED

Additionally, Nafta prohibits "performance requirements." Article 1106 reads:

"[n]o Party may impose or enforce any of the following requirements...(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..."

This means that Nafta governments—and their local governments—cannot pass laws favoring domestic goods (for example, "Made in the USA") or barring specific imports (for example, those produced with child labor).

Expropriation Compensated

Nafta's Article 1110 details the treaty provisions for what are termed expropriation and compensation. It spells out the grounds on which investors can rely to bring claims against the U.S., Canada or Mexico for compensation. Article 1110(1) reads as follows:

"No Party may directly or indirectly nationalize or expropriate an investment of an investor of another Party in its territory or take a measure tantamount to nationalization or expropriation of such an investment ("expropriation"), except: (a) for a public purpose; (b) on a non-discriminatory basis; (c) in accordance with due process of law and Article 1105(1); and (d) on payment of compensation in accordance with paragraphs 2 through 6."

Article 1110(2) defines how the compensation is to be calculated.

Note that these treaty provisions concern safeguarding the rights of one country's investors when they are in another country. Nafta does not authorize an investor to bring claims against its own government.

HOW WOULD A COMPANY ENFORCE ITS ARBITRAL AWARD?

Nafta authorizes an investor to seek enforcement of a final arbitral award in either of two ways: it can try to get its government to take up its case, or it "may seek enforcement of an arbitration award under the ICSID Convention, the New York Convention or the Inter-American Convention...,"[11] and it may seek enforcement under those conventions regardless of whether its government has gotten involved in enforcing the award.[12]

Disputing parties must abide by and comply with a final award without delay.[13] However, if a losing state has not complied voluntarily, Nafta's Article 1136 describes the procedures and mandates the time periods governing how and when a disputing party may seek enforcement of the arbitral award.

On the one hand, the investor may unilaterally decide to seek jucicial enforcement of a final award according to the terms of existing conventions concerning the recognition and enforcement of international arbitral awards.[14] On the other hand, if a disputing state fails to comply with a final award, the investor can get its own state to formally request the commission to establish a new panel under Chapter 20.[15] It is up to the investor if it wishes to pursue either or both options.

If it chose to, the investor's state would seek to have this new, Chapter 20 arbitral panel issue: (1) a determination that the losing state has violated Nafta by failing to abide by or comply with the first, Chapter 11 arbitral award; and (2) a recommendation that the losing state comply with that original award. The remedies under Chapter 20, if a losing state consistently refuses to abide by or comply with the award of a Chapter 11 arbitral panel, include suspending "benefits of equivalent effect" as between the Nafta states.

This means that the prevailing Nafta state would look at the industry in which its citizen was harmed and determine what tariff reduction or other trade liberalizing measures in that area might be rescinded as a way to counter the harm caused by the offending state (similar in concept to retorsion, discussed above.)

Enforcement of a final award will only be possible once the disputing parties have exhausted the appeals process of whichever arbitration regime they have selected for their dispute. Generally, appeal from arbitral awards is deliberately limited to protection against procedural defects in the arbitral process.[16]

Either in addition to or instead of following Nafta Chapter 20 enforcement procedures, as permitted by Article 1136(6), the investor may elect to seek enforcement of the award in its own courts. The investor would be asking the court to enforce the award against the losing state's assets in the investors own country, and the losing party would be trying to convince the court to vacate the award. The treaties governing the recognition and enforcement of international arbitral awards[17] set out the grounds on which a court may vacate an award, however the threshold question facing a court (at least in the United States) would be jurisdictional.

The New York Convention applies to those arbitral awards "made in the territory of a State other than the State where the recognition and enforcement of such awards are sought," and to awards "not considered as domestic awards in the State where their recognition and enforcement are sought."[18] Under U.S. law, if an award arises out of a dispute concerning property located abroad, or concerning parties of differing nationality, it would likely be covered by the terms of the New York Convention.[19]

The New York Convention established seven defenses to the enforcement of arbitral awards,[20] however the most likely defense for a losing Nafta state would also be the weakest one: that recognition or enforcement of the award would be contrary to public policy. It would be difficult for the Nafta states to make an argument premised on the notion that complying with an arbitral award would violate fundamental government policy when the terms of Nafta were negotiated and not imposed, when a vigorous public debate resulted in the passage of the treaty, and when complying with treaty obligations is also fundamental government policy.

If we view the economic commitments of Chapter 11 alongside the treaty's provisions giving legal standing to investors to bring claims against the Nafta governments, we see how Nafta has in fact precipitated a sea change in the balance of power between corporations and sovereign states. By empowering non-state-based entities 1) to unilaterally bring claims against the United States, Canada and Mexico, and 2) to unilaterally seek to enforce arbitral awards based on those claims in the courts of the three states, Nafta has granted enhanced international legal personality to any entity that a) meets the treaty's definition of "national," and b) believes that it has been harmed by a breach of Nafta's economic provisions. Given the volatile nature of the global trading regime, and the deepening challenges to and shifting priorities of the sovereign states, there is no doubt that we will see an increase in disputes and claims under Nafta.

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1 Ambassador Charlene Barshefsky, *Symposium: The Role of Legal Institutions in the Economic Development of the Americas: Keynote Address*, 30 Law & Pol'y Int'l Bus. 1, 5 (1999).

2 The investors cannot "sue" the U.S., Canada or Mexico (i.e., file a complaint in a court of law); rather, they are empowered to submit claims against the states for resolution by arbitration according to the rules and procedures mandated by Nafta.

3 The public debate over Nafta was extensive; however, this feature of the treaty received scant treatment in the media or elsewhere. See Samrat Ganguly, *Note: The Investor-State Dispute Mechanism (ISDM) and a Sovereign's Power To Protect Public Health*, 38 Colum. J. Transnat'l L. 113, 115-116 (1999). For discussion specifically mentioning this change in legal standing (in a review of Nafta's effects after five years), see *Trade Pacts Accused of Subverting U.S. Policies; Commerce: Critics Say Agreements such as Nafta Give Foreign Interests legal Ammunition to Influence Economy As Well As Safety, Health and Other Issues*, Los Angeles Times, Feb. 29, 1999 ("Critics argue that the Chapter 11 provision invites abuse because it defines the rights of foreign investors too broadly and gives multinational firms—whose first obligation is to shareholders, not the public—a legal weapon that was historically reserved for governments.")

4 Definitions of national origin for goods under Nafta and the criteria for national treatment of third-party investors are established in Nafta Part Two, Chapters Three and Four, and Part Five, Chapter Eleven. These criteria involve percentages of ownership, ratios of domestic (U.S., Mexican or Canadian) to "foreign" materials in the composition of goods, and other closely defined elements. See discussion below.

5 The Nafta treaty uses the word "Party" for the signatories to the treaty (currently the United States, Mexico and Canada) and uses the word "investor" for economic entities doing business in the Free Trade Area.

6 See Nafta Article 1115, "Purpose."

7 The treaty language for the right to arbitrate disputes appears in Article 1116(1), which reads:
An investor of a Party [and, in article 1117, 'on behalf of an enterprise or another Party that is a juridical person that the investor owns or controls directly or indirectly'] may submit to arbitration under this Section a claim that another Party has breached an obligation under: (a) Section A [of Chapter 11] or Article 1503(2) (State Enterprises), or (b) 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, and that investor has incurred loss or damage by reason of, or arising out of, that breach.

8 The treaty language for the right to National Treatment appears in Article 1102(1), which reads:
Each Party shall accord to investors of another Party [and, in article 1101(2) 'investments of investors of another Party'] treatment no less favorable than that is accords, in like circumstances, to its own investors with

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respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.

9 The treaty language for the right to Most-Favored-Nation treatment appears in Article 1103(1), which reads:
Each Party shall accord to investors of another Party [and, in article 1103(2), 'investments of investors of another Party'] treatment no less favorable than it accords, in like circumstances, to investors of any other Party or of a non-Party with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.

10 Nafta Part Two: Trade In Goods, Chapter 3: National Treatment and Market Access for Goods; Chapter 4: Rules of Origin.

11 Nafta Article 1136(6).

12 Nafta Article 1136(6) reads:
A disputing investor may seek enforcement of an arbitration award under the ICSID Convention, the New York Convention or the Inter-American Convention regardless of whether proceedings have been taken under paragraph 5.

13 Nafta Article 1136(2) reads:
Subject to paragraph 3 and the applicable review procedure for an interim award, a disputing party shall abide by and comply with an award without delay.

14 Nafta Article 1136(3) reads:
A disputing party may not seek enforcement of a final award until: (a) in the case of a final award made under the ICSID Convention (i) 120 days have elapsed from the date the award was rendered and no disputing party has requested revision or annulment of the award, or (ii) revision or annulment proceedings have been completed; and (b) in the case of a final award under the ICSID Additional Facility Rules or the UNCITRAL Arbitration Rules (i) three months have elapsed from the date the award was rendered and no disputing party has commenced a proceeding to revise, set aside or annul the award, or (ii) a court has dismissed or allowed an application to revise, set aside or annul the award and there is no further appeal.

15 Nafta Article 1136(5) reads:
If a disputing Party fails to abide by or comply with a final award, the Commission, on delivery of a request by a Party whose investor was a party to the arbitration shall establish a panel under Article 2008 (Request for an Arbitral Panel). The requesting Party may seek in such proceedings: (a) a determination that the failure to abide by or comply with the final award is inconsistent with the obligations of the Agreement; and (b) a recommendation that the Party abide by or comply with the final award.

16 David W. Rivkin, *International Arbitration*, in Commercial Arbitration for the 1990s, 123-37 (Richard J. Medalie, ed. 1991).

17 See, e.g., United Nations Convention on the Recognition an Enforcement of Foreign Arbitral Awards (the New York Convention) June 10, 1958, 21 U.S. T. 2517, 330 U.N.T.S.38, codified at 9 U.S.C.§§201-208 (1988); The Convention on the Settlement of Investment Disputes Between States and Nationals of Other States, March 18, 1965, 17 U.S.T. 1270, T.I.A.S No. 6090, 575 U.N.T.S 159, 4 I.L.M 532 (1965) (which created the International Centre for the Settlement of Investment Disputes (ICSID) as a mechanism for the binding resolution of differences between states and foreign nationals; and the Inter-American Convention on International Commercial Arbitration, Jan. 30, 1975, 104 Stat.449, Pan-Am. T.S. 42, codified at 9 U.S.C.§§301-307 (Supp. V 1993).

18 New York Convention, supra note 16, art.1(1).

19 The Federal Arbitration Act, 9 U.S.C.A. 1-16 *et seq.*(1998) (FAA) governs arbitration agreements involving foreign commerce. In §202, Congress attempted to clarify which types of arbitral awards would be covered by the New York Convention, stating in part:
An agreement or award arising out of such a [commercial] relationship which is entirely between citizens of the United States shall be deemed not to fall under the Convention unless that relationship involves property located abroad, envisages some performance...abroad, or has some other reasonable relation with one or more foreign states.
See Lucille M. Ponte, Erika M. Brown, *Resolving Information Technology Disputes After Nafta: A Practical Comparison of Domestic and International Arbitration,* 7 Tul. J. Int'l & Comp. L. 43, text at note 100 (1999).

20 The seven defenses to enforcement under the New York Convention are: proof that (1) either under the law chosen by or applicable to the parties, they were incapable or the agreement is not valid; (2) the defendant was not given proper notice of the arbitration; (3) the award is beyond the scope of the arbitral panel; (4) the arbitral panel was not properly composed; (5) the award is not yet binding on the parties or has been set aside or suspended; (6) the dispute's subject matter is not capable of settlement by arbitration under the laws of the country where the plaintiff is seeking enforcement; or (7) the award's recognition or enforcement would be contrary to public policy. The New York Convention , Article V.