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Articles

***Metalclad v. United Mexican States* Revisited: Judicial Oversight of NAFTA's Chapter Eleven Investor-State Claim Process**

Chris Tollefson*

This is a groundbreaking decision in international law that will be cited frequently as it is the first case ever, to our knowledge, where a host state has been found to breach its duty of 'fair and equitable' treatment.

Dr. Jack J. Coe Jr., co-counsel for Metalclad, on the arbitral award¹

This case highlights how an international trade agreement like NAFTA threatens democracy.

Judy Darcy, President of the Canadian Union of Public Employees (CUPE) on the eve of CUPE's application to intervene in the judicial review of the arbitral award²

INTRODUCTION

No arbitral decision under the North American Free Trade Agreement (NAFTA), indeed few arbitral decisions of any kind,

* Faculty of Law, University of Victoria. I am grateful for the research assistance provided by Peter McPherson (UVic Law, 2001) during the summer of 2001, and for the editorial assistance of Susen Johnson (UVic Law, class of 2005) as this article proceeded through the publication process. I am also grateful to Cecil Branson Q.C. for his insightful comments on an earlier version of this paper.

1. Petitioner's Reply ¶ 72 at 20, *United Mexican States v. Metalclad Corp.*, [2001] 89 B.C.L.R.3d 359 (Can.) (No. L002904).

2. Ian A. Laird, *NAFTA Chapter 11 Meets Chicken Little*, 2 CHI. J. INT'L L. 223, 223 (2001).

have garnered attention rivaling that rendered in the matter of *Metalclad Corporation v. United Mexican States*.³ The NAFTA tribunal's ("the Tribunal") decision in this case marks the first time that an investor has successfully sued a host state under the controversial investor-state claim procedures contained in Chapter Eleven of the NAFTA. But the political salience and legal significance of the decision go much further.

The decision arose out of a dispute between Metalclad, an American-based corporation, and the Mexican municipality of Guadalcazar ("Municipality") over issuing a permit for a hazardous waste treatment facility.⁴ Although Metalclad had secured state and federal approval to operate the facility, the Municipality steadfastly refused to issue a building permit for the facility, citing environmental concerns and community opposition.⁵ Ultimately, Metalclad sued the State of Mexico under the investor-state claim provisions of Chapter Eleven of NAFTA and was awarded compensation in the amount of \$16.685 million.⁶

The Tribunal's ruling was greeted with a flurry of media attention and political commentary, most of it negative and depicting the outcome as a foreboding illustration of the implications of free trade and globalization for local governance and environmental regulation.⁷ Critics invoked the decision as evidence that NAFTA, and in particular Chapter Eleven, represented the triumph of international trade law over domestic law.⁸ The case, it was said, revealed the Chapter's potential as an "offensive strategic tool" in the hands of foreign investors;⁹ allowing them privileged access to and influence within the domestic policy making sphere, and creating formidable new constraints on the ability of governments to balance public and private interests.¹⁰ These impacts, it was predicted, would be most

3. Award, Case No. ARB(AF)/97/1 (Aug. 30, 2000), 16 ICSID REV-FOREIGN INV. L.J. 168 (2001), available at <http://www.naftaclaims.com> [hereinafter Award].

4. *Id.* ¶ 2 at 171-72.

5. *Id.* ¶ 78-79 at 190, ¶ 92 at 193.

6. See generally Lucien J. Dhooge, *The North American Free Trade Agreement and the Environment: The Lessons of Metalclad Corporation v. United Mexican States*, 10 MINN. J. GLOBAL TRADE 209, 214-59 (2001) (explaining the historical background to the litigation).

7. *Id.* at 213.

8. Danielle Knight, *Mexico Ordered To Pay U.S. Company \$17 Million*, INTER PRESS SERV. (August 31, 2001), available at <http://www.igc.org/globalpolicy/socecon/enbronmt/nafta.htm>, cited in Dhooge, *supra* note 6, at 274.

9. *Id.*

10. HOWARD MANN & KONRAD VON MOLTKE, *NAFTA'S CHAPTER 11 AND THE ENVIRONMENT: ADDRESSING THE IMPACTS OF THE INVESTOR-STATE PROCESS ON THE*

profound in the realms of environmental protection and public health, where governments at all levels would be deterred from taking decisive and precautionary steps to protect the public interest.¹¹ The ruling was also characterized as a direct attack on the right of municipal governments to make decisions on development proposals that conflicted with local priorities and concerns.¹²

Unified by their opposition to the Tribunal's decision, a broad coalition of civil society organizations and local governments mobilized.¹³ They demanded that Chapter Eleven be renegotiated or, at the very least, clarified to recognize the right of governments to regulate in the public interest and to ensure greater public participation and transparency in the arbitral process.¹⁴

The decision also provoked considerable attention from legal commentators.¹⁵ In holding for Metalclad, the Tribunal broke controversial new ground in two key respects. First, it interpreted Article 1105 to impose a new duty on NAFTA host governments to ensure that all internal public decision-making processes that may affect foreign investors are fully transparent and certain.¹⁶ Second, it adopted a definition of compensable taking for the purposes of Article 1110 that is much broader than most observers believe prevails under customary international law,¹⁷ and in a manner with which Canada and Mexico have expressed strong disagreement.¹⁸

For these reasons, Mexico's attempt to have the decision judicially set aside was followed with much anticipation and interest. The application was filed in the British Columbia (B.C.) Supreme Court, the jurisdiction where the arbitration was

ENVIRONMENT 15 (Int'l Inst. For Sustainable Dev., Working Paper, 1999), at <http://www.iisd.iisd.ca/trade/chapter11.htm>.

11. Dhooge, *supra* note 6, at 273-74.

12. *Id.* at 277-78.

13. For example, the Council of Canadians, Public Citizen, Greenpeace, the Sierra Club of Canada and the World Wildlife Fund. See sources cited in Dhooge, *supra* note 6, at 213 n.31, 214 nn.34-35, 276 n.512, 277 n.520, & 282 n.555.

14. *Id.*

15. See, e.g., Dhooge, *supra* note 6, at 209; Ian Jack, *Mexico First Partner to Lose NAFTA Case*, FIN. POST, Sept. 1, 2000, at http://www.google.com/search?q=cache:205...tl_mexico.html.

16. Award, *supra* note 3, ¶ 76 at 190.

17. *Id.* at ¶¶ 102-112 at 195-96.

18. See Respondent's Outline of Argument at 2, *United Mexican States v. Metalclad Corp.*, [2001] 89 B.C.L.R.3d 359 (Can.) (No. L002904); Petitioner's Outline of Argument at 3, *United Mexican States v. Metalclad Corp.*, [2001] 89 B.C.L.R.3d 359 (Can.) (No. L002904).

deemed to have taken place under the applicable arbitral rules.¹⁹ Given the public interest in this first judicial review of a Chapter 11 tribunal decision, Mr. Justice Tysoe gave permission for the proceeding to be broadcast live on the Internet, a first for media-shy Canadian courts. He also granted intervenor status to the Governments of Canada and the Province of Quebec, while rejecting a similar application brought on behalf of a national Canadian public sector union.²⁰

Justice Tysoe's decision, rendered May 2, 2001, allowed both Mexico and Metalclad to claim a significant measure of success.²¹ On the one hand, his decision unequivocally overruled the Tribunal's conclusion that Mexico was under a duty of transparency under Article 1105 of NAFTA.²² At the same time, however, he was not prepared to disturb what he termed the Tribunal's "exceedingly broad" definition of expropriation for the purposes of Article 1110.²³

Shortly after Justice Tysoe's decision was rendered, with public scrutiny and debate over Chapter Eleven continuing to mount, the NAFTA Free Trade Commission took the unprecedented step of issuing a joint interpretive statement aimed at clarifying key aspects of the process for the purposes of future arbitrations.²⁴ This statement effectively endorsed two key aspects of Justice Tysoe's ruling with respect to the ambit of Article 1105.²⁵ It also committed the NAFTA Parties to taking greater steps to share documents filed in connection with Chapter Eleven proceedings with members of the public and other levels of government, in the hope that, as the U.S. Trade Representative put it, "sunshine [will] overcome some of [the] fears and concerns" created by the procedure.²⁶

19. United Mexican States v. Metalclad Corp., [2001] 89 B.C.L.R.3d 359 (Can.).

20. Petitioner's Reply ¶ 39 at 11, United Mexican States v. Metalclad Corp., [2001] 89 B.C.L.R.3d 359 (Can.) (No. L002904).

21. *Metalclad*, 89 B.C.L.R.3d at 359.

22. *Id.* at 380.

23. *Id.* at 382-83.

24. NAFTA Free Trade Commission, Notes of Interpretation of Certain Chapter 11 Provisions (July 31, 2001), available at <http://www.dfait-maeci.gc.ca/tna-nafta/NAFTA-Interpr-e.asp>, [hereinafter Interpretive Statement].

25. The statement, discussed *infra* pp. 130-31, supports Justice Tysoe's ruling in two respects. First, it confirms that Article 1105(1) does not "require treatment in addition to, or beyond that which is required by the customary international law minimum standard of treatment." Interpretive Statement, *supra* note 24, at § B(2). Secondly, it confirms that "a breach of another provision of the NAFTA, or of a separate international agreement, does not establish that there has been a breach of Article 1105(1)." *Id.* at § B(3).

26. Jeff Sallot & Heather Scofield, *Agreement Means More Open NAFTA*,

Using Justice Tysoe's judgment as a point of departure to reflect on the interpretive future of Chapter Eleven, this article is divided into six parts. Part I discusses the complex factual and legal history of the dispute leading up to Mexico's application to have the Tribunal's decision set aside in the B.C. Supreme Court. Part II considers the nature and basis of judicial jurisdiction to review awards under Chapter Eleven. Part III examines what standard of review courts should apply to petitions of this kind. Part IV considers the scope and meaning of international minimum standards of treatment, a key basis on which the Tribunal held that Mexico was liable for having breached its obligations under Chapter Eleven. Part V considers the other basis upon which the Tribunal held Mexico liable under Chapter Eleven: its controversial and uncertain provisions relating to expropriation. The article concludes in Part VI with some observations on the rationale and implications of the approach adopted by Justice Tysoe in reviewing the Tribunal's award, giving particular attention to the questions his judgment does not resolve; questions that will undoubtedly preoccupy tribunals and courts called upon to adjudicate future claims emerging from this unique, high profile, international dispute resolution procedure.

I. FACTS AND LEGAL PROCEEDINGS

A. THE FACTS

The dispute in this case centered on a proposal to build a hazardous waste disposal landfill in La Pedrera, a remote community located within the municipality of Guadalcazar, in the State of San Luis Potosi (SLP).²⁷ The landfill operation was owned at all relevant times by Confinamiento Tecnico de Residuos Industriales, S.A. de C.V. (COTERIN), a company incorporated under the laws of Mexico.²⁸

The Municipality is located in a sparsely populated, highly impoverished region of Central Mexico. Its climate is hot and arid, the flora and fauna characteristic of a desert.²⁹ There is little commercial activity; local inhabitants subsist through

GLOBE AND MAIL, Aug. 1, 2001, at B1-2.

27. Award, *supra* note 3, ¶ 28 at 179.

28. Petitioner's Outline of Argument ¶ 8 at 2, *Metalclad* (No. L002904).

29. *Id.* ¶ 323 at 101.

ranching and small scale, communal agricultural production.³⁰ Much of the Municipality lacks running water.³¹ Since the Municipality has no taxing authority and is wholly reliant on state and federal appropriations, there are virtually no public services.³² The Municipal government's only phone-line is shared with a public payphone; it has one station wagon, a jail and two peace officers.³³

1. COTERIN's Attempts to Secure a Landfill Permit

In 1990, COTERIN received federal approval to open a hazardous waste transfer station in La Pedrera.³⁴ It soon came to light that COTERIN, rather than storing and transferring the waste as it was authorized to do, was disposing of untreated waste onsite. The illegal dumping of approximately 20,000 tons of such waste³⁵ provoked vociferous local opposition and led to complaints to the National Human Rights Commission and numerous federal investigations.³⁶ In September 1991, after eleven months of illegal dumping, the federal government ordered the Transfer Station to be closed and sealed the entrance to the site.³⁷

In 1991, and again in 1992, the Municipality turned down applications by COTERIN to expand its La Pedrera operation by constructing a hazardous waste landfill ("Landfill") citing community opposition and the company's failure to remedy existing on-site contamination.³⁸ Despite these refusals, COTERIN continued to pursue its plans to build the Landfill.³⁹ In 1993, it received environmental impact authorization and later a landfill-operating permit from SEMARNAP (the federal secretariat for environmental and natural resources)⁴⁰ as well as a state land

30. *Id.* Ranching and farming activities are carried out by members of *ejidos*, a form of communal land-holding established following the Mexican Revolution of 1910. *Id.*

31. *Id.* ¶ 324 at 101.

32. *Id.* ¶ 326 at 102.

33. *Id.* ¶ 324 at 101, ¶ 327 at 102.

34. Award, *supra* note 3, ¶ 28 at 179.

35. It is alleged that the quantity of waste involved exceeded that spilled in the famous Love Canal case. Petitioner's Outline of Argument ¶ 331 at 103, *Metalclad* (No. L002904).

36. *Id.*

37. *Id.* ¶ 332 at 103.

38. *Id.* ¶ 13 at 3, ¶ 22 at 4.

39. *Id.* ¶¶ 16-20 at 4.

40. Petitioner's Outline of Argument ¶ 12 at 3, *Metalclad* (No. L002904). It ob-

use permit.⁴¹

While COTERIN was in the process of securing these state and federal permits, it was also negotiating an option agreement with Metalclad Corporation ("Metalclad").⁴² Under this agreement, concluded in April 1993, Metalclad gained the right to purchase COTERIN.⁴³ The agreement was conditioned on COTERIN securing a Municipal construction permit for the Landfill or, alternatively, obtaining a definitive judgment from the Mexican courts that such permit was not legally required.⁴⁴ In September 1993, Metalclad exercised its option and completed its purchase, without either of these conditions being met, in reliance on assurances from the federal government that all necessary permits were issued or would be forthcoming.⁴⁵

Construction of the Landfill commenced in April 1994. In October 1994, the Municipality ordered construction activity to be halted on the ground that COTERIN did not have a municipal construction permit.⁴⁶ COTERIN immediately re-applied for a municipal construction permit and carried on with construction, which it completed in March 1995.⁴⁷ When COTERIN tried to "inaugurate" the Landfill later that month, demonstrators blocked the entrance, dispersing several hours later.⁴⁸

Meanwhile, Metalclad was in negotiations with SEMARNAP and, in November 1995, entered into an agreement (the "Convenio").⁴⁹ The Convenio authorized Metalclad to operate the Landfill for five years and required the company to perform site remediation work during the first three years of operation.⁵⁰ It also required Metalclad to pay the Municipality two pesos for every ton of hazardous waste received, and to employ local residents to perform manual labor at the site.⁵¹ Neither

tained these in January 1993 and August 1993 respectively from the National Institute of Ecology (INE) an agency of the federal Secretariat of the Environment, Natural Resources and Fishing (SEMARNAP). *Id.* The State of San Luis Potosi granted a land use permit in May 1993. *Id.*

41. *Id.*

42. *Id.* ¶ 14 at 3.

43. *Id.* ¶ 15 at 3.

44. *Id.*

45. *Id.*

46. Petitioner's Outline of Argument ¶ 18 at 4, *Metalclad* (No. L002904).

47. *Id.* ¶¶ 19-20 at 4.

48. Award, *supra* note 3, ¶ 46 at 182; Petitioner's Outline of Argument ¶ 21 at 4, *Metalclad* (No. L002904).

49. Award, *supra* note 3, ¶ 47 at 182.

50. *Id.* ¶ 48 at 182.

51. *Id.* ¶ 49 at 182. The other terms contained in the Convenio included the designation of thirty-four hectares of the site as a buffer zone for the conservation of

the Municipality nor the State government were involved in negotiating the Convenio.⁵²

In December 1995, at a public meeting to which Metalclad was not invited, the Municipality again rejected COTERIN's application for a construction permit.⁵³ It cited various reasons for this decision including COTERIN's decision to proceed with construction without a permit, its failure to remedy contamination caused by operation of the Transfer Station, community opposition and the adverse environmental impacts associated with operation of the Landfill.⁵⁴

2. Commencement of Legal Proceedings

Shortly after making this decision, the Municipality also filed an administrative complaint with SEMARNAP challenging the Convenio.⁵⁵ When this was dismissed, it filed a writ of *amparo* in federal court challenging SEMARNAP's dismissal of its complaint and seeking an interim injunction on the receipt of new hazardous waste.⁵⁶ In early 1996, the court granted the injunction.⁵⁷

In May 1996, Metalclad commenced an *amparo* action of its own challenging the Municipality's refusal to reconsider its application for a construction permit.⁵⁸ When this *amparo* application was dismissed on jurisdictional grounds, Metalclad filed an appeal that it soon abandoned in favor of direct negotiations with the Municipality.⁵⁹

In October 1996, Metalclad delivered a Notice of Intent to

endemic species and the requirement of the company to consult with government authorities on the remediation of hazardous waste sites. It also required that the company process hazardous waste generated in the State of San Luis Potosi at a 10% discount, provide free medical advice to residents of the Municipality one day per week as well as provide two publicly-accessible courses annually regarding the management of hazardous waste. Petitioner's Outline of Argument ¶ 30 at 6-7, *Metalclad* (No. L002904).

52. Award, *supra* note 3, ¶ 31 at 7.

53. *Id.* ¶ 54-55 at 189, ¶ 91 at 193.

54. *Id.* ¶ 50 at 183; Petitioner's Outline of Argument ¶ 22 at 4-5, *Metalclad* (No. L002904).

55. Award, *supra* note 3, ¶ 55 at 184; *see also* Petitioner's Outline of Argument ¶ 32 at 7, *Metalclad* (No. L002904).

56. Petitioner's Outline of Argument ¶ 34 at 7, *Metalclad* (No. L002904); *see also* Award, *supra* note 3, ¶ 56 at 184.

57. Petitioner's Outline of Argument ¶ 35 at 7, *Metalclad* (No. L002904).

58. *Id.* ¶ 401 at 123.

59. *Id.* ¶ 23 at 5.

Submit a Claim to Arbitration under Article 1119 of NAFTA.⁶⁰ Arbitral proceedings against Mexico were formally commenced in January 1997.

In September 1997, while the arbitration was underway, the Governor of SLP issued an ecological decree ("Ecological Decree"). The Ecological Decree covered 188,758 hectares and encompassed the 814 hectares covered by the Landfill site.⁶¹ An express purpose of the Ecological Decree was to protect endangered cacti species, which studies suggested were found in world-high concentrations within the Municipality.⁶² The Ecological Decree preserved existing permits or authorizations granted prior to its enactment, and it permitted the establishment of new businesses so long as the sustainability of natural resources was ensured and there was compliance with all other applicable laws and regulations.⁶³ Nonetheless, the Tribunal found that the "ecological decree had the effect of barring forever the operation of the landfill."⁶⁴

B. ARBITRAL PROCEEDINGS AND THE AWARD

1. *Convening the Tribunal*

Article 1120 of NAFTA provides that investor claimants may seek relief under one of three sets of arbitral rules: (1) the International Centre for the Settlement of Investment Disputes (ICSID) Rules; (2) the ICSID Additional Facility Rules; or (3) the United Nations Centre for International Trade Law Rules ("UNCITRAL Rules").⁶⁵ Metalclad elected to proceed under the ICSID Additional Facility Rules, whereupon a tribunal ("Tribunal") was convened to hear its claims.⁶⁶ It consisted of former U.S. Attorney General Benjamin R. Civiletti, Jose Luis Siqueiros, a Mexican international law jurist, and Chairman Elihu Lauterpacht, an English international law professor.⁶⁷

60. *Id.* ¶ 49 at 12; *see also* Award, *supra* note 3, ¶ 7 at 173.

61. Petitioner's Outline of Argument ¶ 434 at 132, *Metalclad* (No. L002904).

62. *Id.* ¶ 430 at 131.

63. *Id.* ¶¶ 431 & 433 at 132.

64. Award, *supra* note 3, ¶ 109 at 196.

65. North American Free Trade Agreement, Dec. 17, 1992, U.S.-Can.-Mex., art. 1120, 32 I.L.M. 296, 643 (1993) [hereinafter NAFTA]; *see also* Petitioner's Outline of Argument ¶ 110 at 30, *Metalclad* (No. L002904).

66. Award, *supra* note 3, ¶ 8 at 173; *see also* Petitioner's Outline of Argument ¶ 111 at 30, *Metalclad* (No. L002904).

67. Respondent's Outline of Argument ¶ 22 at 6, *Metalclad* (No. L002904).

The Tribunal designated the City of Vancouver, British Columbia, as the site of the arbitration.⁶⁸

Metalclad alleged six separate NAFTA Chapter Eleven violations.⁶⁹ Of these, its key claims were that Mexico had violated its obligation to accord Metalclad “treatment in accordance with international law, including fair and equitable treatment and full protection and security” under Article 1105 and that Mexico had expropriated its investments contrary to Article 1110.⁷⁰

2. *The Tribunal’s Ruling*

On August 25, 2000, after receiving submissions from the Parties as well as from the Governments of Canada and the United States, the Tribunal issued its ruling.⁷¹ As a threshold issue, the Tribunal decided that Mexico was internationally responsible for the actions of its state and local governments. This conclusion, it held, was consistent with language elsewhere in NAFTA⁷², with customary international law,⁷³ and had, in any event, been conceded by Mexico in pre-hearing submissions.⁷⁴

The Tribunal then considered Metalclad’s allegation that Mexico had violated Article 1105.⁷⁵ In defining the scope and

68. Award, *supra* note 3, ¶ 11 at 174.

69. In addition to its claims under Articles 1105 and 1110 that are discussed *infra* Part I(B)(2), Metalclad contended that Mexico had failed to accord it “national treatment” under Article 1102 due to the Municipality’s selective and discriminatory imposition of a construction permitting requirement; that the imposition of license, permit, testing and study requirements violated Mexico’s obligations under Articles 1103 and 1104 (most favored nation treatment); and that Mexico had imposed performance obligations in violation of Article 1106 by requiring Metalclad to provide safety manuals, design specifications and other information in connection with the permitting process and by soliciting various social service commitments (such as free medical care, potable water and education funding) in return for allowing the project to proceed. For a detailed discussion see Dhooge, *supra* note 6, at 242-47.

70. Award, *supra* note 3, ¶ 72 at 189.

71. *Id.* at 168.

72. NAFTA, *supra* note 65, art. 201(2), 32 I.L.M. at 289, art. 1105, 32 I.L.M. at 639.

73. See, for instance, Article 10 of the draft articles on state responsibility adopted by the International Law Commission of the U.N. in 1975, *cited in* Award, *supra* note 3, ¶ 70 at 188).

74. In its post-hearing submissions, Mexico stated that it does not “plead that the acts of the Municipality were not covered by NAFTA. [Mexico] was, and remains, prepared to proceed on the assumption that the normal rule of state responsibility applies; that is, that the Respondent can be internationally responsible for the acts of state organs at all three levels of government.” Award, *supra* note 3, ¶ 73 at 189.

75. *Id.* ¶ 74 at 190.

nature of Mexico's obligations under Article 1105, it emphasized that an "underlying objective of NAFTA is to promote and increase cross-border investment opportunities and to ensure the successful implementation of investment initiatives."⁷⁶ Drawing on NAFTA's preamble and the language in Chapter Eighteen, the Tribunal concluded that NAFTA imposed broad "transparency obligations" on the Parties to ensure that all legal requirements applicable to investments made under the Agreement are "capable of being readily known to all affected investors."⁷⁷ According to the Tribunal, if a Party is aware of the possibility of misunderstanding or confusion with respect to the nature of these requirements, it is obliged to ensure that the requirements are promptly determined and clarified for the investor's benefit.⁷⁸ In the Tribunal's view, transparency obligations were a core component of the duty to ensure that investors receive international minimum standards of treatment as guaranteed under Article 1105.⁷⁹

Applying this approach, the Tribunal held that Mexico breached its obligations under Article 1105 in two ways. The first was Mexico's acquiescence in the "improper" refusal of the Municipality to grant a construction permit for the Landfill.⁸⁰ In this regard, after considering Mexican law (and preferring the evidence of Metalclad's experts on Mexican law to those put forward by Mexico), the Tribunal held that the Municipality lacked legal authority to issue construction permits for hazardous waste landfills, a jurisdiction it held was within the exclusive purview of the federal government.⁸¹ Secondly, the Tribunal held that even if the Municipality had authority to issue such permits, it could not reject a permit application on the basis of environmental effects or impacts on surrounding communities;⁸² it could only do so based on concerns about the soundness of the proposed construction.⁸³

The Tribunal also held that the Mexican government "failed to ensure a transparent and predictable framework for Metal-

76. *Id.* ¶ 75 at 190.

77. *Id.* ¶ 76 at 190.

78. *Id.*

79. *Id.* ¶¶ 99-101 at 194.

80. Award, *supra* note 3, ¶ 86 at 192 (discussing how the Municipality's denial of the permit was "improper").

81. *Id.* ¶ 105 at 193.

82. *Id.* ¶ 106 at 195-96.

83. *Id.* ¶ 106 at 95-96, ¶ 93 at 193.

clad's business planning and investment."⁸⁴ To this end, the Tribunal relied on a variety of factors including representations made by the federal government at the time of Metalclad's initial investment that a municipal permit was unnecessary, the absence of clear rules as to whether municipal permits were required, the lack of established practices and procedures for handling municipal permits, delays associated with processing Metalclad's final permit application, the failure of the Municipality to give Metalclad notice of the meeting at which its permit application was considered, and legal actions taken by the Municipality to enjoin operation of the landfill upon its completion.⁸⁵

With respect to Article 1110, the Tribunal concluded that the same actions underpinning its opinion that Mexico breached Article 1105 led to the conclusion that Mexico also breached Article 1110.⁸⁶ The relevant language of Article 1110 provides that: "[no] party may directly or indirectly . . . expropriate an investment . . . or take a measure tantamount to . . . 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."⁸⁷ For these purposes, "measure" is broadly defined to include "any law, regulation, procedure, requirement or practice."⁸⁸

The Tribunal defined "expropriation" under Article 1110 as "not only open, deliberate and acknowledged taking of property . . . but also covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use or reasonably-to-be-expected economic benefit of property even if not necessarily to the obvious benefit of the host State."⁸⁹ It then proceeded to hold that Mexico had violated Article 1110 in two ways. The first was by "permitting or tolerating" the conduct of the Municipality in relation to Metalclad (which the Tribunal had already held—with respect to Article 1105—was unfair and inequitable treatment) and by thus participating or acquiescing in denying Metalclad the right to operate the landfill.⁹⁰ This, it held, amounted to a

84. *Id.* ¶ 9 at 173.

85. *Id.* ¶¶ 88, 90, 91, & 94 at 192-93.

86. Award, *supra* note 3, ¶ 104 at 195.

87. *Id.* ¶ 102 at 195 (quoting NAFTA, *supra* note 65, art. 1110, 32 I.L.M. at 641).

88. NAFTA, *supra* note 65, art. 201(1), 32 I.L.M. at 298.

89. Award, *supra* note 3, ¶ 103 at 195.

90. *Id.* ¶ 104 at 195.

measure “tantamount to expropriation” contrary to Article 1110.⁹¹ The Tribunal also held that Mexico had indirectly expropriated Metalclad’s investment contrary to Article 1110 due to the unlawful action of the municipality and by the absence of a timely, orderly, or substantive basis for the Municipality’s decision to deny the permit.⁹²

Finally, although it considered it “not strictly necessary” to dispose of the claim, the Tribunal identified the Ecological Decree enacted by SLP as further ground for a finding of expropriation.⁹³ In its view, this Ecological Decree had the effect of barring forever the operation of the Landfill at the site.⁹⁴ Characterizing implementation of the Ecological Decree as “an act tantamount to expropriation,” it expressly refused to consider “the motivation or intent” underlying its adoption.⁹⁵

According to the Tribunal, Mexico’s breaches of Articles 1105 and 1110 led to a common result: “the complete frustration of the operation of the landfill [negating] the possibility of any meaningful return on Metalclad’s investment.”⁹⁶ Regardless of the source of the breach, therefore, Metalclad had “completely lost” its investment.⁹⁷ The general rule regarding damages under Chapter Eleven is that an investor receives compensation based on the fair market value of the investment immediately prior to the breach.⁹⁸ In this case, however, as the Landfill was not a going concern, the Tribunal held that the measure of damages was Metalclad’s actual investment in the project.⁹⁹ Accordingly, allowing for interest on the award and deducting site remediation costs likely to be incurred by Mexico upon regaining title to the property, the Tribunal awarded Metalclad \$16.685 million.¹⁰⁰

C. JUDICIAL REVIEW

Mexico commenced an application for judicial review of the

91. *Id.*

92. *Id.* ¶ 107 at 195.

93. *Id.* ¶ 109 at 196.

94. *Id.*

95. Award, *supra* note 3, ¶ 111 at 197.

96. *Id.* ¶ 113 at 197.

97. *Id.*

98. *Id.* ¶ 118 at 198 (quoting NAFTA, *supra* note 65, art. 1110, 32 I.L.M. at 641).

99. *Id.* ¶ 122 at 199.

100. *Id.* ¶ 131 at 202.

Tribunal's decision in October 2000.¹⁰¹ Under the ICSID Additional Facility Rules, which governed the arbitration, the applicable law for purposes of this review was that of the jurisdiction in which the award was made.¹⁰² Thus, Mexico petitioned the British Columbia Supreme Court seeking an order setting aside the award of the Tribunal.¹⁰³

Mexico sought review on two principal grounds: it alleged first that the Tribunal had exceeded its jurisdiction and that it had erred in its interpretation and application of Articles 1105 and 1110.¹⁰⁴ First, it alleged that the Tribunal had exceeded its jurisdiction, *inter alia*, by (a) imposing transparency obligations that do not exist under Chapter Eleven and which were beyond the agreed scope of the arbitration; (b) applying Articles 1105 and 1110 so as to equate a violation of domestic law with a violation of international law and, in the process, improperly acting "as if it were a Mexican court of appeal;" (c) making patently unreasonable findings with regard to the relevant evidence; and (d) failing to answer all of the questions presented for its resolution, contrary to the ICSID Additional Facility Rules.¹⁰⁵

Mexico also submitted that the Tribunal had erred in law in its characterization of the transparency-related duties of a Party under Article 1105, and in its over-broad definition of "expropriation" applicable under Article 1105.¹⁰⁶

The case was argued before Mr. Justice Tysoe over the course of ten days in late February and early March 2001. His decision was rendered on May 2, 2001.¹⁰⁷ He later gave supplementary reasons for his decision on October 31, 2001.¹⁰⁸ The particulars of, and reasoning supporting, his judgment will be discussed shortly on a more detailed, thematic basis. As noted

101. Petitioner's Outline of Argument ¶ 1 at 1, *Metalclad* (No. L002904).

102. Rules Governing the Additional Facility for the Administration of Proceedings by the Secretariat of the International Centre for Settlement of Investment Disputes, ICSID Doc. 11 (June 1979), available at <http://www.worldbank.org/icsid/facility/1.htm> [hereinafter Additional Facility Rules]; see also Petitioner's Outline of Argument ¶ 2 at 1, *Metalclad* (No. L002904).

103. Petitioner's Outline of Argument ¶ 45 at 10, ¶ 592 at 181, *Metalclad* (No. L002904); *Metalclad*, 89 B.C.L.R.3d ¶ 1 at 363-64.

104. Petitioner's Outline of Argument ¶¶ 46-47 at 10-11, *Metalclad* (No. L002904).

105. *Id.*

106. *Id.* ¶ 47 at 11.

107. *Metalclad*, 89 B.C.L.R.3d at 359.

108. Supplementary Reasons for Judgment of the Honourable Mr. Justice Tysoe, *United Mexican States v. Metalclad Corp.*, [2001] B.C.S.C. 1529, available at <http://www.courts.gov.bc.ca>.

earlier, both sides were able to claim a measure of success in the result.

Mexico was vindicated insofar as the decision set aside two key legal findings made by the Tribunal: (1) that it had violated its alleged transparency obligations under Article 1105; and (2) that its actions prior to the issuance of the Ecological Decree constituted a violation of Article 1110. In particular, Justice Tysoe accepted Mexico's argument that the Tribunal had exceeded its jurisdiction in deeming transparency obligations to exist under Article 1110, and that this jurisdictional error had "infected" its analysis of the Mexico's liability under Article 1105 prior to issuance of the Ecological Decree.¹⁰⁹

Nonetheless, Justice Tysoe upheld the award to the extent that it was based on the Tribunal's conclusion that the subsequent enactment and implementation of the Ecological Decree amounted to an uncompensated expropriation contrary to Article 1105. In his view, this was a finding of law that was beyond his jurisdiction to overturn.¹¹⁰ He also rejected Mexico's arguments that the Tribunal failed to give proper consideration to Metalclad's "improper acts"¹¹¹ and that the Tribunal had failed, contrary to the ICSID Additional Facility Rules, to answer the questions it had been asked.¹¹² He ordered that Metalclad was entitled to the bulk of its original award¹¹³ and awarded it 75% of the costs of the proceeding.¹¹⁴

In the Parts that follow, Justice Tysoe's resolution of the specific issues before him are addressed as well as the implications for future judicial reviews of this kind.

109. *Metalclad*, 89 B.C.L.R.3d ¶ 78 at 381-82.

110. *Id.* ¶ 99 at 386.

111. *Id.* ¶ 118 at 390.

112. *Id.* ¶ 122 at 392, ¶ 130 at 394.

113. The difference between the Tribunal's award and the amount ordered payable by Justice Tysoe was based on a reduction for interest payable. This reduction is attributable to the difference between the Tribunal's designation of December 5, 1995 (the date when, it deemed, the first breaches of Chapter 11 occurred), and Justice Tysoe's designation of September 20, 1997 (the date on which the Ecological Decree was issued, which he held constituted Mexico's first violation of its Chapter Eleven obligations). *Id.* ¶¶ 134-135 at 395-96.

114. In Canada, the general rule with respect to costs, in contrast to American practice, is that costs "follow the event." In other words, the so-called "English rule" of costs is applied under which the successful party is entitled to recover its legal costs from its opponent based on a tariff system set out in the court rules. Where success is divided, costs are allocated on a *pro rata* basis reflecting, among other things, the degree of success enjoyed by the parties to the litigation. See M. ORKIN, *THE LAW OF COSTS* 2-62 (1994).

II. JUDICIAL REVIEW JURISDICTION WITH RESPECT TO AWARDS UNDER CHAPTER ELEVEN

A. ICSID ADDITIONAL FACULTY RULES

As noted, when Metalclad commenced its Chapter Eleven claim, it invoked the ICSID Additional Facility Rules.¹¹⁵ The ICSID Additional Facility was established by the World Bank to serve as a forum for the resolution of investor-states disputes where the host State is not a signatory to the ICSID Convention.¹¹⁶ This Convention came into force in 1966, but it is not a convention to which either Canada or Mexico have acceded.¹¹⁷

Review procedures under the Additional Facility differ substantially from those under the ICSID Convention. Under the Convention, arbitrations are subject to an internal review mechanism known as an "ad hoc annulment committee."¹¹⁸ The Convention specifically restricts Parties from seeking appeal or review of arbitral awards except by way of the annulment process, thus insulating awards from national law.¹¹⁹ In contrast, review of an award made under the Additional Facility Rules is governed by the law of the forum in which the award was made, including applicable international conventions.¹²⁰

115. Judicial jurisdiction with respect to the review of international arbitral awards can arise either on application to set aside an award (as in the present case) or on an application to enforce the award. In the latter case, judicial jurisdiction is based on the United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards ("New York Convention") of 1958. The New York Convention allows for the recognition and enforcement of a foreign award unless the respondent establishes that the arbitral process suffered from procedural or jurisdictional irregularities, and if the subject matter of the award was not arbitrary or contrary to the public policy of the enforcing country. All three NAFTA Parties are signatories to the New York Convention. The grounds upon which a court may refuse to enforce a foreign award are the same as those governing the setting aside of awards under the UNCITRAL model rules. See Cecil Branson, *Court Review of Awards in Their Country of Origin*, in COMMERCIAL MEDIATION AND ARBITRATION IN THE NAFTA COUNTRIES 190-91 (Luis Miguel Diaz & Nancy A. Oretskin eds., 1999).

116. Petitioner's Outline of Argument ¶ 111 at 30, *Metalclad* (No. L002904).

117. *Id.* ¶ 110 at 30.

118. *Id.* ¶ 112 at 30-31.

119. See *id.* ¶¶ 113-114 at 31.

120. Convention on the Settlement of the Investment Disputes Between States and Nationals of Other States, art. 52, Mar. 18, 1965, 4 I.L.M. 532, 541 (1965); See also W. MICHAEL REISMAN, SYSTEMS OF CONTROL IN INTERNATIONAL ADJUDICATION AND ARBITRATION 46-50 (1992).

B. ICAA v. CAA

Since the Tribunal determined that the place of the arbitration was Vancouver, British Columbia, Mexico's petition was governed by the applicable law of the Province of British Columbia.¹²¹ A key threshold issue for the Court was to determine under what domestic statute the review should proceed. British Columbia has enacted a statute to govern the review of international commercial arbitrations based on a model law developed by the United Nations Commission on International Trade Law (UNCITRAL).¹²² This statute is the International Commercial Arbitration Act (ICAA).¹²³ As its title suggests, the ICAA applies to "international commercial" arbitrations. Arbitrations that do not fit within its terms fall under the jurisdiction of the Commercial Arbitration Act (CAA) that governs review of most other arbitrations conducted within the province.¹²⁴

Determining which of these two statutes governed review of the Tribunal's decision was a critical issue because the standards of review contemplated by ICAA and CAA differ significantly. Mexico's position was that the CAA, which allows courts to set aside awards on broad grounds including errors of law, should apply.¹²⁵ Metalclad submitted that the court's jurisdiction flowed from the ICAA, which authorizes a much more restrictive form of review.¹²⁶

In support of its position, Mexico contended that while this was undoubtedly an "international" arbitration, the relationship between the Parties was not "commercial" as required by the

121. Petitioner's Outline of Argument ¶ 118 at 32, *Metalclad* (No. L002904).

122. *See id.* ¶ 122 at 34-35.

123. R.S.B.C., ch. 233, § 34(2)(a)(iv) [hereinafter ICAA]. The ICAA is based on the UNCITRAL Model Law of International Commercial Arbitration ("Model Law"). *Id.* The Model Law was adopted by UNCITRAL in 1985. The Model Law sets out a Code of procedural rules for international commercial arbitration. Since its inception, many jurisdictions have adopted it, either entirely or with minor changes, into their own law of international commercial arbitration. All Canadian jurisdictions have adopted the Model Law, including the Canadian federal government. Commercial Arbitration Act, S.C., ch. 22 (1986) (Can.) [hereinafter CAA]. For a comparison of British Columbia's ICAA and the Model Law see Dr. G. Herrmann, *The British Columbia Enactment of the UNCITRAL Model Law*, in UNCITRAL ARBITRATION MODEL IN CANADA 65 (R. Paterson & B. J. Thompson, eds., 1987); Bonita J. Thompson, *The Marriage of the UNCITRAL Model Arbitration Law and the UNCITRAL Arbitration Rules*, in UNCITRAL ARBITRATION MODEL IN CANADA 143 (R. Paterson & B. J. Thompson, eds., 1987).

124. *See* Petitioner's Outline of Argument ¶ 120 at 34, *Metalclad* (No. L002904).

125. *See id.* ¶¶ 127-128 at 36, ¶ 144 at 42-43.

126. Respondent's Outline of Argument ¶¶ 20-21 at 6, *Metalclad* (No. L002904).

ICAA.¹²⁷ In its submission:

[T]he relationship that Metalclad claimed existed between it and Mexico was not commercial, even by the widest definition of that term . . . [the] relationship between Metalclad and Mexico was the relationship between government and the governed, between legislator and the subject of legislation . . . Likewise, the relationship between Metalclad and Mexico arising from the provisions of NAFTA Chapter Eleven is not a commercial arbitration agreement. The NAFTA is a treaty . . .
 128

Justice Tysoe was not persuaded by these submissions. In concluding that the ICAA applied, he noted that the definition of “commercial” contained in the ICAA included a relationship of “investing.”¹²⁹ While acknowledging that the dispute between Metalclad and the Municipality had arisen “because the Municipality was purporting to exercise a regulatory function,” in his view “the primary relationship between Metalclad and Mexico was one of investing.”¹³⁰

C. APPLICABLE DOMESTIC ARBITRAL REVIEW RULES IN FUTURE CASES

Despite Justice Tysoe’s ruling, there remains considerable uncertainty as to the applicable rules with respect to setting aside Chapter Eleven awards in future cases. Arguably the only Canadian jurisdiction in which the applicable review rules are clear is at the federal level. This is because the Parliament of Canada amended the federal statute that is based on the UNCITRAL Model Law to provide expressly that Chapter Eleven arbitrations shall be considered “commercial arbitrations” and thus governed by that statute.¹³¹ As a result of this amendment, all Chapter Eleven claims to which Canada is a Party,¹³² such as the pending review of tribunal decision in *S.D. Myers, Inc. v. Government of Canada*,¹³³ or which arise in re-

127. See Petitioner’s Outline of Argument ¶ 131 at 38, ¶¶ 134-137 at 39-40, *Metalclad* (No. L002904).

128. *Id.* ¶¶ 145-146 at 43.

129. *Metalclad*, 89 B.C.L.R.3d ¶ 44 at 372-73.

130. *Id.* ¶ 46 at 373.

131. CAA ch. 17, § 5(4).

132. Respondent’s Outline of Argument ¶ 83 at 26, *Metalclad* (No. L002904) (including Chapter Eleven claims that fall within federal jurisdiction over admiralty, maritime, etc.).

133. NAFTA Arb. Trib. 2000, at <http://www.naftaclaims.com>. In February 2001, the Canadian government filed an application in the Federal Court of Canada to set aside an award made against it under Chapter Eleven arising out of a federal deci-

spect of subject matters within federal jurisdiction, are governed by Canada's version of the Model Law.

Elsewhere in Canada, however, the situation is more uncertain. Like British Columbia, Canada's other nine provinces have legislatively adopted the UNCITRAL Model Law but, as yet, have not specified that Chapter Eleven arbitrations are governed by these statutes that have adopted the Model Law.¹³⁴ Consequently, for arbitrations that are conducted in these jurisdictions, it remains open for a party to borrow Mexico's argument that Chapter Eleven reviews should be governed by domestic arbitral review statutes of general application that offer more liberal grounds for judicial review. Concern about this prospect prompted the United States Government to oppose a proposal to locate the pending Methanex arbitration (a Chapter Eleven claim commenced by a British Columbia-based company against United States) in Canada.¹³⁵ The Methanex tribunal ultimately designated Washington D.C. as the place of arbitration.¹³⁶

Uncertainties also exist with respect to the applicable rules of review when the arbitral venue is Mexico or the United States. Similar arguments to those raised in the present case can be made with respect to Chapter Eleven award review proceedings conducted in Mexico. Mexico has also adopted the UNCITRAL Model Law but has not taken legislative steps to clarify whether these provisions apply to Chapter Eleven claims.¹³⁷ With respect to judicial reviews conducted in the United States, the situation is different. Federally, the United States has not adopted the UNCITRAL Model Law, instead reviews conducted within federal jurisdiction are governed by the Federal Arbitration Act (FAA).¹³⁸ The judicial discretion to vacate an arbitral award under the FAA, and potentially under re-

sion to ban the export of PCBs generated in Canada. *Metalclad*, 89 B.C.L.R.3d ¶ 61 at 377.

134. For a list of the legislative act in each province, see Thompson, *supra* note 123, at 165.

135. *Methanex Corp. v. United States* (NAFTA Arb. Trib. 2000), at <http://www.naftaclaims.com>.

136. *Id.* at ¶ 42.

137. 4 Cód.Com, art. 1415-1463 (1996).

138. See Branson, *supra* note 115, at 208; see also Jessica L. Gelandner, *Judicial Review of International Arbitral Awards: Preserving Independence in International Commercial Arbitrations*, 80 MARQ. L. REV. 625, 627-28 (1997). Although the Model Law has not been adopted federally, it has been adopted by the states of California, Connecticut, Oregon, and Texas. PETER BINDER, INTERNATIONAL COMMERCIAL ARBITRATION IN UNCITRAL MODEL LAW JURISDICTIONS, 8-10 (2000).

lated common law principles, may be considerably broader than under Model Law-based legislation.

III. STANDARD OF REVIEW OF AWARDS UNDER CHAPTER ELEVEN

A. ICAA GROUNDS FOR SETTING AN AWARD ASIDE

A second threshold matter was the legal standard to be employed in reviewing the Tribunal's decision. Having decided that the ICCA governed this review, Justice Tysoe's next task was to consider the nature and ambit of the review contemplated under that statute.

The ICAA offered Mexico three potential grounds for having the award set aside. In this regard, the applicable provisions of the ICAA closely track the language of Article 34 of the UNCITRAL Model Law. They allow an award to be set aside on the grounds that:

- 1)[T]he award deals with a dispute not contemplated by or not falling within the terms of the submission to arbitration, or it contains decisions on matters beyond the scope of the submission to arbitration;¹³⁹
- 2)the composition of the arbitral tribunal or the arbitral procedure was not in accordance with the agreement of the parties;¹⁴⁰ or
- 3)the award is in conflict with the public policy in British Columbia.¹⁴¹

When called upon to apply provisions such as these in jurisdictions that have implemented the Model Law, courts have exercised notable restraint, showing considerable deference to legal and factual arbitral findings. The leading British Columbia decision in the area—*Quintette Coal v. Nippon Steel Corp.*¹⁴²—articulates the standard rationale for this approach:

We are advised that this is the first case under the [ICAA] in which a party to an international commercial arbitration seeks to set the award aside. It is important to parties to future such arbitrations and to the integrity of the process itself that the court express its views on the degree of deference to be accorded the decision of the arbitrators.

139. ICAA § 34(2)(a)(iv).

140. *Id.* § 34(2)(a)(v).

141. *Id.* § 34(2)(b)(ii).

142. *Quintette Coal v. Nippon Steel Corp.*, [1991] 50 B.C.L.R.2d 207 (Can.).

The reasons . . . for restraint in the exercise of judicial review are highly persuasive. The “concerns of international comity, respect for the capacities of foreign and transnational tribunals’ and sensitivity to the need of the international commercial system for predictability in the resolution of disputes” spoken of by Blackmun J. in *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth Inc.*¹⁴³ are as compelling in this jurisdiction as they are in the United States or elsewhere. It is mete, therefore, as a matter of policy, to adopt a standard that seeks to preserve the autonomy of the forum selected by the parties and to minimize judicial intervention when reviewing international commercial arbitral awards in British Columbia.¹⁴⁴

B. PRIVATE COMMERCIAL ARBITRATION V. CHAPTER 11 ARBITRATION: IMPLICATIONS FOR JUDICIAL REVIEW

Mexico argued forcefully that private commercial arbitrations and arbitrations under Chapter Eleven differ significantly in a variety of key respects and that therefore it would be a mistake to employ the same approach to judicial review in both contexts.¹⁴⁵ A compelling argument in its favor is that the investor-state claim procedure is *sui generis*, possessing many characteristics that would tend to justify a greater degree of judicial supervision than would otherwise be appropriate in the review of awards in private commercial arbitrations.¹⁴⁶ Unlike private commercial arbitrations, a claimant under Chapter Eleven is not seeking to enforce an agreement to which it is a party.¹⁴⁷ Its right to seek arbitration is entirely derivative of NAFTA, an international treaty.¹⁴⁸ The fact that an investor can seek such relief represents a significant departure from the general international law principle that only sovereign States are entitled to enforce international treaty obligations.¹⁴⁹ It also represents a departure from the private law principle that strangers to an agreement cannot invoke its arbitration process because it is

143. 473 U.S. 614, 629 (1985).

144. *Quinette Coal*, 50 B.C.L.R.2d at 217.

145. See Petitioner’s Outline of Argument ¶¶ 178-185 at 53-56, *Metalclad* (No. L002904); see also Outline of Argument of Intervenor Attorney General of Canada ¶ 30 at 12, *United Mexican States v. Metalclad Corp.*, [2001] 89 B.C.L.R.3d 359 (Can.) (No. L002904).

146. Petitioner’s Outline of Argument ¶ 179 at 54, ¶ 184 at 55-56, *Metalclad* (No. L002904); see also Outline of Argument of Intervenor Attorney General of Canada ¶¶ 5 & 7 at 3-4, *Metalclad* (No. L002904).

147. Petitioner’s Outline of Argument ¶ 8 at 4, *Metalclad* (No. L002904); see also Outline of Argument of Intervenor Attorney General of Canada ¶ 8 at 4, *Metalclad* (No. L002904).

148. Petitioner’s Outline of Argument ¶ 58 at 15, *Metalclad* (No. L002904).

149. See *id.* ¶ 72 at 19.

only the parties to the agreement who have consented to resolve their disputes in this manner.¹⁵⁰

Thus, while in private commercial arbitrations, the parties to the arbitration agreement are the same parties that ultimately appear in court on an application for review, this is not the case with arbitrations under Chapter Eleven.¹⁵¹ In the latter circumstance, the need to review the award so as to respect the autonomy of the "parties" to resolve their dispute in a preferred arbitral forum is greatly diminished.¹⁵²

There are a variety of other factors that tend to support the position adopted by Mexico that Chapter Eleven awards should be subjected to an enhanced level of judicial scrutiny. Perhaps most compelling among these is that while private commercial arbitrations deal with matters primarily of concern to the immediate private disputants, Chapter Eleven claims have a strong public character. Frequently, as in the present case and many other pending and decided Chapter Eleven disputes, the issues to be decided have broad implications for public policy affecting the ability of governments to promote sustainable development and take measures that protect public health and the environment.¹⁵³ The desirability of ensuring that trade and investment liberalization do not undermine these goals is expressly recognized throughout NAFTA.¹⁵⁴ Indeed, it is in recognition of the need to harmonize trade and environmental objectives, and to encourage public discussion and debate regarding these issues, that the procedural rules and practices governing Chapter Eleven arbitrations are increasingly departing from those that have traditionally governed private commercial arbitrations.¹⁵⁵ Thus, in recent Chapter Eleven decisions, tribunals have held that the strict principle of confidentiality that has tended to hold sway in arbitrations be-

150. *Metalclad*, 89 B.C.L.R.3d ¶ 57 at 376-77; see also Andrea K. Bjorklund, *Contract Without Privity: Sovereign Offer and Investor Acceptance*, 2 CHI. J. INT'L L. 183 (2001) (discussing lack of privity theme in private commercial law).

151. Outline of Argument of Intervenor Attorney General of Canada ¶¶ 8-10 at 4-5, *Metalclad* (No. L002904).

152. See discussion *supra* Part III.B.

153. See Dhooze, *supra* note 6, at 273-82 for a discussion of the public policy implications.

154. In particular, note the reference to sustainable development and environmental protection contained in the NAFTA preamble, art. 1114 and the North American Agreement on Environmental Cooperation as discussed in Dhooze, *supra* note 6, at 274-75.

155. See Charles H. Brower II, *Investor-State Disputes Under NAFTA: The Empire Strikes Back*, 40 Colum. J. Transnat'l L. 43, 46 (2001)

tween private parties does not apply with the same force when a sovereign state is a party to the arbitration.¹⁵⁶ For similar reasons, Chapter Eleven tribunals have allowed non-parties to participate in arbitral proceedings through the filing of amicus briefs.¹⁵⁷ Finally, once again unlike private commercial arbitrations, NAFTA specifically allows parties other than the disputants to take part in Chapter Eleven proceedings.¹⁵⁸

C. A "PRAGMATIC AND FUNDAMENTAL" APPROACH?

Mexico therefore submitted that Justice Tysoe was not constrained by the deferential standard of review traditionally employed in the review of private commercial arbitral awards.¹⁵⁹ Rather, it urged him to employ a more flexible test that Canadian courts have employed to determine the appropriate standard of review when petitioned to review decisions of domestic tribunals and agencies.¹⁶⁰ This so-called "pragmatic and functional" approach calls upon the court to consider a variety of case-specific factors before determining the appropriate standard of review.¹⁶¹ According to Mexico, applying this approach would vest the court with a broader discretionary and more context-specific basis on which to review the Tribunal's decision.¹⁶²

Justice Tysoe was not prepared to adopt the pragmatic and functional test approach. Echoing submissions made by Metalclad,¹⁶³ he voiced concern about importing into the realm of arbi-

156. The *sui generis* nature of the Chapter Eleven process is also implicitly recognized in the recent decision of the Parties to issue an interpretive statement on this issue. See Interpretive Statement, *supra* note 24; Sallot & Scofield, *supra* note 26, at B1-2; Jan Cienski, *NAFTA Chapter 11 Facing Closer Public Scrutiny*, NAT'L POST, August 1, 2001, at C5.

157. Brower, *supra* note 155, at 47-48.

158. NAFTA, *supra* note 65, art. 1127-1129, 32 I.L.M. at 645.

159. Petitioner's Outline of Argument ¶ 202 at 62, *Metalclad* (No. L002904). Petitioner's Outline of Argument

160. *Id.*

161. Relevant factors include: "1) the presence or absence of a privative clause; 2) the relative expertise of the tribunal, as compared to the Court; 3) the nature of the decision being made (i.e., whether it is a question of law or fact); 4) whether the decision to be made is 'polycentric' (i.e., necessarily involves a consideration of often-conflicting and multi-faceted issues); and 5) the purpose of the provision." *Id.* ¶ 203 at 62.

162. See *id.* ¶ 204 at 63.

163. See Respondent's Outline of Argument ¶ 169, at 57, *Metalclad* (No. L002904):

[t]he question of the appropriate standard of review does not arise under the International Commercial Arbitration Act. The provisions of that legislation set out a complete code governing the Court's authority to set aside

tral review a test “developed as a branch of statutory interpretation in respect of domestic tribunals created by statute.”¹⁶⁴ In his view, the standard of review to be employed under the ICAA was inherent in the language of the Act. It was unnecessary and unhelpful, he intimated, to bring extraneous legal concepts or tests to bear on this task.

Other courts will likely be tempted to follow Justice Tysoe’s lead in concluding that applications to set aside Chapter Eleven awards should be approached solely with reference to the express statutory language contained in the applicable domestic review statute. The only source of potential uncertainty is reviews conducted in the United States where, as has been noted, Chapter Eleven awards will fall to review under the Federal Arbitration Act.¹⁶⁵ As with laws based on the UNCITRAL model, the FAA expressly provides that an award may be vacated on the basis that the tribunal exceeded its authority.¹⁶⁶ However, American courts have interpreted the FAA as leaving open an additional common law ground for setting aside an award known as the “manifest disregard” standard.¹⁶⁷ This non-statutory standard emerges from dicta in the 1953 U.S. Supreme Court case of *Wilko v. Swan*.¹⁶⁸ Many courts have since relied on the comments in *Wilko* as an additional ground for arbitral review, although this manifest disregard standard has also been the subject of judicial criticism.¹⁶⁹ The standard has been characterized as “something beyond and different from a mere error of law or failure on the part of the arbitrators to understand or apply the law,”¹⁷⁰ that arises where the arbitrator “understood and correctly stated the law but proceeded to ignore it.”¹⁷¹ Of late, the vitality of this standard has been cast into se-

an arbitral award including the bases for review, and implicitly, the standard of review to be applied. There is no need to look beyond the language of the statute to determine the appropriate standard of review.

Id.

164. See *Metalclad*, 89 B.C.L.R.3d ¶ 54 at 375.

165. 9 U.S.C. §§ 1-16 (1994).

166. 9 U.S.C. § 10(a)(4).

167. 346 U.S. 427, 436 (1953).

168. *Id.*

169. This is especially true in Eleventh and Seventh Circuit decisions. See, e.g., *Raiford v. Merrill Lynch*, 903 F.2d 1410, 1412 (11th Cir. 1990); *Bavarati v. Josephthal, Lyon & Ross, Inc.*, 28 F.3d 704, 706 (7th Cir. 1994). See also *Gelander*, *supra* note 138, at 636-37.

170. *Siegal v. Titan Indus. Corp.*, 779 F.2d 891, 892 (2d Cir. 1985), *quoted in Gelander*, *supra* note 137, at 636).

171. *Id.*

rious doubt¹⁷² but the U.S. Supreme Court has not yet pronounced its fate.

IV. INTERNATIONAL MINIMUM STANDARD OF TREATMENT: ARTICLE 1105

A. THE AWARD

The primary basis upon which the Tribunal held Mexico liable for damages was its violation of Article 1105. As discussed, in making this finding, it concluded that Article 1105 imposed a broad obligation on Mexico to create and maintain a domestic legal and regulatory environment that offers a high level of predictability and certainty for investors.¹⁷³ Moreover, the Tribunal held that where a central government was aware that subordinate governments had interfered with or undermined investor certainty, or acted in ways that were inconsistent with applicable domestic law, the central government is duty-bound to intervene to protect the investor's interest or face liability under Article 1105.¹⁷⁴

According to the Tribunal, these transparency-related obligations were a component of a host State's duty under Article 1105(1) to ensure that NAFTA investors receive "treatment in accordance with international law, *including* fair and equitable treatment and full protection and security."¹⁷⁵ In support of this conclusion, the Tribunal relied on Chapter One of NAFTA, which it characterized as making "prominent" reference to the concept of "transparency."¹⁷⁶ It cited NAFTA Article 102(1) to the effect that "an underlying objective of NAFTA is to promote and increase cross-border investment opportunities and ensure the successful implementation of investment initiatives."¹⁷⁷ Ultimately, the Tribunal concluded that Mexico had violated Article 1105 due to the legally "improper" actions of state and local

172. *Baker Marine (Nig.) Ltd. v. Chevron (Nig.) Ltd.*, 191 F.3d 194 (2d Cir. 1999).

173. Award, *supra* note 3, ¶ 76 at 26-27.

174. *See id.* ¶¶ 74-76 at 26-27.

175. *See id.* ¶ 74 at 26, (quoting NAFTA, *supra* note 65, art. 1105(1), 32 I.L.M. at 639) (emphasis added).

176. Award, *supra* note 3, ¶ 76 at 26-27 (citing NAFTA, *supra* note 65, art. 102(1), 32 I.L.M. at 297).

177. Award, *supra* note 3, ¶ 75 at 26-27 (citing NAFTA, *supra* note 65, art. 102(1), 32 I.L.M. at 297).

governments in relation to Metalclad, and the failure of the federal government, knowing of the difficulties Metalclad was encountering, to intervene on investor's behalf.

B. ISSUES AND ARGUMENTS ON JUDICIAL REVIEW

The investor protections under Article 1105 complement those that investors receive under two companion provisions; Articles 1102 (national treatment) and 1103 (most favored nation treatment). Article 1102 requires that a Party must treat the investors and investments of another Party no less favorably than it treats its own investors and their investments.¹⁷⁸ Article 1103 requires that a Party must treat the investors and investments of another Party no worse than it treats the investors or investments of any other party.¹⁷⁹ The national treatment and most favored treatment principles (or "disciplines") are relative concepts: a Party's compliance with these disciplines is defined in relation to how that Party treats other investors.

In contrast, Article 1105 imposes an absolute duty that renders irrelevant how the Party treats other investors or investments.¹⁸⁰ In other words, it is designed to ensure that investors or investments of another Party can legally expect to receive treatment that is in accordance with an absolute minimum standard. As expressed in a recent decision, Article 1105 "[i]s a floor below which treatment of foreign investors must not fall, even if a government is not acting in a discriminatory manner."¹⁸¹

What legal foundation supports this conceptual floor was, and remains, a matter of considerable dispute and uncertainty. The Tribunal's decision brings into focus three key issues: (1) whether Article 1105 is based exclusively on the customary international law notion of "minimum treatment" or on broader notions of procedural fairness; (2) what sources of law may be relied upon to define the scope of the Article; and finally (3) to what extent may a tribunal consider and make determinations on questions of domestic law when deciding whether a Party is in breach of its obligations under the Article.

178. NAFTA, *supra* note 65, art. 1102, 32 I.L.M. at 639.

179. *Id.* art. 1103, 32 I.L.M. at 639.

180. *Id.* art. 1105, 32 I.L.M. at 639-40.

181. *Metalclad*, 89 B.C.L.R.3d ¶¶ 61-63 at 377-78.

1. Article 1105 and International Law

Mexico contended that, with respect to all of these issues, the Tribunal committed errors that justified setting aside its award. With respect to the first issue, it is clear that the Tribunal proceeded on the basis that the scope of Article 1105 extended beyond norms that have become an accepted part of customary international law. This is evident insofar as its decision does not invoke customary international law as the basis for imposing transparency requirements on Mexico; rather, in its view, these requirements flowed from conventional international law, namely the NAFTA. The two Chapter Eleven tribunals that have directly considered this key question have arrived at divergent conclusions.

The tribunal in *S.D. Myers* held that the terms “fair and equitable treatment” and “full protection and security” modify and illustrate the concept of international minimum standard.¹⁸² As such, it concluded that the Article would only be violated “when it is shown that an investor has been treated in such an unjust or arbitrary manner that the treatment rises to the level that is unacceptable from the international perspective.”¹⁸³ In making this determination, it emphasized that a tribunal must pay deference to the right of domestic authorities to regulate matters within their borders, and to applicable international law.¹⁸⁴ The tribunal in *Pope & Talbot Inc. v. Canada*¹⁸⁵ inter-

182. *Metalclad*, 89 B.C.L.R.3d ¶ 62 at 378.

183. *Metalclad*, 89 B.C.L.R.3d ¶ 63 at 378. See also Petitioner’s Reply ¶ 123 at 32, *Metalclad* (No. L002904) (noting that “Official acts in relation to murder, armed robbery, arbitrary and unlawful detentions, kidnappings and hostage-takings have been found to violate the international minimum standard. The conduct attributed to Mexico, even on *Metalclad*’s interpretation of the facts, is not remotely like that found in the existing cases.”); *Neer (U.S.A.) v. United Mexican States*, 4 R.I.A.A. 60 (Mexico-U.S. General Claims Comm’n) (1926) [murder]; *United States (Faulkner) v. United Mexican States* 21 A.J.I.L. 349 (Mexico-U.S. General Claims Comm’n) (1927) [imprisoned without charge]; *United States (Chattin) v. United Mexican States*, 22 A.J.I.L. 667 (Mexico-U.S. General Claims Comm’n) (1928) [grave judicial irregularities]; *United States (Roberts) v. United Mexican States*, Op. of Com. 77 (Mexico-U.S. General Claims Comm’n) (1926) [arbitrary detention in intolerable conditions]; *United States (Way) v. United Mexican States*, 23 A.J.I.L. 466 (1929) (Mexico-U.S. General Claims Comm’n) [arbitrary arrest and detention]; *Case Concerning United States Diplomatic and Consular Staff in Tehran*, 1979 I.C.J. 3 [hostage-taking]; *Asian Agric. Prod. Ltd. v. Rep. Sri Lanka*, 30 I.L.M. 577 (ICSID Tribunal) (1991) [BIT case—destruction of property during battle between government troops and armed guerillas]; *Am. Mfg. & Trading Inc. v. Zaire*, 36 I.L.M. 1531 (ICSID Tribunal) (1997) [BIT case—looting by government forces].

184. *Metalclad*, 89 B.C.L.R.3d ¶ 63 at 378.

185. NAFTA Arb. Trib. 2001, at <http://www.dfait-maeci.gc.ca/tna-nac/>

preted the Article much more broadly. In its view, Chapter Eleven investors enjoy not only the benefit of such protections as exist under international law but also added “fairness elements.”¹⁸⁶ It supported this conclusion by relying on language found in the Model Bilateral Investment Treaty of 1987.¹⁸⁷ In so doing, the Tribunal rejected the submission of the United States as intervenor that the NAFTA Parties did not intend to diverge from the customary international law concept of fair and equitable treatment.¹⁸⁸

2. Article 1105 and the NAFTA Architecture

Mexico’s second argument was that the Tribunal exceeded its jurisdiction by importing into Chapter Eleven transparency obligations articulated elsewhere in the NAFTA. In this regard, Mexico noted that transparency is nowhere mentioned in Chapter Eleven.¹⁸⁹ And while the concept is addressed in Chapter Eighteen, Mexico emphasized that party obligations set forth outside Chapter Eleven are not enforceable by private parties under Chapter Eleven.¹⁹⁰ In Mexico’s submission, the governing law with respect to the rights of investors that the Tribunal was bound to apply was exclusively set out in Chapter Eleven as defined in the context of customary international law.¹⁹¹

Mexico also submitted that, in any event, the Tribunal misconstrued the nature of the transparency obligations imposed under Chapter Eighteen. In this regard, it noted that the Tribunal misstated the language of Article 102(1), which, contrary to what the Tribunal suggested, did not require the Parties to “ensure” the successful implementation of investment initiatives but rather exhorts them to take steps to “increase substantially investment opportunities” within the NAFTA region.¹⁹² Moreover, it noted that the Tribunal erroneously characterized “transparency” as an “objective” of NAFTA whereas the Agree-

Award_Merits-e.pdf, quoted in *Metalclad*, 89 B.C.L.R.3d ¶ 64 at 378).

186. *Pope & Talbot*, ¶¶ 109-113 at 47-52.

187. The provision states that investment shall be accorded fair and equitable treatment, shall enjoy full protection and security and shall in no case be accorded treatment less than that required by international law. *Metalclad*, 89 B.C.L.R.3d ¶ 64 at 378.

188. *Id.*

189. See Petitioner’s Outline of Argument ¶ 248 at 78, *Metalclad* (No. L002904).

190. See *id.* ¶ 250 at 77.

191. See *id.* ¶ 244 at 76.

192. See *id.* ¶¶ 263-265 at 81-82.

ment clearly stipulates that it is one of a number of principles and rules through which NAFTA's various objectives are to be accomplished.¹⁹³

3. Article 1105 and Domestic Law

The third ground relied on by Mexico to set aside the award was that the Tribunal "substituted itself for a Mexican court, disagreeing with the decisions of the Municipality and finding that in its view of Mexican law, the permit denial was improper."¹⁹⁴ To this end, Mexico asserted that the Tribunal ignored the fact that a Mexican court had rejected, on jurisdictional grounds, a challenge brought by Metalclad with respect to the permit denial, a rejection Metalclad later appealed but ultimately abandoned. According to Mexico, by ignoring these facts, and constituting itself as a "Mexican court of appeal" empowered it to decide questions of domestic law, the Tribunal assumed a jurisdiction it did not possess.¹⁹⁵ Moreover, it argued that the State of Mexico should only be held liable, in such circumstances, if there was no domestic mechanism available to the investor capable of resolving alleged domestic impropriety, in which case the absence or inadequacy of such an mechanism might then give rise to a breach of international law actionable under Chapter Eleven.¹⁹⁶

C. THE DECISION ON REVIEW

The issue for Justice Tysoe on review was whether the three errors alleged by Mexico constituted a legal basis for setting aside the award under the ICAA. Ultimately he decided that Mexico should succeed with respect to the first two grounds for review it had advanced on the basis that the Tribunal exceeded the scope of the submission to arbitration.¹⁹⁷ As a result, he did not find it necessary to consider Mexico's arguments with respect to the third ground: namely that the Tribunal lacked jurisdiction to decide issues of domestic law.¹⁹⁸

Justice Tysoe had little difficulty in concluding that Article

193. *Id.* ¶¶ 266-269 at 82-83.

194. *Id.* ¶ 280 at 85.

195. See Petitioner's Reply § I at 30-31, *Metalclad* (No. L002904); Petitioner's Outline of Argument ¶ 46 at 10-11, ¶¶ 280-283 at 85-86, *Metalclad* (No. L002904).

196. See Petitioner's Outline of Argument § C at 84-88, *Metalclad* (No. L002904).

197. *Metalclad*, 89 B.C.L.R.3d ¶ 137 at 396.

198. See *supra* Part VI.D.3.

1105 only protected investors against state action that offended the minimum standard of treatment recognized in customary international law.¹⁹⁹ In his view, there was no evidence that transparency had become part of customary international law.²⁰⁰ Nor was he persuaded that the NAFTA Parties intended to depart from prevailing customary law in this regard.²⁰¹ Had they wished to depart from customary law and adopt the broader protections available under the Model Bilateral Investment Treaty, he reasoned, they would have employed explicit language to this end.²⁰² In this regard, he expressly disagreed with the tribunal in *Pope & Talbot*, preferring the analysis of the tribunal in *SD Myers*.²⁰³

A more difficult question was whether it could be said that the Tribunal had exceeded the scope of the submission to arbitration. Was this an instance of the Tribunal “simply interpret[ing] the wording of Article 1105?”²⁰⁴ If this were the case, he doubted whether he possessed jurisdiction to set aside the award.²⁰⁵ In his view, however, the error committed by the Tribunal was more profound; in his words, the Tribunal had “misstated the applicable law to include transparency obligations and it then made its decision on the basis of the concept of transparency.”²⁰⁶

In reaching this conclusion, Justice Tysoe relied heavily on Mexico’s arguments that the Tribunal had incorrectly identified transparency as an objective of NAFTA, and that it erroneously imported the transparency provisions of Chapter Eighteen into its analysis of state obligations under Chapter Eleven.²⁰⁷ In his opinion, it was clear that the Tribunal had held Mexico liable on the basis of transparency and, in so doing, went beyond the scope of the submission to arbitration “because there are no transparency obligations contained in Chapter Eleven.”²⁰⁸ In this regard, he was careful to note that even had he agreed with the analysis of the tribunal in *Pope & Talbot*, he would have

199. See *Metalclad*, 89 B.C.L.R.3d ¶ 60 at 577, ¶ 62 at 378.

200. *Id.* ¶ 68 at 379.

201. *Id.* ¶ 65 at 379.

202. *Id.*

203. See *id.* ¶¶ 64-65 at 378-79.

204. See *id.* ¶ 70 at 380.

205. See *Metalclad*, 89 B.C.L.R.3d ¶ 69 at 380.

206. *Id.* ¶ 70 at 380.

207. *Metalclad*, 89 B.C.L.R.3d ¶¶ 71-72 at 380.

208. *Id.* ¶ 72 at 381.

still arrived at the same conclusion.²⁰⁹ This was because regardless of whether Article 1105 imposed obligations broader than those prevailing under customary international law, the NAFTA Parties could not be taken to have agreed to transparency requirements found elsewhere in NAFTA.²¹⁰ By purporting to impose such requirements, the Tribunal exceeded the scope of the Parties submission to arbitrate.²¹¹

As noted in the introduction, three months after Justice Tysoe's decision was rendered, the NAFTA Free Trade Commission issued an interpretive statement on the ambit of Article 1105 that lends strong support to the conclusions he reached in this part of his judgment. The statement unequivocally restricts the obligations of the Parties under the Article to providing treatment in accordance with international minimum standards as prescribed in international customary law.²¹² In so doing, the statement represents a clear rejection of the conclusion of the Tribunal in *Pope and Talbot* that the Article imposed additional "fairness elements" akin to those found in the *Model Bilateral Investment Treaty*. The interpretive statement also addresses the question of whether a breach of provisions contained elsewhere in the NAFTA or other international agreements can provide the foundation for concluding that there has been a breach of Article 1105. In this regard, the statement does not go so far as to suggest, as Justice Tysoe has done, that it is impermissible for a tribunal to consider such breaches when deciding whether a Party has violated the Article. It does, however, underscore that breaches of international obligations other than those set out in Chapter Eleven are not sufficient on their own to establish a breach of Article 1105.²¹³

V. EXPROPRIATION: ARTICLE 1110

A. THE AWARD

Most of the public attention garnered by Chapter Eleven to date is due to the uncertainty surrounding the scope and nature of its provisions dealing with expropriation as set out in Article

209. *Id.* ¶ 74 at 381.

210. *Id.* ¶ 75 at 381.

211. *See id.* ¶ 74 at 381.

212. *See* Interpretive Statement, *supra* note 24, § B.

213. *See id.*

1110(1). Critics have argued that the breadth of the language in this Article leaves open the possibility that investors will be able to secure damage awards for adverse affect to investments where governments have implemented *bona fide* measures to protect public health or the environment.²¹⁴

In holding Mexico liable for damages under Chapter Eleven, the Tribunal held that Mexico had violated Article 1110 in two ways. First, it concluded that the facts that gave rise to the conclusion that Mexico failed to meet its “transparency” obligations under Article 1105 also constituted a violation of Article 1110.²¹⁵ In the alternative, it held that the actions of the state government in passing and implementing the Ecological Decree also constituted a violation of the Article.²¹⁶

Despite the fact that Article 1110 formed the basis for two of the three grounds upon which it concluded Mexico was liable under Chapter Eleven, the Tribunal’s discussion of its jurisdiction over expropriation under the Article is remarkably sparse.²¹⁷ After setting out the text of Article 1110(1), the Tribunal stated:

Thus, expropriation under NAFTA includes not only open, deliberate and acknowledged takings of property, such as outright seizure or formal or obligatory transfer of title in favour of the host State, but also covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use or reasonably-to-be-expected economic benefit of property even if not necessarily to the obvious benefit of the host State.²¹⁸

The Tribunal did not elaborate or provide authority in support of the conclusions contained in this paragraph; indeed, its use of the term “thus” suggests that it considered that this conclusion followed “inexorably from the language of Article 1110.”²¹⁹

According to the Tribunal, the Article protects investors not only against measures in the nature of *expropriation*, but also

214. See generally Dhooge, *supra* note 6; David A. Gantz, *Reconciling Environmental Protection and Investor Rights Under Chapter 11 of NAFTA*, 31 ENVTL. L. R. 10646 (2001); MANN & VON MOLTKE, *supra* note 10; J. Martin Wagner, *International Investment, Expropriation and Environmental Protection*, 29 GOLDEN GATE U. L. REV. 465 (1999); Chris Tollefson, *Games Without Frontiers: Investor Claims and Citizen Submissions Under the NAFTA Regime*, 27 YALE J. INT’L L. (forthcoming Winter 2002).

215. Award, *supra* note 3, ¶ 104 at 195.

216. *Id.* ¶ 109 at 196.

217. Award, *supra* note 3, ¶ 103 at 195.

218. *Id.*

219. Petitioner’s Outline of Argument ¶ 309 at 96, *Metalclad* (No. L002904).

from measures that *interfere with property rights*. This conclusion is highly controversial both in terms of legal soundness and its ramifications for the fiscal capacity, political appetite and legal ability of governments to regulate in the public interest.

Imposing on a Party the obligation to pay compensation whenever it enacts a measure that incidentally interferes with an investor's exercise of its property rights—or reasonably anticipated economic benefits that might flow from the exercise of such rights—has far-reaching budgetary and sovereignty implications for domestic governments. This is particularly, but not exclusively, the case with respect to regulatory policy designed to promote environmental and public health objectives. Moreover, it is an interpretation that imposes obligations that extend far beyond those that states owe to investors under domestic American, Canadian and Mexican law.²²⁰

B. ISSUES AND ARGUMENTS ON REVIEW

More germane to the judicial review was the question of whether the Tribunal's decision was vulnerable to be set aside. In this regard, both Mexico and Metalclad agreed that the Tribunal was obliged to apply Article 1110 in a manner that was consistent with the prevailing customary international law definition of "expropriation."²²¹ Under the UNCITRAL Model law, in order for the Tribunal's decision to be set aside, Mexico was required to establish that the Tribunal did not simply commit an error of law in interpreting and applying Article 1110, but rather that it acted in a manner that could justify the conclusion that it exceeded its jurisdiction.²²² This was a tall order given the fluid and uncertain nature of the applicable customary international law.

1. Customary International Law

Classical customary international law has traditionally recognized the existence of two distinct varieties of compensable expropriation. The first, *direct expropriation*, occurs where a State undertakes a measure that directly deprives a former

220. For a useful summary of current U.S. takings law see *Palazzolo v. State ex rel. Tavares*, 746 A.2d 707 (R.I. 2000).

221. See Petitioner's Outline of Argument ¶ 546 at 163, *Metalclad* (No. L002904); see also Respondent's Outline of Argument ¶ 531 at 153, *Metalclad* (No. L002904).

222. See *Metalclad*, 89 B.C.L.R.3d ¶ 50 at 374.

owner of their property rights by way of seizure, legislation or nationalization.²²³ Customary international law also recognizes, however, that a State is liable to pay compensation in situations where the impugned measure has affected property rights in a more indirect fashion.²²⁴ The ambit of what is usually termed *indirect expropriation* (or “creeping expropriation”) has eluded precise definition. Unlike direct expropriation, indirect expropriation is said to arise where the owner formally retains legal title to the property in question but suffers serious interference with his or her property rights that are attributable to state action.²²⁵ The open-ended nature of this definition leaves key questions unresolved on which Justice Tysoe received lengthy submissions.

One area of dispute concerned how serious and permanent an interference must be before it qualifies as indirect expropriation under customary international law.²²⁶ The position taken by Mexico was that the interference must be so serious as “to affect title” of the property and that it must be permanent and irreversible.²²⁷ For its part, Metalclad emphasized the fact-dependent nature of the inquiry, asserting that indirect expropriations frequently arise through the “cumulative effects” of government action. Under this approach, it was unnecessary that the State actions adversely impact title before compensation was owed; moreover, the deprivation of property rights need only be “significant” and not merely “ephemeral.”²²⁸

A second area of definitional dispute concerned the relevance of the policy rationale underlying the impugned measure. On this point, Metalclad’s position was categorical: a duty to compensate under international customary law for interference with property can arise “whether or not it is the by-product of

223. See Respondent’s Outline of Argument ¶ 53 at 153, *Metalclad* (No. L002904) (citing *Compania del Desarrollo de Santa Elena, S.A.*, Rep. of Costa Rica ICSID Case No. ARB/96/1, ¶¶ 76-77, ICSID Rev., at 193-94).

224. See *id.*

225. Petitioner’s Outline of Argument ¶ 554 at 166, *Metalclad* (No. L002904) (citing *Starrett Housing Corporation, Starrett Systems, Inc., Starrett Housing International Inc. v. the Government of the Islamic Republic of Iran, Bank Omran, Bank Mellat, and Bank Marzaki* (Iran-US Claims Tribunal 1983) 85 I.L.R. 349 at 390).

226. *Metalclad*, 89 B.C.L.R.3d ¶ 78 at 381-82.

227. See Petitioner’s Outline of Argument ¶ 555 at 166, *Metalclad* (No. L002904).

228. Respondent’s Outline of Argument ¶¶ 527-528 at 151-52, *Metalclad* (No. L002904) (citing *Compania del Desarrollo*, ICSID Rev. ¶ 77 at 194 with respect to “ephemeral”).

otherwise legitimate regulation and even though substantial interference with property interests was not the government's ostensible intention."²²⁹ Mexico argued that this position amounted to a "radical departure from classical international law."²³⁰

2. Customary International Law in Article 1110

Learned commentaries on customary international law seem to support the approach advocated by Mexico. According to such commentaries, customary international law has resisted pressures to expand the obligations of States to compensate for other deprivations of property rights for two reasons: (1) to do otherwise would make it impossible for governments to carry out their legitimate functions; and (2) the right of States to take regulatory action for the common good of society is a core feature of state sovereignty.²³¹ On this point, as intervenor, Canada urged the Court to be mindful of the decision in *SD Myers*, where that tribunal quite clearly expressed the view that non-discriminatory regulatory measures taken to protect the public interest, particularly in relation to public health and the environment, did not constitute expropriation contrary to Chapter Eleven.²³²

Metalclad contended that when the totality of the circumstances surrounding the relationship between the investor and Mexican regulatory authorities was considered, the inexorable conclusion was that its investment had been expropriated as was properly found by the Tribunal.²³³ Mexico's position, in contrast, was that the Tribunal adopted an entirely novel and overbroad definition of expropriation under Article 1110 unknown to customary international law.²³⁴ Secondly, it asserted that, even applying the test it had itself enunciated, the Tribunal had erred in finding a violation of Article 1110 because at no time

229. See Respondent's Outline of Argument ¶ 526 at 151, *Metalclad* (No. L002904).

230. Petitioner's Outline of Argument ¶ 561 at 168, *Metalclad* (No. L002904).

231. See M. Sornarajah, *The International Law on Foreign Investment* 298-300 (1994).

232. See Outline of Argument of Intervenor Attorney General of Canada ¶ 67 at 21, *Metalclad* (No. L002904).

233. Respondent's Outline of Argument ¶¶ 522-523 at 153, ¶¶ 529-530, at 155-56, *Metalclad* (No. L002904).

234. See Petitioner's Outline of Argument ¶ 547 at 163, *Metalclad* (No. L002904).

did Metalclad possess a property right to operate a hazardous waste facility.²³⁵ In particular, Mexico contended that the present facts were readily distinguishable from instances in which a State had shut down or curtailed a licensed or permitted activity.²³⁶ Mexico also claimed that the Tribunal had no jurisdiction to consider Metalclad's claim arising from the Ecological Decree that was issued nine months after the company had abandoned its plan to proceed with the Landfill and commenced arbitration proceedings, asserting that this constituted an "additional claim" that was only arbitrable with its consent.²³⁷ Finally, it contended that the Ecological Decree was a lawful and valid exercise of governmental police powers that could be justified under Article 1114 of NAFTA that protects the rights of Parties to adopt *bona fide* environmental measures.²³⁸

C. THE DECISION ON REVIEW

Justice Tysoe dealt with the issue of expropriation in two stages: pre- and post-Ecological Decree. As noted earlier, the facts invoked by the Tribunal to conclude that Mexico was in breach of its transparency obligations under Article 1105 were virtually identical to those it relied on to conclude that Mexico was in breach of Article 1110.²³⁹

Justice Tysoe found this troubling, observing that the Tribunal's analysis of Article 1105 had "infected its analysis of Article 1110" as it applied to Mexico's actions pre-Ecological Decree.²⁴⁰ In his view, the Tribunal's reliance on a concept that was beyond the scope of the submission to arbitrate—transparency—to ground a conclusion that there had been an "expropriation" contrary to Article 1110 meant that this latter finding must also be set aside on the ground that it was beyond the scope of the submission to arbitrate.²⁴¹

His reasons with respect to the status and implications of the Ecological Decree are somewhat more complex. In his view, the Tribunal's finding with respect to the Ecological Decree was

235. See *id.* ¶¶ 339-341 at 105-06.

236. See *id.* ¶ 47 at 11, ¶¶ 563-566 at 169-70.

237. See Article 48 of the ICSID Additional Facility Rules, *supra* note 102; see also discussion in *Metalclad*, 89 B.C.L.R.3d ¶¶ 77-95 at 381-85.

238. See Petitioner's Outline of Argument ¶ 435 at 132-33, *Metalclad* (No. L002904).

239. See Award, *supra* note 3, ¶ 104 at 195.

240. See *Metalclad*, 89 B.C.L.R.3d ¶ 78 at 381-82.

241. See *id.* ¶ 79 at 382, ¶ 133 at 395.

not connected to its earlier analysis on the “transparency” issue.²⁴² As such, it was necessary for him to consider whether to set aside the Tribunal’s finding that the Ecological Decree, standing alone, violated Article 1110.²⁴³

He rejected, in summary fashion, Mexico’s argument that the Tribunal should not have considered the Ecological Decree as a separate ground, holding that Mexico had ample opportunity to respond to the argument as it was clearly advanced in Metalclad’s initial memorial in the case.²⁴⁴ Mexico also argued, however, that the definition of “expropriation” adopted by the Tribunal was a “patently unreasonable” error of law, an error that was so clearly wrong that it constituted a basis for setting aside the Tribunal’s decision under the ICAA.²⁴⁵ It therefore contended that an error of this seriousness should be considered as a “variety of excess of jurisdiction” or, alternatively, as an independent ground for setting aside the award on the basis that it conflicted with public policy.²⁴⁶

The concept of “patently unreasonable” originates in Canadian administrative law;²⁴⁷ it is not a term that appears in, or has been relied on previously, by courts when interpreting the ICAA or the Model Law.²⁴⁸ Its function in Canadian administrative law is to balance the value of recognizing tribunal autonomy and expertise with the value of judicial accountability.²⁴⁹ As such, it is a test that insulates a tribunal from judicial intervention with respect to simple errors of law and fact while empowering a reviewing court to overturn a decision that it deems patently unreasonable.²⁵⁰

In the result, it was unnecessary for Justice Tysoe to decide whether “patent unreasonableness” should be recognized as a basis for setting aside an award under the ICAA.²⁵¹ This was

242. *Id.* ¶ 94 at 385.

243. *Id.*

244. *Id.* ¶¶ 88-90 at 384.

245. See Petitioner’s Outline of Argument ¶ 46 at 10-11, ¶ 221 at 70-71, ¶¶ 374-375 at 116-17, *Metalclad* (No. L002904).

246. See *Metalclad*, 89 B.C.L.R.3d ¶ 96 at 385. The public policy ground is set out in § 34(2)(b)(ii) of the ICAA, *supra* note 123.

247. See, e.g., *Pezim v. British Columbia (Superintendent of Brokers)*, [1994] 2 S.C.R. 557 (Can.); *Canada (Director of Investigations and Research) v. Southam Inc.*, [1997] 1 S.C.R. 748; *Pushpanathan v. Canada (Minister of Citizenship and Immigration)*, [1998] 1 S.C.R. 982.

248. *Id.*

249. Petitioner’s Outline of Argument ¶ 172 at 52, *Metalclad* (No. L002904).

250. *Id.*

251. *Metalclad*, 89 B.C.L.R.3d ¶ 97 at 386.

because, in his view, the Tribunal did not commit a “patently unreasonable” error in its analysis of the Ecological Decree.²⁵²

Dealing first with the Tribunal’s definition of “expropriation”, Justice Tysoe acknowledged that it was “extremely broad” and, in his opinion, could be violated by a “legitimate rezoning of property by a municipality or other zoning authority.”²⁵³ However, in his view, the definition of expropriation was a question of law with which he was not entitled to interfere under ICAA.²⁵⁴ Moreover, the manner in which the Tribunal applied this definition to the facts surrounding the issuance of the Ecological Decree could not, in his view, be said to be “patently unreasonable.”²⁵⁵ In particular, he noted Mexico’s argument that the Tribunal had failed to address whether the Ecological Decree might be justified under Article 1114(1) of NAFTA as a measure taken to “ensure that investment activity . . . [was] undertaken in manner sensitive to environmental concerns.”²⁵⁶ However, in Justice Tysoe’s view, it could not be said that the Tribunal’s failure in this regard was “patently unreasonable.”²⁵⁷

As such, Justice Tysoe concluded that he had no jurisdiction under the ICAA to set aside the Tribunal’s decision that the Ecological Decree amounted to an expropriation without compensation, contrary to Article 1110.

VI. IMPLICATIONS FOR JUDICIAL REVIEW OF FUTURE CHAPTER 11 AWARDS

Mexico won, in that Chapter Eleven can’t hurt them as much anymore Our case has shown it is almost frivolous to pursue your rights.

Anthony Dabbene, (CFO, Metalclad) on Justice Tysoe’s decision²⁵⁸

The Tribunal took a treaty obligation in Chapter Eighteen and read it into Article 1105. The implications of this, if it were allowed to stand, would be horrendous...it [Justice Tysoe’s decision] was a great result in terms of getting rid of some terrible law.

252. *Id.*

253. *Id.* ¶ 99 at 386.

254. *Id.*

255. *Id.* ¶ 100 at 386.

256. *Id.* ¶ 104 at 386.

257. *Metalclad*, 89 B.C.L.R.3d ¶ 104 at 386.

258. *US Firm Sees NAFTA Case Win as Hollow Victory*, THE GLOBE AND MAIL, May 5, 2001, Canadian Business, at B3.

Anonymous source quoted in *International Trade Reporter*²⁵⁹

Although Justice Tysoe's judgment may not have been warmly received at Metalclad headquarters, it is unlikely that other NAFTA investors will share this gloomy assessment. For the most part, the decision is a highly cautious one that approaches the task of reviewing the award deferentially. This interpretation keeps with the posture courts have traditionally adopted when reviewing awards made in the private international commercial law context. It carefully refrains from embarking on a trial *de novo* style reconsideration of the legal issues decided during the course of the Tribunal's work.²⁶⁰ It also leaves unanswered a variety of intriguing and important interpretive and procedural questions relating to the future operation of Chapter Eleven.²⁶¹

A. NATURE AND STANDARD OF REVIEW

One of the hardest-fought battles before Justice Tysoe, and one in which Metalclad can claim an unequivocal victory, concerns the threshold issue of characterizing the nature of the review process. Mexico forcefully contended that the deferential approach to review that courts have traditionally used in the review of private commercial arbitral awards is inappropriate, and that a more interventionist supervisory jurisdiction should be employed.²⁶² As discussed earlier, there are compelling conceptual and contextual reasons that support Mexico's position.

A key reason why courts defer to arbitral awards in the private commercial context is their concern for respecting the autonomy of the arbitrating parties to decide the scope of the submission to arbitrate.²⁶³ In the context of Chapter Eleven of NAFTA, however, the investor is not a party to the submission to arbitrate.²⁶⁴ Moreover, Mexico argued with some force that the context within which Chapter Eleven arbitrations arise

259. Peter Menyasz, *Mexico challenges NAFTA ruling in favour of U.S. Waste Management Firm*, INTERNATIONAL TRADE REPORTER CURRENT REPORTS (May 8, 2001) 296 available at <http://www.bna.com/current/itr/maintop.htm>.

260. See generally *Metalclad*, 89 B.C.L.R.3d at 359-96.

261. *Metalclad*, 89 B.C.L.R.3d ¶¶ 119-132 at 390-95.

262. See Petitioner's Outline of Argument ¶¶ 179-186 at 54-56, *Metalclad* (No. L002904).

263. See generally ALAN REDFERN & MARTIN HUNTER, LAW AND PRACTICE OF INTERNATIONAL COMMERCIAL ARBITRATION 3-8 (3d ed. 1999).

264. See Petitioner's Outline of Argument ¶¶ 90-93 at 24-25, *Metalclad* (No. L002904).

dramatically differs from that which ordinarily gives rise to disputes dealt with in the three arbitral facilities designated under NAFTA.²⁶⁵ While these facilities are accustomed to dealing with private disputes of limited concern to non-parties, Mexico argued that Chapter Eleven disputes involved quintessentially public issues.²⁶⁶

On the basis of these submissions, Mexico asked Justice Tysoe to proceed into uncharted waters. Its goal was to persuade him to depart from the prevailing jurisprudence with respect to the review of arbitral awards under the B.C. version of the UNCITRAL model law and adopt a more rigorous approach to reviewing awards made under Chapter Eleven.²⁶⁷ Mexico proposed that such an approach could be developed by invoking, through analogy, jurisprudential concepts—the so-called “pragmatic and functional” approach and the “patently unreasonable” test—that have evolved in the context of domestic Canadian administrative law.²⁶⁸

Justice Tysoe’s reasons do not disclose whether he was sympathetic to Mexico’s arguments concerning the conceptual and contextual reasons that might justify a different approach to judicial review under Chapter Eleven than ordinarily prevails in private commercial arbitrations.²⁶⁹ It is clear, however, that he was uncomfortable with Mexico’s submission to the extent that it suggested he depart from the literal language of the ICAA. Undoubtedly, judges in other jurisdictions will be called upon to consider this same argument before long. Whether they will share Justice Tysoe’s diffidence on this issue remains to be seen.

B. ARTICLE 1110: EXPROPRIATION

Having concluded that his jurisdiction to review the Tribunal’s award was limited to the grounds specified under the ICAA, it is not surprising that Justice Tysoe declined to grapple with the question of whether the Tribunal erred in defining “ex-

265. *Id.* ¶¶ 96-104 at 26-29, ¶ 110 at 29; see Respondent’s Outline of Argument ¶ 44 at 14, *Metalclad* (No. L002904).

266. See Petitioner’s Outline of Argument ¶¶ 163-164 at 48, ¶¶ 184-185 at 55-56, *Metalclad* (No. L002904).

267. See *id.* ¶ 193 at 58.

268. See Petitioner’s Outline of Argument ¶ 198 at 59-60, *Metalclad* (No. L002904).

269. See *Metalclad*, 89 B.C.L.R.3d ¶¶ 53-54 at 375-76; see also Petitioner’s Outline of Argument ¶¶ 163-164 at 48, ¶¶ 184-185 at 55-56, *Metalclad* (No. L002904).

propriation" for the purposes of Article 1110. While clearly aware that the Tribunal's definition is "extremely broad," Justice Tysoe did not see his function as assessing whether the Tribunal has arrived at a definition that was legally correct, or for that matter even close to being legally correct.²⁷⁰ Even if the waters of customary international law on this topic were not so murky, it would seem that he was unprepared to dive in.

Justice Tysoe's decision to review the award of the Tribunal on a deferential private international law standard and his related decision to eschew entirely review of its controversial definition of "expropriation" will disappoint critics of Chapter Eleven.²⁷¹ It will also undoubtedly be cited by some as further evidence that the Chapter gives precedence to trade law over domestic regulation, to corporate power over community control, and to investor rights over state sovereignty.²⁷² More to the point, Justice Tysoe's decision underscores the limits of judicial review as a meaningful vehicle for exercising supervisory control over the interpretive discretion vested in Chapter Eleven tribunals.

Consequently, Justice Tysoe's decision is likely to add fodder to the argument that the NAFTA Parties should issue an interpretive statement with respect to the nature and scope of Article 1110. Until very recently, Mexico has strongly resisted the suggestion that interpretive statements be used to clarify the meaning of Chapter Eleven provisions, despite Canadian – and, of late, American – support for such an approach.²⁷³ Since the election of President Fox, Mexico has adopted a more conciliatory posture on this question, a direct result of which is the Parties' interpretive statement on confidentiality issues and Article 1105 announced in July 2001.²⁷⁴

What is perhaps most striking about this interpretive statement is that it does not address the vexed issue of expropriation under Article 1110, a provision that is in far greater need of clarification than any other in Chapter Eleven. Now that the Parties have shown a willingness to employ interpretive statements, and Justice Tysoe's decision has illustrated the

270. See *Metalclad*, 89 B.C.L.R.3d ¶ 99 at 386.

271. *Id.* at ¶¶ 39-49 at 371-73, ¶¶ 77-80 at 381-82.

272. See Dhooze, *supra* note 6, at 273-74.

273. See *id.* at 286 (citing then-Canadian Minister of International Trade Sergio Marchi, *Address to the NAFTA Fifth Anniversary Luncheon*, MANN AND VON MOLTKE, *supra* note 10, at 10 (discussing Mexico's reluctance)).

274. Interpretive Statement, *supra* note 24.

limited role of judicial review in constraining the interpretive discretion of Chapter Eleven tribunals, the Parties will likely face increasing pressure to develop an interpretive statement that specifically addresses Article 1110.

In this regard, critics have urged the formulation of an interpretive statement that specifically excludes from challenge under Chapter Eleven non-discriminatory measures based on a public purpose consistent with a legitimate objective as defined in Article 915(1).²⁷⁵ For environmental measures that are alleged to be discriminatory, the interpretive statement would direct the tribunal to consider a variety of factors before reaching a conclusion that Chapter Eleven has been violated including: (1) the investment's location and likely environmental impacts; (2) the local environment's carrying capacity; (3) the current state of relevant scientific knowledge; and (4) the need for governments to employ a precautionary approach to development.²⁷⁶ An interpretive statement of this kind would thus allow governments to legally defend measures taken on the basis of legitimate environmental, scientific and public policy concerns that would "otherwise appear to be a discriminatory confiscation of a foreign investment."²⁷⁷

C. ARTICLE 1105: TRANSPARENCY AND INTERNATIONAL MINIMUM STANDARD OF TREATMENT

For Mexico, the most welcome aspect of Justice Tysoe's judgment was his decision to set aside what one of Metalclad's co-counsel characterized as the most groundbreaking element of the award: the Tribunal's finding that Mexico had breached its obligations to ensure a transparent regulatory environment for NAFTA investors.²⁷⁸ This is a conclusion that critics of Chapter Eleven should applaud. The sweeping nature of the Tribunal

275. Chapter 9 of NAFTA sets standards with respect to the creation, maintenance and operation of technical regulations and sanitary measures by the Parties. Article 915(1) prescribes the legitimate objectives that such regulations and measures may validly serve. These "legitimate objectives" include: (a) safety; (b) protection of human, animal or plant life or health, the environment or consumers ...; and (c) sustainable development, considering, among other things, where appropriate, fundamental climatic, or other geographical factors, technological or infrastructural factors, or scientific justification but does not include the protection of domestic production. NAFTA, *supra* note 65, art. 915(1), 32 I.L.M. at 391-92.

276. See MANN & VON MOLTKE, *supra* note 10, at 72-73; Dhooge, *supra* note 6, at 288.

277. See Dhooge, *supra* note 6, at 288.

278. *Metalclad*, 89 B.C.L.R.3d ¶¶ 57-76 at 376-81.

decision in this respect was nothing short of revolutionary; imposing on host States an affirmative obligation to relieve investors of all risks, legal, political and otherwise, inherent in the regulatory process.²⁷⁹ If the existence of such an obligation under Chapter Eleven were to be generally recognized it would amount to an unprecedented constraint on state sovereignty, and compel significant and undesirable democracy-reducing, risk minimization behavior by all levels of government within the NAFTA region.²⁸⁰

It might be questioned whether Justice Tysoe's ruling on the transparency issue can be reconciled with his reluctance to interfere with the Tribunal's rulings addressing the definition and application of the concept of expropriation set out in Article 1110.²⁸¹ In considering the apparent inconsistency between these two holdings, it is important to appreciate the narrow basis on which Justice Tysoe determined he had grounds to set aside the Tribunal's determination on the transparency issue under Article 1105. As he emphasized, this was not merely a case of a tribunal simply interpreting the wording of Article 1105 in a manner that he considered incorrect as a matter of applicable customary international law.²⁸² Had the error arisen in this manner, Justice Tysoe was of the view that he would have lacked jurisdiction, under the ICAA, to interfere with the Tribunal's conclusion no matter how egregiously such a conclusion conflicted with customary international law.²⁸³ What vested him with authority to set aside the impugned ruling was that the Tribunal incorrectly stated the applicable law to include NAFTA provisions outside of Chapter Eleven.²⁸⁴ Therefore, it was the Tribunal's invocation of the NAFTA preamble and Chapter Eighteen in connection with its Article 1105 analysis that made its ruling vulnerable to judicial review.²⁸⁵ It was on this basis that he concluded the Tribunal's ruling exceeded the Parties' agreement on the submission to arbitrate as crystallized in the architecture of NAFTA.²⁸⁶

Inherent in this proposition is an interesting corollary. On this reasoning, the brief and cryptic nature of the Tribunal's

279. See Dhooge, *supra* note 6, at 269-70.

280. See Dhooge, *supra* note 6, at 263-73.

281. NAFTA, *supra* note 65, art. 1110, 32 I.L.M. at 641-42.

282. See *Metalclad*, 89 B.C.L.R.3d ¶ 70 at 380.

283. *Id.* ¶ 69 at 380.

284. *Id.*

285. See *id.* ¶ 26 at 369, ¶ 72 at 380.

286. *Id.*

reasons with respect to its interpretation of the concept of expropriation paradoxically would appear to serve to insulate these reasons from judicial review.²⁸⁷ Had the Tribunal referred to NAFTA provisions outside of Chapter Eleven in support of its interpretation of Article 1110, on Justice Tysoe's analysis, this would vest a reviewing court with jurisdiction to consider and set aside the decision of the Tribunal on the basis that it exceeded the Parties' submission to arbitrate. Where a tribunal declines or omits to provide such authority, on this analysis, the ambit of judicial review would be significantly constrained.

D. ISSUES NOT ADDRESSED: "ENVIRONMENTALLY SENSITIVE" INVESTMENT, STATE RESPONSIBILITY AND GOVERNING LAW

As important as what Justice Tysoe's ruling decides is what his ruling, and this litigation more generally, leaves unresolved. In this category, three issues stand out: (1) the ability of NAFTA Parties to insist that investments within their territories are "undertaken in a manner sensitive to environmental concerns;"²⁸⁸ (2) the responsibility of Parties for the actions of subordinate levels of government; and (3) the extent to which tribunals should be entitled to determine matters of domestic law.

1. *Environmentally Sensitive Investment*

A key basis upon which Canada and, to a lesser extent, Mexico challenged the decision of the Tribunal was its almost complete failure to refer to the prominent role the NAFTA architecture ostensibly gives to environmental protection and sustainable development. Canada argued that the Tribunal gave inappropriate weight to preambular language relating to the goal of ensuring "a predictable commercial framework for business planning and investment," ignoring the Parties' commitment, also expressed in the preamble, to "promote sustainable development" and to "strengthen the development and enforcement of environmental laws and regulations."²⁸⁹ Moreover, Mexico submitted that the Tribunal's analysis of the actions of the Municipality and of the Ecological Decree failed to consider Ar-

287. See *id.* ¶ 77 at 381, ¶¶ 82-84 at 382-83.

288. See NAFTA, *supra* note 65, art. 1114, 32 I.L.M. at 642.

289. See Outline of Argument of Intervenor Attorney General of Canada ¶¶ 34-46 at 13-16, *Metalclad* (No. L002904); see also NAFTA, *supra* note 65, pmb1., 32 I.L.M. at 297.

ticle 1114(1) of NAFTA, which purports to protect the right of a Party to adopt, maintain, and enforce measures necessary to ensure that "investment activity in its territory is undertaken in a manner sensitive to environmental concerns."²⁹⁰

Justice Tysoe did not address Canada's submissions and dismissed Mexico's argument on the basis that the Tribunal's failure to consider Article 1114(1) in its analysis of the Ecological Decree was not "patently unreasonable."²⁹¹ While his treatment of these submissions conforms with the conventionally accepted view of role to be adopted by a reviewing court, once again, in this respect, the decision provides fodder for critics of Chapter Eleven who will surely argue that the process unduly insulates tribunals from accountability for ensuring the Chapter is interpreted in a fashion that properly recognizes not only the rights of investors, but also broader environmental and social values. On the basis of Justice Tysoe's decision, it is now more apparent than ever that the only viable means to ensure that tribunals take such values into account is by means of an interpretive statement of the type described earlier.²⁹²

2. *State Responsibility*

Another key issue that was addressed only peripherally in the litigation is the vexed question of state responsibility. The Tribunal dealt with this issue in a cursory manner. According to the Tribunal, the question was disposed of by Mexico's concession, in a pre-hearing submission, that it "was . . . prepared to proceed on the assumption that the normal rule of state responsibility applies; that is that [Mexico] can be internationally responsible for the acts of state organs at all three levels of government."²⁹³ Nor is this an issue discussed in the reasons on judicial review, although the issue was directly raised in intervenor submissions.²⁹⁴

Mexico's pre-hearing concession that, under customary international law, a State may be held internationally responsible for the acts of subordinate state governments begs a question that neither the Tribunal nor Justice Tysoe addressed: in what

290. See Petitioner's Outline of Argument ¶ 435 at 132-33, *Metalclad* (No. L002904); see also NAFTA, *supra* note 65, art. 1114, 32 I.L.M. at 642.

291. See *Metalclad*, 89 B.C.L.R.3d ¶ 104 at 387.

292. See discussion *supra* Part IV.C.

293. See Award, *supra* note 3, ¶ 73 at 189.

294. Outline of Argument of Intervenor Province of Quebec at 2, *United Mexican States v. Metalclad Corp.*, [2001] 89 B.C.L.R.3d 359 (Can.) (No. L002904).

circumstances this liability should be deemed to arise. Under customary international law, the doctrine has historically been understood to deny a State the ability to seek immunity from responsibility on the basis that subordinate levels of government are independent or autonomous.²⁹⁵ But the question of in what circumstances, under customary international law, the acts of subordinate state organs should be legally attributed to a central government is less clear. NAFTA addresses this very issue by providing that Parties to the Agreement must ensure “that *all necessary measures* are taken in order to give effect to the provisions of this Agreement . . . except as otherwise provided in this Agreement, by state and provincial governments.”²⁹⁶ NAFTA expressly provides that a reference to a state or province includes local governments of that state or province.²⁹⁷

As intervenor, the Province of Quebec urged that when determining whether state responsibility should be deemed to arise under Chapter Eleven, a tribunal should first identify what “necessary measures” should be required of a State to give effect to the Agreement and then, having done so, the tribunal should address the question of whether such necessary measures were in fact taken.²⁹⁸ Neither the reasons of the Tribunal nor those of Justice Tysoe address the question of “necessary measures.”

Mexico, moreover, contended that the Tribunal erred by

295. See, e.g., the draft articles on state responsibility adopted by the International Law Commission of the United Nations in 1975 (as yet still being considered), which states:

[t]he conduct of an organ of a State, of a territorial government entity or of an entity empowered to exercise elements of the Governmental authority, such organ having acted in that capacity, shall be considered as an act of the State under international law even if, in the particular case, the organ exceeded its competence according to internal law or contravened instructions concerning its activity.

Yearbook of the International Law Commission, 1975, vol. II, at 61, *cited in* Award, *supra* note 3, ¶ 73 at 189.

296. NAFTA, *supra* note 65, art. 105, 32 I.L.M. at 298 (emphasis added).

297. *Id.* art. 201(2), at 299. The analogous provision in the GATT obliges that member states to take “such reasonable measures as may be available.” General Agreement on Tariffs and Trade, Oct. 30, 1947, art. 24(6), 61 Stat. A-11, A-66-67, T.I.A.S. 1700, 55 U.N.T.S. 194, 272. As with the NAFTA provision, however, the precise meaning and ambit of this provision as it applies to federal states where legal authority is decentralized, as exists in Canada and Australia for instance, is uncertain. *Id.*

298. Outline of Argument of Intervenor Province of Quebec at 5, *Metalclad* (No. L002904).

holding it liable, even though Metalclad had abandoned domestic remedies aimed at challenging the Municipality's decision to deny its facility a construction permit.²⁹⁹ According to Mexico, Metalclad's failure to pursue its legal rights in the Mexican legal system was relevant to the question of state responsibility.³⁰⁰ In its view, an investor has no valid claim against a State, in circumstances in which it is impugning the actions of subordinate governments, where there is no evidence that the State has been derelict in its duty "for example, by failure to afford a remedy, or by the removal of domestic remedies."³⁰¹

While Mexico's submissions on this point were rendered moot by Justice Tysoe's finding that the Tribunal had exceeded its jurisdiction with respect to Article 1105, it might be argued that the Tribunal erred in failing to consider whether Mexico failed to take "all necessary measures" in response to the state government's enactment of the Ecological Decree.

3. Governing Law

A final and related question that neither the Tribunal nor Justice Tysoe addressed, and which is bound to figure prominently in future Chapter Eleven litigation, concerns governing law or *lex arbitri*.³⁰² A key feature of proceedings before the Tribunal was testimony by experts called by both sides with respect to the legality of the Municipality's refusal to grant the construction permit sought by COTERIN.³⁰³ Ultimately, the Tribunal sided with opinions offered by Metalclad's experts, namely that the refusal was legally improper insofar as it was based on grounds within the jurisdiction of the federal government.³⁰⁴ Before Justice Tysoe, Mexico challenged not only this conclusion but also the right of the Tribunal to reach this conclusion. Mexico contended that the governing law for the purposes of Chapter Eleven arbitrations is NAFTA and applicable rules of international law.³⁰⁵ This, it emphasized, distinguished Chapter Eleven arbitral proceedings from private commercial arbitra-

299. Petitioner's Outline of Argument ¶ 287 at 88, *Metalclad* (No. L002904).

300. *See id.* ¶ 301 at 93.

301. *See id.*

302. *See generally* John Collier & Vaughan Lowe, *The Settlement of Disputes in International Law* 229-232 (1999).

303. *See* Award, *supra* note 3, ¶ 79 at 190.

304. *Id.* ¶ 86 at 192.

305. NAFTA, *supra* note 65, art. 1131(1), 32 I.L.M. at 645; *see also* Petitioner's Outline of Argument ¶¶ 99-105 at 26-29, *Metalclad* (No. L002904).

tions conducted under the ICSID rules that vest tribunals with jurisdiction to decide issues of domestic law.³⁰⁶ As noted earlier, Mexico argued that the Tribunal ignored this jurisdictional limitation and constituted itself as a Mexican appellate court empowered to decide issues of domestic law.³⁰⁷

In other Chapter Eleven litigation, tribunals have been reluctant to allow investors to expose to arbitral review domestic judicial decisions.³⁰⁸ Illustrative in this regard is the admonition of the Tribunal in *Feldman v United Mexican States* that Chapter Eleven tribunals do “not have, in principle, jurisdiction to decide upon claims arising because of an alleged violation of . . . domestic Mexican law.”³⁰⁹ Before Justice Tysoe, Metalclad did not contest Mexico’s assertion that the Tribunal lacked jurisdiction to determine questions of Mexican domestic law *qua* law.³¹⁰ However, Metalclad contended that the Tribunal embarked upon this inquiry in its “fact-finding” capacity, an inquiry necessitated by the fact that no Mexican court had ever ruled on the key question of Municipal jurisdiction over construction permits.³¹¹ In these circumstances, it could be argued that the Tribunal had no option but to proceed to hear and assess expert evidence on this point of law, given its relevance to the dispute.³¹² However, to cloak Chapter Eleven tribunals with even this limited “fact-finding” jurisdiction to interpret local laws poses obvious dangers. As the International Court of Justice has observed: “[q]uestions relating to these matters are of an extremely complicated and technical nature: they are highly controversial and it is not easy to decide which solution is right and which wrong [moreover] we cannot assert that incorrect decisions constitute in themselves a denial of justice and

306. Convention on the Settlement of Investment Disputes, Mar. 18, 1965, art. 42(1), 17 U.S.T. 1270, 1286, 575 U.N.T.S. 159.

307. See Petitioner’s Reply ¶¶ 116-120 at 30-31, *Metalclad* (No. L002904); Petitioner’s Outline of Argument ¶ 46 at 10-11, ¶¶ 280-283 at 85-86, *Metalclad* (No. L002904).

308. See, e.g., Azinian et. al. v. United Mexican States, ISCID Case No. ARB(AF)/97/2, 39 I.L.M. 537 (1999), cited in Petitioner’s Outline of Argument ¶ 284 at 86-87, *Metalclad* (No. L002904) (holding court decision itself must constitute a violation of the treaty).

309. Petitioner’s Outline of Argument ¶ 286 at 88, *Metalclad* (No. L002904).

310. See Respondent’s Outline of Argument ¶ 387 at 119, *Metalclad* (No. L002904).

311. *Id.*

312. Indeed, during submissions by counsel for the Province of Quebec, Justice Tysoe posed a question along precisely these lines. Outline of Argument of Intervenor Province of Quebec at 12, *Metalclad* (No. L002904).

involve international responsibility.”³¹³

EPILOGUE

That both Mexico and Metalclad filed appeals from Justice Tysoe’s judgment suggests that neither side in this dispute believes that it has decisively prevailed in this precedent-setting bitter legal battle. Yet for both parties, the prospect of the matter being considered afresh puts at risk the benefits that accrue to them if the judgment stands. As such, the judgment has created incentives for the parties to settle their dispute out of court.³¹⁴ Meanwhile, in a similar way, the *Metalclad v. United Mexican States* litigation has seemingly succeeded in creating the necessary incentives for NAFTA Parties to pay close, critical, and continuing attention to the Chapter Eleven process.

313. Separate opinion of Judge Tanaka, *Barcelona Traction, Light and Power Company, Limited*, 1970 I.C.J. 156.

314. On October 30, 2001, while this article was in publication, Mexico formally abandoned its appeal. Notice of Abandonment of Appeal, at <http://www.dfait-maeci.gc.ca/tna-nac/Metal-appeal.pdf>. Metalclad abandoned its cross-appeal. Notice of Abandonment of Cross Appeal, at <http://www.dfait-maeci.gc.ca/tna-nac/Metal-cross-appeal.pdf>.

Editor's Note

As *The NAFTA Trucking Dispute: Pretexts for Noncompliance and Policy Justifications for U.S. Facilitation of Cross-Border Services* went to publication, President Bush signed the Department of Transportation and Related Agencies Appropriations Act of 2002 (Act). The Act was passed in response to the decision by a NAFTA arbitral panel examining U.S. restrictions on cross-border trucking with Mexico. The Panel held that the United States violated its NAFTA obligations by restricting trucking and allowed Mexico to levy trade sanctions in response. Mr. Sheppard's article describes the complicated NAFTA trucking debate and asserts that the principal arguments used by those opposed to opening the border should not deter policy-makers who would seek increased cross-border trucking.

The United States has enacted legislation that appears to allow Mexican truck drivers access to U.S. highways in increasing numbers. In fact, the stringent regulations embodied in the Act are receiving a mixed reaction in both countries. The Act places such heavy administrative regulations on border crossings that the climate has remained hostile to Mexican trucking operators. A brief description of the Act and its implications follows Mr. Sheppard's article. In *Update: Department of Transportation and Related Agencies Appropriations Act of 2002*, Mr. Price argues that many of the controversies that existed before the Act passed remain significant obstacles to cross-border trucking today.

