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Investor-State Dispute Settlement Between Developed Countries: Reflections on the Australia-United States Free Trade Agreement

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Investor-State Dispute Settlement Between Developed Countries: Reflections on the Australia-United States Free Trade Agreement

William S. Dodge*

ABSTRACT

Free trade agreements between developed countries now frequently contain provisions on investor protection, but the resolution of disputes remains problematic. Chapter 11 of the North American Free Trade Agreement (NAFTA) allows investors to bring direct claims against a host state before an international tribunal without exhausting domestic remedies. This has resulted in a number of claims against the United States by Canadian investors and against Canada by U.S. investors. Chapter 11 of the Australia-United States Free Trade Agreement (AUSFTA) does not permit direct claims, relying instead on a state-to-state dispute resolution mechanism.

This Article reviews the evolution of investment-dispute resolution from diplomatic protection to NAFTA and AUSFTA. It suggests that because developed countries have developed legal systems capable of resolving investment disputes

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expeditiously and without bias, it should be possible to marry the advantages of direct claims with those of the local remedies rule, allowing investors to enforce their own rights under a treaty but requiring them to do so in domestic courts first.

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As Sherlock Holmes knew, sometimes the best clue is the dog that doesn't bark.¹ In the case of the Australia-United States Free Trade Agreement (AUSFTA),² that dog is the mechanism for settling investor-state disputes. Chapter 11 of AUSFTA, like its North American Free Trade Agreement (NAFTA)³ counterpart and the investment chapters of other recent free trade agreements (FTAs), contains substantial protections for nationals of one signatory country who invest in the other.⁴ In contrast to these other agreements, however, Chapter 11 of AUSFTA does not allow investors to bring claims directly against a host government before a panel of arbitrators. The Australian Department of Foreign Affairs and Trade explains that "[t]his outcome recognises the fact that both countries have robust and sophisticated domestic legal systems that provide

1. See Arthur Conan Doyle, *Silver Blaze*, in *THE COMPLETE SHERLOCK HOLMES* 335 (1927).

2. Australia-United States Free Trade Agreement, U.S.-Austl., May 18, 2004, 118 Stat. 919, available at www.dfat.gov.au/trade/negotitions/us.html [hereinafter AUSFTA].

3. North American Free Trade Agreement, U.S.-Can.-Mex., Dec. 17, 1992, 32 I.L.M. 289 (1993) [hereinafter NAFTA].

4. AUSFTA, *supra* note 2, ch. 11.

adequate scope for investors, both domestic and foreign, to pursue concerns about government actions.”⁵ Foreign investors may not submit their AUSFTA claims to these “robust and sophisticated domestic legal systems,” however, for in neither the United States nor Australia may private parties bring suits to enforce AUSFTA.⁶ Thus, the only way of enforcing the agreement’s investment provisions is through Chapter 21’s state-to-state dispute settlement provisions,⁷ a throwback to the era of diplomatic protection.

The likely reason for the absence of investor-state dispute settlement provisions in AUSFTA is a desire to avoid the experiences of the United States and Canada under NAFTA Chapter 11. NAFTA Chapter 11 allows investors of one NAFTA party to bring claims directly against the government of another NAFTA party before an international panel of arbitrators.⁸ Moreover, because NAFTA Article 1121 waives the local remedies rule, investors are not required to exhaust their remedies in domestic court before filing Chapter 11 claims.⁹ Although both the United States and Canada had entered bilateral investment treaties (BITs) providing for immediate, direct claims by investors before NAFTA, such treaties had always been with less developed countries that made few investments in their more developed partners.¹⁰ The obligations of such treaties are reciprocal in theory but not in fact, for it is generally only the less developed country that bears the risk of being sued.¹¹ NAFTA Chapter 11 marked the first instance of an investment treaty between two capital-exporting states allowing for immediate, direct claims,¹² and both the United States and Canada have been unpleasantly surprised to find themselves on the receiving end of such claims for the first time.¹³

5. Australia Department of Foreign Affairs and Trade, AUSFTA Frequently Asked Questions, http://www.dfat.gov.au/trade/negotiations/us_fta/faqs.html [hereinafter FAQs].

6. See *infra* notes 140–46 and accompanying text.

7. AUSFTA, *supra* note 2, ch. 21.

8. NAFTA, *supra* note 3, ch 11.

9. See *infra* notes 104–07 and accompanying text.

10. Indeed, Professor Sornarajah states that one feature of the BITs “is that they are treaties between unequal partners.” M. SORNARAJAH, *THE INTERNATIONAL LAW ON FOREIGN INVESTMENT* 207 (1994). For lists of BITs by country see <http://www.worldbank.org/icsid/treaties/treaties.htm>.

11. There are, of course, a few exceptions. See, e.g., *Maffezini v. Spain*, ICSID Case No. ARB/97/7 (Nov. 13, 2000), 40 I.L.M. 1148 (2001) (awarding damages against Spain to Argentine investor under Argentina-Spain BIT).

12. Barton Legum, *The Innovation of Investor-State Arbitration Under NAFTA*, 43 HARV. INT’L L.J. 531, 537 (2002). Legum cites the Energy Charter Treaty as a second instance, though one that has not yet given rise to many claims. See *id.* at 537 n.41.

13. See Jack J. Coe, Jr., *Taking Stock of NAFTA Chapter 11 in its Tenth Year: An Interim Sketch of Selected Themes, Issues, and Methods*, 36 VAND. J. TRANSNAT’L L. 1381 (2003) (detailing claims under NAFTA).

As NAFTA and AUSFTA illustrate, the question of how to resolve investment disputes between developed countries is a vexing one.¹⁴ Investment agreements between developed countries are different from those between developed and developing countries in at least two respects. First, as NAFTA has shown, allowing direct claims in agreements between developed countries inevitably results in claims against those countries (although it is difficult to find much sympathy for developed countries that are simply held to standards they have long pressed on developing countries). Second, as the Australian government points out,¹⁵ developed countries have developed legal systems that are capable of handling international investment disputes expeditiously and without bias. This Article suggests that the best way to resolve investment disputes between developed countries is to marry the advantages of direct claims with those of the local remedies rule, allowing foreign investors to enforce their own rights under a treaty but requiring them to do so in domestic courts first.

Part I reviews the evolution of investment-dispute resolution from diplomatic protection to the advent of direct investor claims and BITs. Along the way, it discusses the advantages traditionally associated with the local remedies rule, as well as some of the considerations that led to the development of direct claims. Part II describes the system of dispute resolution established in NAFTA Chapter 11, with particular attention to the unintended consequences of waiving the local remedies rule including the impact on state sovereignty. AUSFTA's quite different system of dispute resolution is considered in Part III. AUSFTA solves some of the problems of NAFTA, but only by returning to a system of diplomatic protection that is unlikely to provide any real help to investors.

Part IV proposes a new system for the resolution of investment disputes between developed countries that combines the advantages of direct claims with those of the local remedies rule. Under this proposal, investors would be permitted to bring both international and domestic claims directly against a host state, but would have to bring these claims in the domestic courts of the host state first. Only after exhausting these domestic remedies would investors have recourse to an international arbitral tribunal. Such a system would protect sovereignty, reduce errors, and allow for the resolution of all claims—international and domestic—in a single forum.

14. This question is likely to arise again in the context of negotiations between Canada and the European Union on a Trade and Investment Enhancement Agreement. See Canada-European Union Trade and Investment Enhancement Agreement: Framework for the Agreement, <http://www.dfait-maeci.gc.ca/tna-nac/rb/tiea-en.asp>.

15. See *supra* note 5 and accompanying text.

I. FROM DIPLOMATIC PROTECTION TO BITs

The resolution of international investment disputes has changed over the past century or so. Disputes that were once handled only on a state-to-state basis are now commonly resolved through arbitrations in which private parties bring their own claims. The evolution of dispute resolution from diplomatic protection to direct claims involves two related developments: first, the establishment of fora for direct claims; and second, the growing use of treaties, breaches of which might be raised either in those fora or sometimes even in domestic courts.

A. *Diplomatic Protection*

The traditional means of obtaining redress for foreign investors harmed by breaches of international law is known as “diplomatic protection.”¹⁶ The Permanent Court of International Justice in the *Mavrommatis* case noted: “It is an elementary principle of international law that a State is entitled to protect its subjects, when injured by acts contrary to international law committed by another State, from whom they have been unable to obtain satisfaction through the ordinary channels.”¹⁷ Such protection could take the form of “consular action, negotiation, mediation, judicial and arbitral proceedings, reprisals, retorsion, severance of diplomatic relations, economic pressure and, the final resort, the use of force.”¹⁸

Whatever the form, though, diplomatic protection could be exercised only after the private party had tried and failed to obtain relief through “ordinary channels”¹⁹—that is, through the domestic

16. Draft Articles on Diplomatic Protection, art. 1, UN Doc. A/CN.4/L.647 (INT’L L. COMM’N 2004) (“Diplomatic protection consists of resort to diplomatic action or other means of peaceful settlement by a State adopting in its own right the cause of its national in respect of an injury to that national arising from an internationally wrongful act of another State.”) [hereinafter Draft Articles].

17. *Mavrommatis Palestine Concessions* (Greece v. U.K.), 1924 P.C.I.J. (ser. A) No. 2, at 12 (Aug. 30).

18. International Law Commission, *First Report on Diplomatic Protection*, 15, UN Doc. A/CN.4/506 (2000) (prepared by John R. Dugard) [hereinafter First Dugard Report]; see also FREDRICK SHERWOOD DUNN, *THE PROTECTION OF NATIONALS: A STUDY IN THE APPLICATION OF INTERNATIONAL LAW* 18 (1932).

[Diplomatic protection] embraces generally all cases of official representation by one Government on behalf of its citizens or their property interests within the jurisdiction of another, for the purpose, either of preventing some threatened injury in violation of international law, or of obtaining redress for such injuries after they have been sustained.

But see Draft Articles, *supra* note 16, art. 1 (limiting diplomatic protection to means of “peaceful settlement”).

19. *Mavrommatis*, 1924 P.C.I.J. (ser. A) No. 2, at 12.

courts of the host state. "The rule that local remedies must be exhausted before international proceedings may be instituted is a well-established rule of customary international law," the International Court of Justice observed in the *Interhandel* case.²⁰ "Before resort may be had to an international court . . . , it has been considered necessary that the State where the violation occurred should have an opportunity to redress it by its own means, within the framework of its own domestic legal system."²¹

The local remedies rule has many advantages. On the most abstract level, and from the host state's point of view, the rule shows respect for its "sovereign character."²² "[T]he right of sovereignty and independence warrants the local State in demanding for its courts freedom from interference, on the assumption that they are capable of doing justice."²³ But the host state benefits from the local remedies rule in more practical ways as well. The rule recognizes that a state does not exercise complete control over every actor that may engage its international responsibility and gives the state an opportunity to redress violations by individuals or low-level officials before the dispute is taken to an international level.²⁴ It generally allows disputes to be settled at a lower cost to the host state and with less publicity than an international adjudication.²⁵ And it protects the host state against at least some abuses of diplomatic protection.²⁶

The investor's home state shares with the host state an interest in avoiding international disputes if possible.²⁷ The local remedies rule also relieves the home state of the burden "of espousing claims that might be resolved at a lower level or which [are] unfounded and

20. *Interhandel Case* (Switz. v. U.S.), 1959 I.C.J. 5, 27 (Mar. 21). The local remedies rule is independent of the practice of diplomatic protection, having been applied during the earlier era of reprisals as well as, more recently, to direct claims by individuals. See C.F. AMERASINGHE, *LOCAL REMEDIES IN INTERNATIONAL LAW* 22-42 (2d ed. 2004).

21. *Interhandel*, 1959 I.C.J. at 27.

22. AMERASINGHE, *supra* note 20, at 61.

23. EDWIN M. BORCHARD, *THE DIPLOMATIC PROTECTION OF CITIZENS ABROAD* 817 (1915); see also Eduardo Jiménez de Aréchaga, *International Responsibility*, in *MANUAL OF PUBLIC INTERNATIONAL LAW* 531, 584 (Max Sorensen ed., 1968) ("The foundation of the rule is the respect for the sovereignty and jurisdiction of the state competent to deal with the question through its judicial organs").

24. See BORCHARD, *supra* note 23, at 817 ("[I]f the injury is committed by an individual or minor official, the exhaustion of local remedies is necessary to make certain that the wrongful act or denial of justice is the deliberate act of the State").

25. AMERASINGHE, *supra* note 20, at 61.

26. See Jiménez de Aréchaga, *supra* note 23, at 584 (noting that without the local remedies rule the alien "could immediately introduce the political influence of his state of nationality on the slightest difficulty arising with another government").

27. See BORCHARD, *supra* note 23, at 817 ("[T]he home Government of the complaining citizen must give the offending Government an opportunity of doing justice to the injured party in its own regular way, and thus avoid, if possible, all occasion for international discussion.").

frivolous.”²⁸ International tribunals may benefit from the rule to the extent that it lightens their caseloads²⁹ and, in cases where an international proceeding cannot be avoided, permits development of the facts and law involved, particularly domestic law on which the international tribunal may lack expertise.³⁰ Finally, although the foreign investor derives little benefit from the local remedies rule,³¹ it cannot really complain about its application for “the citizen going abroad is presumed to take into account the means furnished by local law for the redress of wrongs.”³²

Once a foreign investor had exhausted local remedies and its state had decided to espouse the claim, the dispute underwent a sort of theoretical “transformation.”³³ The state was now “asserting its own rights—its right to ensure, in the person of its subjects, respect for the rules of international law.”³⁴ The origin of the claim in an injury to a private interest was now “irrelevant,” and the espousing state became the “sole claimant.”³⁵ Of course, this transformation was a “fiction,”³⁶ and the espousing state’s claim continued to depend on the private party in a number of ways: the state could not maintain its claim unless the private party had exhausted local remedies;³⁷ the state could not maintain its claim unless the private party still had the nationality of the espousing state;³⁸ and damages to the state

28. AMERASINGHE, *supra* note 20, at 57.

29. *Id.* at 58 (“There may also be an objective contemplated in the relief of international tribunals from being excessively burdened with litigation.”).

30. *Id.* at 59; *see also* Case of Certain Norwegian Loans (Fr. v. Nor.), 1957 I.C.J. 9, 97 (July 6) (dissenting opinion of Judge Read) (“[I]t is important to obtain the ruling of local courts with regard to the issues of fact and law involved, before the international aspects are dealt with by an international tribunal.”).

31. *See* AMERASINGHE, *supra* note 20, at 61 (“The rule is of little benefit to the alien if he can obtain quicker, more efficient and cheaper justice through an international adjudication.”). If an international adjudication is not expected to be quicker, more efficient, and cheaper, a foreign investor is unlikely to pursue it. *See id.*

32. BORCHARD, *supra* note 23, at 817.

33. International Law Commission, *Preliminary Report on Diplomatic Protection*, 5, UN Doc. A/CN.4/484 (1998) (prepared by Mohamed Bennouna) [hereinafter Bennouna Report].

34. Mavrommatis Palestine Concessions (Greece v. U.K.), 1924 P.C.I.J. (ser. A) No. 2, at 12 (Aug. 30).

35. *Id.*

36. Bennouna Report, *supra* note 33, at 7; *cf.* First Dugard Report, *supra* note 18, at 7 (“We should not dismiss an institution, like diplomatic protection, that serves a valuable purpose simply on the ground that it is premised on a fiction and cannot stand up to logical scrutiny.”).

37. *See generally* International Law Commission, *Second Report on Diplomatic Protection*, UN Doc. A/CN.4/514 (2001) (prepared by John R. Dugard) (discussing exhaustion of local remedies); International Law Commission, *Third Report on Diplomatic Protection*, UN Doc. A/CN.4/523 (2002) (prepared by John R. Dugard) (discussing exceptions to the general principle that local remedies must be exhausted).

38. *See generally* International Law Commission, *First Report on Diplomatic Protection*, Addendum, UN Doc. A/CN.4/506/Add.1 (2000) (prepared by John R. Dugard) (discussing requirement of continuous nationality); International Law Commission,

were measured by the damages to the private party.³⁹ Nevertheless, the fiction of the state as claimant had important consequences for it tended to politicize investment disputes.

One aspect of this politicization was an increase in “international friction.”⁴⁰ Professor Hersch Lauterpacht observed that “the espousal of a claim by the State tends to impart to the complaint the complexion of political controversy and of unfriendly action.”⁴¹ Writing about diplomatic protection, Professor Brierly went so far as to claim that equating the interests of powerful individuals with the interests of an entire country was the greatest threat to peace in the modern world.⁴² The political character of diplomatic protection also meant that power differences inevitably affected the resolution of investment disputes. Diplomatic protection “came to be seen by developing nations, particularly in Latin America, as a discriminatory exercise of power rather than as a method of protecting human rights.”⁴³

Even for investors from powerful states, diplomatic protection had its drawbacks, for the espousing state had complete discretion over the claim.⁴⁴ In *Barcelona Traction*, the International Court of Justice noted that “[t]he State must be viewed as the sole judge to decide whether its protection will be granted, and to what extent it is granted, and when it will cease,” a discretion “the exercise of which

Fourth Report on Diplomatic Protection, UN Doc. A/CN.4/530 (2003) (prepared by John R. Dugard) (discussing diplomatic protection of corporations and shareholders).

39. See *Factory at Chorzów (Merits)* (F.R.G. v. Pol.), 1928 P.C.I.J. (ser. A) No. 17, at 28 (Sept. 13) (“[R]eparation due by one State to another . . . takes the form of an indemnity for the calculation of which the damage suffered by a private person is taken as the measure.”).

40. Hersch Lauterpacht, *The Subjects of the Law of Nations*, 63 L.Q. REV. 438, 454 (1947).

41. *Id.*

42. J.L. Brierly, *La Fondement du Caractère Obligatoire du Droit International*, 23 RECUEIL DES COURS 468, 531 (1928).

La plus grande menace—et de beaucoup—qu’encourt la paix dans le monde moderne est la tendance grandissante qu’ont les gouvernements à placer le pouvoir de l’État derrière les intérêts économiques privés de leurs nationaux, et à identifier ainsi les intérêts de quelques individus puissants avec les intérêts de tout le pays.

43. First Dugard Report, *supra* note 18, at 5; see also Bennouna Report, *supra* note 33, at 3 (noting that “one of the main criticisms of this institution” has been “that it is in essence discriminatory because only powerful States are able to use it against weaker States”). In response, Latin American countries developed the Drago Doctrine (prohibiting the use of force to recover debts) and the Calvo Doctrine (maintaining that States owed aliens no duties beyond national treatment). See First Dugard Report, *supra* note 18, at 17. See generally DONALD R. SHEA, *THE CALVO CLAUSE* (1955); Amos S. Hershey, *The Calvo and Drago Doctrines*, 1 AM. J. INT’L L. 26 (1907).

44. For a good, recent overview of the hurdles that investors seeking diplomatic protection face, see Andrea K. Bjorklund, *Reconciling State Sovereignty and Investor Protection in Denial of Justice Claims*, 45 VA. J. INT’L L. 1, 12–16 (2005).

may be determined by considerations of a political or other nature, unrelated to the particular case.”⁴⁵ Professor Jessup complained that “[i]nstances in which the Department of State has declined to press diplomatic representations on behalf of importunate claimants are frequent and have often been due, not to the demerits of the claims, but to some overriding policy of fostering friendly relations.”⁴⁶

The shortcomings of diplomatic protection led Professor Lauterpacht to argue for expanding the International Court of Justice’s jurisdiction to allow direct claims by individuals for violations of international law.⁴⁷ In the end, however, it was not the World Court but the World Bank that provided a forum for direct claims by foreign investors.

B. Direct Claims

The International Centre for Settlement of Investment Disputes (ICSID) was established in 1966 to hear “any legal dispute arising directly out of an investment, between a Contracting State . . . and a national of another Contracting State, which the parties to the

45. Barcelona Traction, Light and Power Company, Ltd., 1970 I.C.J. 3, 44 (Feb. 5); see also BORCHARD, *supra* note 23, at 29.

[I]t is clear that by international law there is no legal duty incumbent upon the state to extend diplomatic protection. Whether such a duty exists towards the citizen is a matter of municipal law of his own country, the general rule being that even under municipal law the state is under no legal duty to extend diplomatic protection.

RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW § 902, cmt. 1 (1987) (“The President may refuse to present a claim, settle it by negotiation, abandon it, or join it with other claims for *en bloc* resolution.”).

46. Philip C. Jessup, *Responsibility of States for Injuries to Individuals*, 46 COLUM. L. REV. 903, 908 (1946); see also J.L. BRIERLY, *THE LAW OF NATIONS* 277 (Humphrey Waldock ed., 6th ed. 1963) (“The procedure, too, is far from satisfactory from the individual’s point of view. He has no remedy of his own, and the state to which he belongs may be unwilling to take up his case for reasons which have nothing to do with its merits . . .”); Brierly, *supra* note 42, at 531.

C’est tout au mieux une méthode primitive d’assurer la justice, qui souvent agit de façon peu satisfaisante pour l’individu lésé lui-même, car l’État auquel il appartient peut être trop faible pour soutenir sa cause, ou peut préférer ne le pas faire pour des raisons politiques étrangères au bien-fondé de la revendication.

47. Lauterpacht, *supra* note 40, at 453–58; see also Jessup, *supra* note 46, at 910 (favoring “procedural developments in international relations such as the establishment of special claims commissions to which the individual would have the right of direct access”); BRIERLY, *supra* note 46, at 277 (suggesting that “allowing individuals access in their own right to some form of international tribunal . . . is a possible reform which deserves to be considered”).

dispute consent in writing to submit to the Centre.”⁴⁸ There were precedents for allowing direct claims, most significantly the Mixed Arbitral Tribunals established after the First World War by the Treaty of Versailles.⁴⁹ Unlike earlier mechanisms, however, ICSID was both permanent and not limited to claims arising from a particular historical event. Under the ICSID Convention, the investor’s direct claim against the host state was to be exclusive of any other remedy,⁵⁰ and an investor’s home state was precluded from exercising diplomatic protection with respect to disputes submitted to ICSID.⁵¹

Investors were generally not required to exhaust local remedies before bringing their claims, although states were permitted under Article 26 of the ICSID Convention to require exhaustion as a condition of their consent to arbitration.⁵² Waiver of the local remedies rule was particularly important to investors in developing countries. The report of the World Bank’s executive directors noted diplomatically that although “investment disputes are as a rule settled through” domestic channels, “experience shows that disputes

48. Convention on the Settlement of Investment Disputes Between States and Nationals of Other States art. 25, 4 I.L.M. 532, 536 (1965) (entered into force Oct. 14, 1966) [hereinafter ICSID Convention].

49. Treaty of Versailles art. 297, June 28, 1919, 225 Consol. T.S. 188, 328–31, reprinted in 13 AM. J. INT’L. L. 151, 305–306 (Supp. 1919). Other previous examples include the Central American Court of Justice, which operated from 1908–1918, the Arbitral Tribunal established by the Upper Silesia Convention of 1922, and the Supreme Restitution Court established in 1952 to handle property disputes arising from the Nazi regime. See Shigeru Oda, *The Individual in International Law*, in MANUAL OF PUBLIC INTERNATIONAL LAW 469, 511–13 (Max Sorensen ed., 1968); P.K. Menon, *The International Personality of Individuals in International Law: A Broadening of the Traditional Doctrine*, 1 J. TRANSNAT’L L. & POL’Y 151, 158–63 (1992). Undoubtedly the most important subsequent example is the Iran-United States Claims Tribunal. See generally David D. Caron, *The Nature of the Iran-United States Claims Tribunal and the Evolving Structure of International Dispute Resolution*, 84 AM. J. INT’L L. 104 (1990).

50. ICSID Convention, *supra* note 48, art. 26, 4 I.L.M. at 536 (“Consent of the parties to arbitration under this Convention shall, unless otherwise stated, be deemed consent to such arbitration to the exclusion of any other remedy.”).

51. *Id.* art 27(1), 4 I.L.M. at 536.

No Contracting State shall give diplomatic protection, or bring an international claim, in respect of a dispute which one of its nationals and another Contracting State shall have consented to submit or shall have submitted to arbitration under this Convention, unless such other Contracting State shall have failed to abide by and comply with the award rendered in such dispute.

52. *Id.* art. 26, 4 I.L.M. at 536 (“A Contracting State may require the exhaustion of local administrative or judicial remedies as a condition of its consent to arbitration under this Convention.”). The only Contracting State to have done so by notification to ICSID was Israel, which later withdrew this condition. CHRISTOPH SCHREUER, *THE ICSID CONVENTION: A COMMENTARY* 391 (2001). A few other countries require exhaustion of local remedies in some of their BITs consenting to ICSID jurisdiction. See *id.* at 392 n.137.

may arise which the parties wish to settle by other methods.”⁵³ Others have been more blunt: “A foreign investor, justifiably in many instances, will not have confidence in the impartiality of the local tribunals and courts in settling any disputes that may arise between him and the host state.”⁵⁴ Providing investors with a more reliable remedy was expected to “stimulate a larger flow of private international investment.”⁵⁵

Although encouraging international investment was the “primary purpose” of the ICSID Convention,⁵⁶ another advantage was the “depoliticization” of investment disputes.⁵⁷ As Professor Schreuer explains:

[T]he arbitration procedure provided by ICSID offers considerable advantages to both sides. The foreign investor no longer depends on the uncertainties of diplomatic protection but obtains direct access to an international remedy. The dispute settlement process is depoliticized and subjected to objective legal criteria In turn, the host State by consenting to ICSID arbitration obtains the assurance that it will not be exposed to an international claim by the investor’s home State⁵⁸

Thus, ICSID’s provision for direct claims addressed the shortcomings of diplomatic protection that Professors Lauterpacht, Brierly, and Jessup had noted.⁵⁹

When the ICSID Convention was drafted, it was expected that host states would consent to ICSID jurisdiction either through direct agreements with investors or through domestic legislation.⁶⁰ BITs had just begun to appear and were barely mentioned in the ICSID Convention’s *travaux préparatoires*.⁶¹ BITs soon proliferated, however,⁶² and commonly provided for direct claims by investors with ICSID arbitration as one of the available options.⁶³ As it has turned

53. Report of the Executive Directors on the Convention on the Settlement of Investment Disputes between States and Nationals of Other States, ¶ 10 (Mar. 18, 1965), 4 I.L.M. 524, 525 [hereinafter Executive Directors’ Report].

54. SORNARAJAH, *supra* note 10, at 250; *see also* SCHREUER, *supra* note 52, at 6 (“Rightly or wrongly, the national courts of one of the disputing parties are not perceived as sufficiently impartial.”).

55. Executive Directors’ Report, *supra* note 53, ¶ 12, 4 I.L.M. at 525.

56. *Id.*

57. Ibrahim F.I. Shihata, *Towards a Greater Depoliticization of Investment Disputes: The Roles of ICSID and MIGA*, in THE WORLD BANK IN A CHANGING WORLD 309 (1991).

58. SCHREUER, *supra* note 52, at 398.

59. *See supra* notes 40–47 and accompanying text.

60. SCHREUER, *supra* note 52, at 194–210.

61. *Id.* at 210.

62. By the end of 2004, there were 2,392 BITs. U.N. CONFERENCE ON TRADE AND DEVELOPMENT, WORLD INVESTMENT REPORT 2005: TRANSNATIONAL CORPORATIONS AND THE INTERNATIONALIZATION OF R&D 24 (2005).

63. SCHREUER, *supra* note 52, at 210–21.

out, one of ICSID's principal tasks is now to resolve investment disputes that arise under treaties.

C. Treaties

The protection of foreign investment by treaty long predates the BITs. Provisions in modern BITs concerning national treatment, most-favored-nation treatment, the minimum standard of treatment, expropriation, and the transfer of proceeds each have antecedents in nineteenth-century commercial treaties.⁶⁴ Between 1923 and 1938, the United States negotiated a series of Friendship, Commerce, and Consular Relations Treaties (FCCRs) containing more explicit protections for foreign investors.⁶⁵ Then, from 1946 to 1966, the United States concluded a set of Friendship, Commerce, and Navigation Treaties (FCNs).⁶⁶ Many of the FCNs, like the FCCRs and earlier commercial agreements, were concluded with developed countries, including Belgium, Denmark, France, Germany, Italy, Japan, and the Netherlands.⁶⁷ Although the FCNs showed a good deal of continuity with their predecessors,⁶⁸ one important difference was the appearance in the FCNs of a provision for the resolution of disputes, which the United States had previously resisted.⁶⁹ Almost all of the FCNs provided for state-to-state dispute resolution by the International Court of Justice.⁷⁰ In practice, however, state-to-state dispute resolution under these treaties was exceptionally rare, and

64. Kenneth J. Vandeveld, *The Bilateral Investment Treaty Program of the United States*, 21 CORNELL INT'L L.J. 201, 204-05 (1988); see also ROBERT RENBERT WILSON, UNITED STATES COMMERCIAL TREATIES AND INTERNATIONAL LAW 104-12 (1960) (discussing property protections in pre-1923 commercial treaties). For a list of U.S. commercial treaties through 1959, see WILSON, *supra* at 331-34.

65. See WILSON, *supra* note 64, at 113-16; Vandeveld, *supra* note 64, at 205-06.

66. See WILSON, *supra* note 64, at 116-22; Vandeveld, *supra* note 64, at 206-08.

67. See WILSON, *supra* note 64, at 333-34; see also Vandeveld, *supra* note 64, at 207 ("The United States successfully negotiated modern FCN agreements with major developed countries but had difficulty concluding them with third world states.").

68. See Herman Walker, Jr., *Modern Treaties of Friendship, Commerce, and Navigation*, 42 MINN. L. REV. 805, 807 (1958) (noting that the pattern of FCNs was "of a kind with its predecessors, and in the same direct line of evolution, having the same broad design and covering generally the same subject-matter").

69. WILSON, *supra* note 64, at 23 ("Prior to World War II, there had been suggestion of inserting in a commercial treaty a clause binding the parties to adjudicate disputes concerning interpretation or application, but the United States did not agree with the suggestion."); see also Herman Walker, Jr., *Treaties for the Encouragement and Protection of Foreign Investment: Present United States Practice*, 5 AM. J. COMP. L. 229, 239 (1956) (referring to provision for resolution of disputes as "signalling the outstanding advances which current treaty policy has effected over that prevailing in previous years").

70. One exception was the treaty with Muscat. WILSON, *supra* note 64, at 24.

only in the *ELSI* case did the United States take a claim against another developed country to the International Court of Justice.⁷¹

Neither the FCNs nor the earlier commercial treaties provided for direct investor claims, but private parties could sometimes assert claims under these treaties in domestic court. U.S. courts have held these commercial treaties to be “self-executing,” in the sense that “they are binding domestic law of their own accord, without the need for implementing legislation.”⁷² Private parties have invoked these treaties in U.S. courts to defend against civil liability,⁷³ enjoin enforcement of a municipal ordinance,⁷⁴ compel the issuance of a certificate of incorporation,⁷⁵ and claim the right to inherit property.⁷⁶

In the late-1970s, after a hiatus of more than a decade, the United States launched a new program to expand treaty protections for foreign investment.⁷⁷ Modeled on treaties that European countries had been concluding since 1959,⁷⁸ these BITs differed from the FCNs

71. See *Elettronica Sicula S.p.A. (ELSI)* (U.S. v. Italy), 1989 I.C.J. 15 (July 20).

72. *Spiess v. C. Itoh & Co. (America), Inc.*, 643 F.2d 353, 356 (5th Cir. 1981), *vacated on other grounds*, 457 U.S. 1128 (1982) (referring to the 1953 U.S.-Japan Treaty of Friendship, Commerce, and Navigation); see also *Asakura v. City of Seattle*, 265 U.S. 332, 341 (1924) (noting that the 1911 U.S.-Japan Treaty of Commerce and Navigation “operates of itself without the aid of any legislation, state or national; and it will be applied and given authoritative effect by the courts”). On the various meanings of self-execution, see Carlos Manuel Vázquez, *The Four Doctrines of Self-Executing Treaties*, 89 AM. J. INT’L L. 695 (1995).

73. See, e.g., *Bennett v. Total Minatome Corp.*, 138 F.3d 1053 (5th Cir. 1998); *Spiess*, 643 F.2d 353.

74. See *Asakura*, 265 U.S. 332.

75. See *Jordan v. Tashiro*, 278 U.S. 123 (1928).

76. See *Kolovrat v. Oregon*, 366 U.S. 187 (1961); *Hauenstein v. Lynham*, 100 U.S. 483 (1879). It is less certain whether private parties may rely on these treaties to recover damages for expropriation against foreign governments in U.S. courts. A few courts have held that they may. See *Am. Int’l Group, Inc. v. Islamic Republic of Iran*, 493 F. Supp. 522, 525 (D.D.C. 1980), *modified on other grounds*, 657 F.2d 430 (D.C. Cir. 1981) (“Plaintiffs can assert their rights to recover damages in this Court for violations of the Treaty [of Amity with Iran].”); see also *Kalamazoo Spice Extraction Co. v. Provisional Military Gov’t of Socialist Ethiopia*, 729 F.2d 422, 428 (6th Cir. 1984) (allowing counterclaim for expropriation under 1953 Treaty of Amity and Economic Relations with Ethiopia). The U.S. government has recently taken the position that they may not, arguing that private parties lack a cause of action for such claims. See Brief for the Overseas Private Investment Corp. in Opposition at 12, *McKesson HBOC, Inc. v. Islamic Republic of Iran*, Nos. 01-1521, 01-1708, available at <http://www.usdoj.gov/osg/briefs/2002/0responses/2001-1521.resp.pdf> (“The United States does not interpret the Treaty of Amity to create a private right of action as a matter of United States law for a United States citizen to sue Iran in the courts of this country.”). In light of the U.S. position, the Court of Appeals for the D.C. Circuit vacated an earlier decision holding that the Treaty of Amity with Iran created a private cause of action and remanded that issue to the district court. See *McKesson HBOC, Inc. v. Islamic Republic of Iran*, 320 F.3d 280, 281 (D.C. Cir. 2003).

77. Vandevelde, *supra* note 64, at 208–10.

78. *Id.* at 208; see also RUDOLF DOLZER & MARGRETE STEVENS, *BILATERAL INVESTMENT TREATIES* 1 (1995) (“The modern BIT is European in origin.”).

and earlier commercial treaties in important ways. First, while earlier commercial treaties had covered a range of subjects, BITs focused exclusively on investment.⁷⁹ Second, while many of the earlier treaties were with developed countries, BITs were targeted at less developed countries.⁸⁰ And third, while the FCNs provided only for state-to-state dispute resolution and their predecessors did not mention disputes at all, BITs allowed direct investor claims without requiring the exhaustion of local remedies.⁸¹ The first BIT the United States signed in 1982 provided for ICSID arbitration.⁸² The recently revised U.S. model BIT offers a menu of alternatives, including: (1) arbitration under the ICSID Convention if both the host state and the investor's home state are parties to the Convention; (2) arbitration under the ICSID Additional Facility Rules if either the host state or the investor's home state are parties to the Convention; (3) arbitration under the UNCITRAL Arbitration Rules; or (4) arbitration under any other rules to which both the investor and the host state agree.⁸³

BITs offered foreign investors the benefits of avoiding domestic courts in less developed countries and of using a depoliticized process in which they could press their own claims without intermediation by their home states.⁸⁴ Because these treaties were with capital-importing countries, they also created little risk of claims against the United States. None of the countries with which the United States has concluded BITs have nationals who are significant investors in the United States.⁸⁵ While these BITs were reciprocal in theory, they were not in fact.⁸⁶

79. Vandevelde, *supra* note 64, at 206.

80. *Id.* at 209.

81. *Id.* at 256.

82. Treaty Concerning the Reciprocal Encouragement and Protection of Investments art. VII, U.S.-Egypt, Mar. 11, 1986, http://www.unctad.org/sections/dite/ia/docs/bits/us_egypt.pdf.

83. United States 2004 Model BIT, art. 24(3), <http://www.state.gov/documents/organization/38710.pdf>; see also DOLZER & STEVENS, *supra* note 78, at 129 ("[M]ost modern treaties allow for the possibility of a choice between different arbitral regimes.").

As noted above, U.S. courts have allowed private parties to rely upon the provisions of FCNs and earlier commercial treaties. See *supra* notes 72–76 and accompanying text. The same should be true of BITs, which contain similar protections phrased in similar language, although no court seems to have addressed the question to date.

84. See *supra* notes 44–46 and accompanying text. Less developed countries signed these agreements to encourage investment flows in an increasingly competitive world. See generally Andrew T. Guzman, *Why LDCs Sign Treaties That Hurt Them: Explaining the Popularity of Bilateral Investment Treaties*, 38 VA. J. INT'L L. 639 (1998).

85. The following countries have concluded BITs with the United States, although not all of these have entered into force: Albania, Argentina, Armenia, Azerbaijan, Bahrain, Bangladesh, Belarus, Bolivia, Bulgaria, Cameroon, Congo, Congo (Brazzaville), Croatia, Czech Republic, Ecuador, Egypt, El Salvador, Estonia, Georgia,

II. NAFTA

Although the United States continues to negotiate BITs,⁸⁷ it has also moved to incorporate investment chapters in its FTAs. The United States' first FTA, which was concluded with Israel in 1985, contained no investment provisions besides a prohibition of performance requirements.⁸⁸ In negotiating the 1988 Canada-United States Free Trade Agreement, however, the United States pressed hard to include a chapter on investment, partly in hopes of setting a precedent for the Uruguay Round of GATT negotiations.⁸⁹ Although Canada initially resisted, it ultimately gave way.⁹⁰ Chapter 16 of the Canada-U.S. FTA contained investor protections similar to those in U.S. BITs, but without any provision for direct investor claims.⁹¹ Breaches of these provisions could be raised only in state-to-state dispute settlement under the terms of Chapter 18.⁹²

This changed when Canada and the United States came to negotiate an expanded FTA that would include Mexico. Mexico had never before signed an investment treaty, and the United States was determined to see that NAFTA included an investment chapter. NAFTA Chapter 11 followed the basic outlines of the U.S. model BIT, allowing investors from one NAFTA party to bring claims directly

Grenada, Haiti, Honduras, Jamaica, Jordan, Kazakhstan, Kyrgyzstan, Latvia, Lithuania, Moldova, Mongolia, Morocco, Mozambique, Nicaragua, Panama, Poland, Romania, Russia, Senegal, Slovakia, Sri Lanka, Trinidad and Tobago, Tunisia, Turkey, Ukraine, Uruguay, and Uzbekistan. See Fact Sheet, U.S. Bilateral Investment Treaty Program, <http://www.state.gov/e/eb/rls/fs/22422.htm> [hereinafter U.S. BIT Fact Sheet].

86. There were efforts in the 1990s to negotiate a multilateral agreement on investment among the members of the OECD, which would have allowed direct claims and thus exposed the United States to claims by investors from other capital-exporting States. See THE MAI NEGOTIATING TEXT 70-76 (as of Apr. 24, 1998), <http://www.oecd.org/dataoecd/46/40/1895712.pdf>. For a discussion of the failure of these negotiations, see Peter T. Muchlinski, *The Rise and Fall of the Multilateral Agreement on Investment: Where Now?*, 34 INT'L LAW. 1033 (1999).

87. The United States and Uruguay signed a BIT on Oct. 25, 2004. See U.S. BIT Fact Sheet, *supra* note 85.

88. See Agreement on the Establishment of a Free Trade Area art. 13, U.S.-Isr., Apr. 22, 1985, 24 I.L.M. 653, 662.

89. See Jean Raby, *The Investment Provisions of the Canada-United States Free Trade Agreement: A Canadian Perspective*, 84 AM. J. INT'L L. 394, 403 (1990). The Uruguay Round did produce an agreement on investment, the Trade-Related Investment Measures Agreement (TRIMS), but its substantive provisions are limited and, like other World Trade Organization (WTO) agreements, it does not allow for claims by private parties. See generally MICHAEL J. TREBILCOCK & ROBERT HOWSE, *THE REGULATION OF INTERNATIONAL TRADE* 351-53 (2d ed. 1999) (discussing TRIMS).

90. See Raby, *supra* note 89, at 405-09.

91. See Free Trade Agreement ch. 16, Can.-U.S., Jan. 2, 1988, 27 I.L.M. 281, 373-80 (1988). Canada had not concluded any BITs prior to the Canada-U.S. FTA. See ICSID, *Bilateral Investment Treaties: Canada*, <http://www.worldbank.org/icsid/treaties/canada.htm> [hereinafter Canada BITs]. It signed its first BIT with the Russian Federation on November 20, 1989. See *id.*

92. See Free Trade Agreement, *supra* note 91, ch. 18.

against the government of another NAFTA party.⁹³ Between the signing of the Canada-U.S. FTA and the end of the NAFTA negotiations, Canada had also concluded five BITs providing for direct claims by investors,⁹⁴ which made it more difficult for Canada to resist similar provisions in NAFTA.⁹⁵ None of the countries with which Canada and the United States had signed BITs had significant investments in their developed partners, but Canada and the United States had made enormous investments in each other's economies.⁹⁶ And while the novelty of an investment agreement between two developed economies was noted at the time,⁹⁷ its implications were not fully appreciated.

Canada and the United States soon found themselves to be respondents in a number of claims filed by the other's investors. As of this writing, Canada has lost two cases to U.S. investors⁹⁸ and has settled a third.⁹⁹ A fourth is pending.¹⁰⁰ Eleven cases have been filed

93. See NAFTA, *supra* note 3, ch. 11; see also North American Free Trade Agreement Implementation Act Statement of Administrative Action, H.R. Doc. No. 103-159, at 145 (1993) (noting that Chapter 11 arbitration "is patterned after the investor-State dispute settlement mechanism of the standard U.S. bilateral investment treaty").

94. See Canada BITs, *supra* note 91 (listing agreements with Russia, Poland, the Czech Republic, Hungary, and Argentina).

95. One of the Chapter 11 negotiators has recounted:

I remember at one point during the negotiations that Canada was resisting particular provisions that the United States and Mexico were urging. It was discovered that these very same provisions appeared in Canada's bilateral investment treaty with the then-Soviet Union. And the question raised to the Canadian Minister was, Is it really your position that you will treat investors from the Soviet Union more favorably than you will treat investors from either the United States or Mexico?

Daniel M. Price, *Chapter 11 Investor-State Dispute Settlement: Frankenstein or Safety Valve?*, 26 CAN.-U.S. L.J. 107, 108 (2000).

96. According to Canadian government statistics, at the end of 1993 Canadian investment in the United States exceeded C\$67 billion, while U.S. investment in Canada exceeded C\$90 billion. See Foreign Direct Investment and Canadian Direct Investment Abroad (May 2004), <http://www.dfait-maeci.gc.ca/eet/pdf/CIIP03-en.pdf>. By the end of 2003, these figures had risen to C\$164 billion and C\$228 billion, respectively. *Id.*

97. See Daniel M. Price, *An Overview of the NAFTA Investment Chapter: Substantive Rules and Investor-State Dispute Settlement*, 27 INT'L LAW. 727, 736 (1993) (noting that Chapter 11 "represents the first occasion when two developed OECD countries have made the same commitments to each other that they have demanded of developing countries").

98. See *Pope & Talbot, Inc. v. Canada*, Award on Damages (NAFTA Ch. 11 Arb. Trib., May 31, 2002), http://www.dfait-maeci.gc.ca/tna-nac/documents/damage_award.pdf; *S.D. Myers, Inc. v. Canada*, Award on Damages (NAFTA Ch. 11 Arb. Trib., Oct. 21, 2002), <http://www.dfait-maeci.gc.ca/tna-nac/documents/MyersPA.pdf>.

99. See *Dispute Settlement: Ethyl Corp. v. Canada*, <http://www.dfait-maeci.gc.ca/tna-nac/ethyl-en.asp>.

100. See *Dispute Settlement: United Parcel Serv. of Am., Inc. v. Canada*, <http://www.dfait-maeci.gc.ca/tna-nac/parcel-en.asp>. The Canadian government's

against the United States by Canadian investors.¹⁰¹ The United States has won all four of the cases decided thus far,¹⁰² though it prevailed in *Loewen* only on the basis of technicalities.¹⁰³

Although both Canada and the United States have well developed legal systems,¹⁰⁴ NAFTA Chapter 11 does not require investors to exhaust local remedies before filing claims against those countries.¹⁰⁵ Instead Article 1121 requires investors to “waive their right to initiate or continue before any administrative tribunal or court under the law of any Party, or other dispute settlement procedures, any proceedings with respect to the measure of the disputing Party that is alleged to be a breach”¹⁰⁶ The proceedings that must be waived include those alleging only breaches

website lists an additional eight cases in which notices of intent were received but in which no claims were submitted. See Dispute Settlement, NAFTA-Chapter 11-Investment, Cases Filed Against the Gov't of Canada, <http://www.dfait-maeci.gc.ca/tna-nac/gov-en.asp>.

101. See <http://www.state.gov/s/l/c3741.htm>.

102. See *Mondev Int'l Ltd. v. United States*, Award, (NAFTA Ch. 11 Arb. Trib. Oct. 11, 2002), <http://www.state.gov/documents/organization/16586.pdf>; *ADF Group, Inc. v. United States*, Award (NAFTA Ch. 11 Arb. Trib. Jan. 9, 2003), <http://www.state.gov/documents/organization/16586.pdf>; *Loewen Group, Inc. v. United States*, Award (NAFTA Ch. 11 Arb. Trib. June 26, 2003), 42 I.L.M. 811 (2003), <http://www.state.gov/documents/organization/22094.pdf>; *Methanex Corp. v. United States*, Final Award (NAFTA Ch. 11 Arb. Trib. Aug. 3, 2005), <http://www.state.gov/documents/organization/51052.pdf>.

103. See William S. Dodge, *International Decisions: Loewen Group, Inc. v. United States and Mondev International Ltd. v. United States*, 98 AM. J. INT'L L. 155, 157–58 (2004).

104. Cf. Bernardo Sepulveda Amor, *International Law and National Sovereignty: The NAFTA and the Claims of Mexican Jurisdiction*, 19 HOUS. J. INT'L L. 565, 581 (1997) (“Mexico has its own juridical order capable of giving full satisfaction to the obligations contained in the NAFTA—including, of course, those in Chapter 11.”). For a suggestion about what to do when the courts of the parties to an investment agreement inspire different levels of confidence, see *infra* note 210.

105. Although waiver of the local remedies rule is not express, Chapter 11 tribunals have generally held that it is properly inferred from Article 1121. See *Feldman v. Mexico*, Award (NAFTA Ch. 11 Arb. Trib. Dec. 16, 2002), 42 I.L.M. 625, 639 (2003) (“Article 1121(2)(b) and (3) substitutes itself as a qualified and special rule on the relationship between domestic and international judicial proceedings, and a departure from the general rule of customary international law on the exhaustion of local remedies.”); *Waste Mgmt., Inc. v. Mexico*, Mexico’s Preliminary Objection Concerning the Previous Proceedings (NAFTA Ch. 11 Arb. Trib. June 26, 2002), 41 I.L.M. 1315, 1321 (2002) (“In common with almost all investment treaties, there is no requirement of exhaustion of local remedies.”); *Metalclad Corp. v. Mexico*, Award, (NAFTA Ch. 11 Arb. Trib. Aug. 30, 2000), 40 I.L.M. 36, 49 n.4 (2001) (“Mexico does not insist that local remedies must be exhausted. Mexico’s position is correct in light of NAFTA Article 1121(2)(b)”). But see *Loewen Group*, 42 I.L.M. at 838 (“Article 1121 involves no waiver of the duty to pursue local remedies in its application to a breach of international law constituted by a judicial act.”). For a discussion of the issue that predated these awards, see William S. Dodge, *National Courts and International Arbitration: Exhaustion of Remedies and Res Judicata Under Chapter Eleven of NAFTA*, 23 HASTINGS INT’L & COMP. L. REV. 357, 373–76 (2000).

106. NAFTA, *supra* note 3, arts. 1121(1)(b), 1121(2)(b).

of domestic law.¹⁰⁷ Subject to Chapter 11's three-year statute of limitations, an investor is free to pursue domestic remedies *before* it files a Chapter 11 claim,¹⁰⁸ but ultimately it must choose between national courts and international arbitration.

This choice is not made any easier by the fact that no single forum has jurisdiction over both Chapter 11 and domestic-law claims. The jurisdiction of Chapter 11 tribunals extends only to breaches of Chapter 11 and customary international law,¹⁰⁹ while U.S. and Canadian courts are prohibited by NAFTA's implementing legislation from hearing private causes of action or defences based on the agreement.¹¹⁰ But in the real world, issues of domestic law are

107. See *Waste Mgmt., Inc. v. Mexico*, Arbitral Award (NAFTA Ch. 11 Arb. Trib. June 2, 2000), 40 I.L.M. 56, 66 (2001) ("[T]he waiver required under NAFTA Article 1121 calls for a show of intent by the issuing party vis-à-vis its waiver of the right to initiate or continue any proceedings whatsoever before other courts or tribunals with respect to the measure allegedly in breach of the NAFTA provisions.").

108. See NAFTA, *supra* note 3, art. 1116(2) ("An investor may not make a claim if more than three years have elapsed from the date on which the investor first acquired, or should have first acquired, knowledge of the alleged breach and knowledge that the investor has incurred loss or damage."); *id.* art. 1117(2).

An investor may not make a claim on behalf of an enterprise described in paragraph 1 if more than three years have elapsed from the date on which the enterprise first acquired, or should have first acquired, knowledge of the alleged breach and knowledge that the enterprise has incurred loss or damage.

109. See *id.*, art. 1131(1) ("A Tribunal established under this Section shall decide the issues in dispute in accordance with this Agreement and applicable rules of international law."); see also *Azinian v. Mexico*, Award (NAFTA Ch. 11 Arb. Trib. Nov. 1, 1999), 39 I.L.M. 537, 549 (2000) ("Arbitral jurisdiction under Section B is limited . . . as to subject matter: claims may not be submitted to investor-state arbitration under Chapter Eleven unless they are founded upon the violation of an obligation established in Section A."); *ADF Group, Inc. v. United States* (NAFTA Ch. 11 Arb. Trib. Jan. 9, 2003) ¶ 190, <http://www.state.gov/documents/organization/16586.pdf> ("[T]he Tribunal has no authority to review the legal validity and standing of the U.S. measures here in question under U.S. internal administrative law. Our jurisdiction is confined by NAFTA Article 1131(1) to assaying the consistency of the U.S. measures with relevant provisions of NAFTA Chapter 11 and applicable rules of international law."); *Waste Mgmt., Inc. v. Mexico*, Final Award (NAFTA Ch. 11 Arb. Trib. Apr. 30, 2004), 43 I.L.M. 967, 989 (2004) ("NAFTA Chapter 11 is not a forum for the resolution of contractual disputes.").

110. North American Free Trade Agreement Implementation Act § 102(c)(1), Pub. L. No. 103-182 (codified at 19 U.S.C.A. § 3312(c)(1)) [hereinafter NAFTA Implementation Act] ("No person other than the United States . . . shall have any cause of action or defense under the [NAFTA] . . ."); *id.* § 102(c)(2) (codified at 19 U.S.C.A. § 3312(c)(2)).

No person other than the United States . . . may challenge, in any action brought under any provision of law, any action or inaction by any department, agency, or other instrumentality of the United States, any State, or any political subdivision of a State on the ground that such action or inaction is inconsistent with the [NAFTA] . . .

North American Free Trade Agreement Implementation Act § 6(2), 1993 Consolidated Statutes of Canada, c. 44.

frequently intertwined with Chapter 11 claims. Whether a concession contract was expropriated may depend on whether the government had legitimate grounds to repudiate it under domestic law.¹¹¹ Whether the denial of a municipal construction permit violated the international minimum standard of treatment may depend on whether the permitting authority had jurisdiction over environmental matters.¹¹² And a foreign investor who waives its domestic remedies to pursue a Chapter 11 claim may find in the end that the local government's misconduct violated only domestic law and could only have been pursued in a domestic forum.¹¹³

One supposed reason for not allowing U.S. courts to hear treaty claims is to protect state sovereignty,¹¹⁴ but in the NAFTA context such protection has proved illusory. Prohibitions against private causes of action and related provisions have been included in legislation implementing U.S. trade agreements since 1979.¹¹⁵

Subject to Section B of Chapter Eleven of the Agreement, no person has any cause of action and no proceedings of any kind shall be taken, without the consent of the Attorney General of Canada, to enforce or determine any right or obligation that is claimed or arises solely under or by virtue of the Agreement.

An investor may raise a breach of Chapter 11 in Mexican court, but doing so precludes the investor from subsequently bringing its claim before a Chapter 11 tribunal. See NAFTA, *supra* note 3, annex 1120.1(a) ("[A]n investor of another Party may not allege that Mexico has breached an obligation under [NAFTA] . . . both in an arbitration under this Section and in proceedings before a Mexican court or administrative tribunal . . .").

111. See, e.g., *Azinian*, 39 I.L.M. at 551-55 (noting that the invalidity or proper rescission of a concession contract under Mexican law would defeat a claim that the concession was expropriated).

112. See, e.g., *Metalclad Corp. v. Mexico*, Award, (NAFTA Ch. 11 Arb. Trib. Aug. 30, 2000), 40 I.L.M. 36, 48-49 (2001) (concluding that denial of municipal construction permit for hazardous waste landfill on the basis of environmental concerns breached Article 1105 when Mexican law gave the federal government exclusive authority over the regulation of hazardous wastes).

113. See, e.g., *Waste Mgmt.*, 43 I.L.M. 967.

114. See MICHELLE SAGER, ONE VOICE OR MANY? FEDERALISM AND INTERNATIONAL TRADE 122 (2002) (noting that during the negotiation of NAFTA and the Uruguay Round "[t]he preservation of federalism emerged as a key ingredient for continued state support for trade liberalization"). For a good account of state efforts to preserve sovereignty under NAFTA and GATT, see *id.* at 89-123.

115. These provisions have evolved over time. Section 3 of the Trade Agreements Act of 1979 provided that U.S. law was to prevail in the event of a conflict with GATT and prohibited private causes of action under the agreement unless Congress explicitly provided otherwise. See Trade Agreements Act of 1979, Pub. L. No. 96-39, § 3(a) & (f), 93 Stat. 144 (1979). Section 5 of the United States-Israel Free Trade Area Implementation Act of 1985 was virtually identical. See U.S.-Israel Free Trade Area Implementation Act of 1985, Pub. L. No. 99-47, § 5(a) & (d), 99 Stat. 82 (1985). Section 102 of the United States-Canada Free Trade Agreement Implementation Act of 1988 repeated these provisions and added others concerning state law, providing that the FTA would prevail over inconsistent state law but that only the United States could challenge state law as inconsistent with the agreement. See U.S.-Canada Free Trade Agreement Implementation Act of 1988, Pub. L. No. 100-

Indeed, the U.S. House of Representative's report on NAFTA's implementing legislation noted that its limitations were "consistent with the Trade Agreements Act of 1979 implementing the Tokyo Round of multilateral trade negotiations, the U.S.-Israel Free Trade Area Implementation Act of 1985, and the U.S.-Canada FTA Implementation Act of 1988."¹¹⁶ This citation of precedents, however, masks an important difference. None of these other agreements provided private parties an alternative forum in which to bring claims.¹¹⁷ In the case of the General Agreement on Tariffs and Trade (GATT) and the earlier FTAs, the effect of precluding private causes of action was to give the United States a monopoly over enforcement of the agreement. NAFTA Chapter 11, by contrast, did allow investors to bring claims to enforce the agreement. The effect of these same implementing provisions in the context of NAFTA, then, was not to prevent private claims alleging that state and local laws violated the agreement, but instead to direct these claims into an international rather than a domestic forum.

Of the eleven NAFTA cases filed against the United States, five have alleged breaches by state or local governments.¹¹⁸ Although these claims are brought against the United States, rather than the states, and any damages awarded would come in the first instance from the federal treasury, state and local officials have expressed concern.¹¹⁹ The National Conference of State Legislatures (NCSL) has sought assurances "that the federal government will not shift the cost of compensation under a Chapter 11 award to states whose

449, § 102(b)(1) & (3), 102 Stat. 1851 (1988). These provisions were then incorporated in Section 102 of the North American Free Trade Agreement Implementation Act and in Section 102 of the Uruguay Round Agreements Act. See Pub. L. No. 103-465, § 102, 108 Stat. 4809 (1994) (codified at 19 U.S.C. § 3512). They have also been included in the implementing legislation for every subsequent FTA.

There are also parallels in the non-self-execution declarations the United States has made with respect to human rights treaties since the late 1970s. See Curtis A. Bradley & Jack L. Goldsmith, *Treaties, Human Rights, and Conditional Consent*, 149 U. PA. L. REV. 399, 419-22 (2000).

116. H.R. Rep. No. 103-361, pt. 1, at 18, (1993), reprinted in 1993 U.S.C.C.A.N. 2552, 2568.

117. GATT dispute resolution, both before and after the Uruguay Round, was limited to state parties, and as noted above neither the U.S.-Israel nor the U.S.-Canada FTAs allowed direct investor claims. See *supra* notes 88-92 and accompanying text.

118. See U.S. Dept. of State, Cases Filed Against the United States of America, <http://www.state.gov/s/l/c3741.htm> (indicating that the cases alleging breaches by state or local government are *Glamis Gold Ltd.*, *Grand River Enterprises Six Nations Ltd.*, *Loewen Group, Inc.*, *Methanex Corp.*, and *Mondev International Ltd.*).

119. See, e.g. Letter from National Conference of State Legislatures, National League of Cities, and National Association of Towns and Townships to Chuck Grassley, Chairman, Senate Finance Committee (Apr. 12, 2005), <http://www.ncsl.org/standcomm/scecon/grassleyletter041205.htm> ("The interplay of state and local judicial authorities and jurisdictions and the quasi-judicial, ad hoc bodies created to consider investor-state disputes continues to trouble our members.").

measures are challenged and will not withhold federal funds otherwise appropriated by the Congress to a state as a means of enforcing compliance with provisions of NAFTA.”¹²⁰ The NCSL has also asked the federal government not to “seek to preempt state law as a means of enforcing compliance with NAFTA without expressly stated intent to do so by the Congress.”¹²¹ The federal government has provided only the latter assurance.¹²² Available documents reflect some state assistance in defending claims based on state measures,¹²³ but ultimately it is the federal government of the United States that makes the decisions about how to defend such claims.¹²⁴ Ironically, the federalism protections found in NAFTA’s implementing legislation have not worked to protect state sovereignty but have instead exposed state laws to international claims without allowing the states to control the defence of those claims. As will be seen below, AUSFTA does protect the states from similar challenges, but only at the expense of making its investment protections largely unenforceable.

120. Nat’l Conference of State Legislatures, Economic Development, Trade and Cultural Affairs Committee, 2004–2005 Policy on the North American Free Trade Agreement, <http://www.ncsl.org/statefed/EconDev.htm#NAFTA> [hereinafter NCSL NAFTA Policy].

121. *Id.*

122. See Ambassador Peter F. Allgeier, Acting U.S. Trade Rep., Remarks at the Nat’l Conference of State Legislatures: Trade Agreements and the States 2 (Apr. 16, 2005), available at http://www.ustr.gov/assets/Document_Library/USTR_Zoellick_Speeches/2005/asset_upload_file62_7628.pdf.

Trade agreements do *not* restrict a state’s right to regulate and do not automatically pre-empt, invalidate or overturn state laws And international panels set up to look at disputes over trade agreements have no authority to change U.S. law or to require any state or local government to change its laws or decisions. Only the federal or state governments can change a federal or state law.

123. See *Grand River Enter. v. United States*, Minutes of the First Session of the Tribunal, 2 (Mar. 31, 2005) (NAFTA/UNCITRAL Arbitration), <http://www.state.gov/documents/organization/45017.pdf> (listing William Lieblich, Nat’l Assoc. of Attorneys General, as assisting respondent); *Methanex Corp. v. United States*, Final Award, pt. II, ch. A, 2–3 (NAFTA Ch. 11 Arb. Trib. Aug. 3, 2005), <http://www.state.gov/documents/organization/51052.pdf> (noting that representatives of California attended oral meetings and hearings and “worked closely with the USA in formulating the USA’s case”). NCSL has asked for “the right of attorneys for the state to participate as part of the ‘team’ defending a state law before international tribunals.” Nat’l Conference of State Legislatures, Economic Development, Trade and Cultural Affairs Committee, 2004–2005 Policy on Free Trade and Federalism, <http://www.ncsl.org/statefed/EconDev.htm#freetrade> [hereinafter NCSL Free Trade Policy].

124. State representatives are not listed on any of the briefs or pleadings filed by the United States in any of the five cases noted above. Briefs and pleadings are available at <http://www.state.gov/s/l/c3741.htm>.

III. AUSFTA

The Australia-United States FTA was signed on May 18, 2004, and entered into force on January 1, 2005.¹²⁵ Chapter 11 of AUSFTA covers investment and includes essentially the same substantive provisions as NAFTA Chapter 11, although some key differences show that the negotiators took the NAFTA experience into account.¹²⁶ What distinguishes AUSFTA from NAFTA is its lack of a provision for direct investor claims.¹²⁷ Enforcement of AUSFTA Chapter 11 is limited to the state-to-state dispute settlement procedures set forth in Chapter 21.¹²⁸ Moreover, it seems likely that an investor would have

125. Press Release, Office of the United States Trade Rep., Landmark U.S.-Australia Free Trade Agreement Goes into Effect Today (Jan. 1, 2005), *available at* http://www.ustr.gov/Document_Library/Press_Releases/2005/January/Lmark_U.S.-Australia_Free_Trade_Agreement_Goes_Into_Effect_Today.html.

126. To give two examples, AUSFTA Article 11.5's minimum standard of treatment provides for "treatment in accordance with the *customary* international law minimum standard of treatment of aliens" (emphasis added) and states explicitly that "[a] determination that there has been a breach of another provision of this Agreement, or of a separate international agreement, does not establish that there has been a breach of this Article." AUSFTA, *supra* note 2, art. 11.5. The analogous provision of NAFTA, Article 1105, used the more ambiguous phrase "treatment in accordance with international law," leading some NAFTA tribunals to conclude that breach of another provision of NAFTA would constitute a breach of article 1105 as well. See William S. Dodge, *International Decisions: Metalclad Corp. v. Mexico and Mexico v. Metalclad Corp.*, 95 AM. J. INT'L L. 910, 916 (2001).

AUSFTA also includes an interpretive Annex 11-B on expropriation specifying that "[e]xcept in rare circumstances, non-discriminatory regulatory actions by a Party that are designed and applied to achieve legitimate public welfare objectives, such as the protection of public health, safety, and the environment, do not constitute indirect expropriations." AUSFTA, *supra* note 2, annex 11-B(4)(b). This largely closes the door to regulatory expropriation claims that awards like *Metalclad* had opened. See *Metalclad Corp. v. Mexico*, Award, (NAFTA Ch. 11 Arb. Trib. Aug. 30, 2000), 40 I.L.M. 36, 50 (2001).

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.

127. Article 11.16 provides only for future consultations concerning the development of investor-state dispute settlement if "there has been a change in circumstances affecting the settlement of disputes on matters within the scope of this Chapter." AUSFTA, *supra* note 2, art. 11.16.

128. Chapter 21 provides in the first instance for consultations between the state parties, *id.* art. 21.5, and referral to the standing Joint Committee established by the agreement, *id.* art. 21.6. If these fail to resolve the dispute, it may be taken to a dispute settlement panel of three. *Id.* art. 21.7. The panel may determine if the

to exhaust its domestic remedies before Chapter 21's procedures could be invoked.¹²⁹

AUSFTA's failure to provide for direct investor claims does not represent a rejection of such claims more generally by either the United States or Australia. Between NAFTA and AUSFTA, the United States negotiated FTAs with Singapore, Chile, Morocco, and the CAFTA-DR countries¹³⁰ providing for investor-state dispute settlement,¹³¹ as well as BITs with an additional twenty-one countries¹³² allowing for direct claims. Australia has only recently started to negotiate FTAs,¹³³ but its FTAs with Singapore and Thailand each include provisions for investor-state dispute resolution,¹³⁴ as do Australia's many BITs with developing countries.¹³⁵

measure at issue is a breach of the agreement but does not award damages. *Id.* art. 21.9. Compensation seems to be contemplated only if the breaching state refuses to implement the panel's report and even then must be negotiated by the parties. *Id.* art. 21.11.1. The ultimate sanction is suspension of benefits under the agreement, the amount of which the panel may determine. *Id.* art. 21.11.2-7.

129. In the *ELSI* case, a Chamber of the ICJ held a provision in the Italy-U.S. FCN providing for the resolution of disputes between the two States was insufficient to waive the local remedies rule, stating that it was "unable to accept that an important principle of customary international law should be held to have been tacitly dispensed with, in the absence of any words making clear an intention to do so." *Elettronica Sicala S.p.A. (ELSI) (U.S. v. Italy)*, 1989 I.C.J. 15, 42 (July 20). There is no provision in Chapter 11 or Chapter 21 of AUSFTA analogous to Article 1121 of NAFTA, which NAFTA tribunals have found to waive the exhaustion requirement. *See supra* notes 104-07 and accompanying text.

130. Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua, and the Dominican Republic.

131. *See* Free Trade Agreement, ch. 10, U.S.-Sing., May 6, 2003, available at http://www.ustr.gov/assets/Trade_Agreements/Bilateral/Singapore_FTA/Final_Texts/asset_upload_file708_4036.pdf; Free Trade Agreement, ch. 10, U.S.-Chile, June 6, 2003, available at http://www.ustr.gov/assets/Trade_Agreements/Bilateral/Chile_FTA/Final_Texts/asset_upload_file1_4004.pdf; Free Trade Agreement, ch. 10, U.S.-Morocco, June 16, 2004, available at http://www.ustr.gov/assets/Trade_Agreements/Bilateral/Morocco_FTA/Final_Text/asset_upload_file651_3838.pdf; Free Trade Agreement, ch. 10, Cen. Am.-Dom. Rep.-U.S., Aug. 8, 2004, available at http://www.ustr.gov/assets/Trade_Agreements/Bilateral/CAFTA/CAFTA-DR_Final_Texts/asset_upload_file328_4718.pdf.

132. Albania, Azerbaijan, Bahrain, Belarus, Bolivia, Croatia, El Salvador, Estonia, Georgia, Honduras, Jamaica, Jordan, Latvia, Lithuania, Mongolia, Mozambique, Nicaragua, Trinidad and Tobago, Ukraine, Uruguay, and Uzbekistan. *See* U.S. BIT Fact Sheet, *supra* note 85.

133. *See* Bryan Mercurio, *Should Australia Continue Negotiating Bilateral Free Trade Agreements? A Practical Analysis*, 27 UNSW L.J. 667 (2004).

134. Free Trade Agreement, ch. 8, art. 14, Sing.-Austl., Feb. 17, 2003, available at http://www.dfat.gov.au/trade/negotiations/aust-thai/aus-thai_FTA_text.pdf; Free Trade Agreement, art. 917, Austl.-Thail., July 5, 2004, available at http://www.dfat.gov.au/trade/negotiations/aust-thai/aus-thai_FTA_text.pdf.

135. UNCTAD lists BITs between Australia and the following countries: Argentina, Chile, China, Czech Republic, Egypt, Hungary, Lithuania, Pakistan, Philippines, Poland, India, Indonesia, Hong Kong, Laos, Papua New Guinea, Peru, Romania, Sri Lanka, Uruguay, and Vietnam. *See* U.N. Conference on Trade and

Because little investment from these countries flows into either the United States or Australia, these other agreements pose little risk of direct investor claims against the Australian and U.S. governments. The investment relationship between the United States and Australia is quite different. According to Australia's Department of Foreign Affairs and Trade, the United States is the largest foreign investor in Australia, supplying nearly thirty percent of its foreign investment, while Australia is the tenth largest foreign owner of U.S. assets.¹³⁶ In 2002, U.S. investment in Australia was valued at US\$36.3 billion, on a historical-cost basis, while Australian investment in the United States was valued at US\$24.5 billion.¹³⁷ Given these levels of investment, allowing direct claims under AUSFTA would inevitably have led to a repetition of the Canadian and U.S. experience under NAFTA.

Of course, neither Australia nor the United States explained the absence of investor-state dispute resolution in terms of a desire not to be sued. The Australian government said "[t]his outcome recognises the fact that both countries have robust and sophisticated domestic legal systems that provide adequate scope for investors, both domestic and foreign, to pursue concerns about government actions."¹³⁸ The United States took the same line, though it seemed less pleased with the result and more concerned not to set a precedent:

In recognition of the unique circumstances of this Agreement—including, for example, the longstanding economic ties between the United States and Australia, their shared legal traditions, and the confidence of their investors in operating in each others' markets—the

Development (UNCTAD), Investment Instruments Online, Bilateral Investment Treaties, <http://www.unctadxi.org/templates/DocSearch.aspx?id=779>.

136. See DEPARTMENT OF FOREIGN AFFAIRS AND TRADE, AUSTRALIA-UNITED STATES FREE TRADE AGREEMENT: ADVANCING AUSTRALIA'S ECONOMIC FUTURE 4 (2004), http://www.dfat.gov.au/trade/negotiations/us_fta/ausfta_brochure.pdf.

137. See UNITED STATES INTERNATIONAL TRADE COMMISSION, U.S.-AUSTRALIA FREE TRADE AGREEMENT: POTENTIAL ECONOMYWIDE AND SELECTED SECTORAL EFFECTS 99, 101 (May 2004), <http://hotdocs.usitc.gov/docs/pubs/2104f/pub3697.pdf> [hereinafter ITC REPORT].

138. FAQs, *supra* note 5; see also AUSTRALIA DEPARTMENT OF FOREIGN AFFAIRS AND TRADE, THE AUSTRALIA-UNITED STATES FREE TRADE AGREEMENT (AUSFTA): ADVANCING AUSTRALIAN INVESTMENT AND SERVICES EXPORTS 5 (2004), www.dfat.gov.au/trade/negotiations/us_fta/fact_sheets/Services.pdf.

Significantly, the Agreement also does not allow for private investors to trigger dispute settlement processes under its provisions to challenge government decisions, known as 'Investor-State Dispute Settlement'. Only the two governments may initiate a dispute procedure if they believe the other party is not complying with its obligations under the investment chapter of the Agreement. This result recognises that both countries have established, robust and sophisticated legal systems that provide adequate scope for both domestic and foreign investors to pursue concerns about government actions.

two countries agreed not to adopt procedures in the Agreement that would allow investors to arbitrate disputes with governments. This issue will be revisited if circumstances change.¹³⁹

In neither the United States nor Australia, however, will these “robust and sophisticated domestic legal systems”¹⁴⁰ get the chance to hear claims under AUSFTA itself.¹⁴¹ U.S. implementing legislation for AUSFTA follows the same pattern as NAFTA’s,¹⁴² providing that “[n]o person other than the United States . . . shall have any cause of action or defense under the Agreement”¹⁴³ or “may challenge . . . any action or inaction by any department, agency, or other instrumentality of the United States, any State, or any political subdivision of a State, on the ground that such action or inaction is inconsistent with the Agreement.”¹⁴⁴ Australia’s implementing legislation¹⁴⁵ does not deal with this question explicitly, but it is well established that the provisions of a treaty “do not form part of Australian law unless those provisions have been validly incorporated into our municipal law by statute” and that “a treaty which has not been incorporated into our municipal law cannot operate as a direct source of individual rights and obligations under that law.”¹⁴⁶

What Australia and the United States have created, then, is a system for protecting foreign investors that depends entirely on

139. Office of the United States Trade Representative, U.S.-Australia FTA Summary of the Agreement (July 15, 2004), http://www.ustr.gov/Trade_Agreements/Bilateral/Australia_FTA/US-Australia_FTA_Summary_of_the_Agreement.html. It appears that U.S. business interests were the strongest advocates of including an investor-state provision. The U.S. International Trade Commission reported, “The U.S. business community would have preferred that the FTA include an ‘investor-state’ dispute resolution mechanism. Industry representatives view this as a significant shortcoming of the agreement, and an important step back from previous FTAs and Bilateral Investment Treaties (BITs) concluded by the United States.” ITC REPORT, *supra* note 137, at 105–06; *see also* JOINT STANDING COMMITTEE ON TREATIES, PARLIAMENT OF AUSTRALIA, REPORT 61: THE AUSTRALIA-UNITED STATES FREE TRADE AGREEMENT 52, <http://www.aph.gov.au/house/committee/jsct/usafta/report/fullreport.pdf> (“American business interests were pushing for investor-state dispute settlement.”).

140. FAQs, *supra* note 5.

141. *See* AUSFTA, *supra* note 2, art. 21.15 (“Neither Party may provide for a right of action under its domestic law against the other Party on the ground that a measure of the other Party is inconsistent with this Agreement.”). In fact, the limitations on private parties invoking AUSFTA in domestic court go far beyond this. *See infra* notes 142–46 and accompanying text.

142. *See supra* note 110 and accompanying text.

143. United States-Australia Free Trade Agreement Implementation Act, Pub. L. No. 108–286, § 102(c)(1), 118 Stat. 919 (2004) (codified at 19 U.S.C. § 3805 note).

144. *Id.* § 102(c)(2). Like NAFTA’s implementing legislation, the AUSFTA Implementation Act also provides that U.S. law is to prevail in the event of a conflict and that only the United States may bring suit to have a state law declared invalid under the agreement. *See id.* § 102(a), (b)(2).

145. US Free Trade Agreement Implementation Act 2004, c. 120 (Austl.), available at http://www.austlii.edu.au/au/legis/cth/consol_act/uftaia2004363.

146. Minister for Immigration and Ethnic Affairs v. Teoh (1995) 183 CLR 273, 286–87 (Austl.).

diplomatic protection and resembles those in operation before the advent of ICSID and the BITs. Indeed, in one respect, the agreement is even more restrictive than earlier treaties, for breaches of AUSFTA may not be raised in domestic courts, whereas the provisions of earlier treaties could in at least some instances.¹⁴⁷ Instead, investors will have to find proxies for their Chapter 11 claims in the domestic laws of Australia and the United States, alleging a violation of the U.S. Constitution's Fifth Amendment¹⁴⁸ or Article 51(xxxi) of the Australian Constitution,¹⁴⁹ rather than an expropriation in violation of AUSFTA Article 11.7. Only when an investor has exhausted these domestic-law claims will its home state be able to raise the breach of AUSFTA through the Chapter 21 process.¹⁵⁰ Even then, it is not certain that the investor's home state will do so, for that state may prefer to forgive the breach in the interests of smooth diplomatic relations.¹⁵¹

This system will undoubtedly protect the Australian and U.S. governments from having to defend themselves against direct claims from each other's investors. The direct claims they will not have to face include those based on state and local measures, promoting federalism. This has only been achieved, however, by making the substantive provisions of AUSFTA largely unenforceable. Justice Holmes once observed that "[l]egal obligations that exist but cannot be enforced are ghosts that are seen in the law but that are elusive to the grasp."¹⁵² AUSFTA Chapter 11 is a ghost.

IV. THE BEST OF BOTH WORLDS

One might reasonably argue that there is no need for investment agreements between developed countries because those countries' domestic legal systems already provide sufficient protections for

147. See *supra* notes 72–76 and accompanying text.

148. U.S. CONST. amend. V (“[N]or shall private property be taken for public use, without just compensation.”).

149. Commonwealth of Australia Constitution Act c. I, pt. V, §51 (xxxix) (granting Parliament the power to acquire “property on just terms from any State or person for any purpose in respect of which the Parliament has power to make laws”).

150. See *supra* note 129 and accompanying text.

151. See *supra* notes 44–46 and accompanying text.

152. *Western Maid v. Thompson*, 257 U.S. 419, 433 (1922); see also Richard B. Lillich, *The Diplomatic Protection of Nationals Abroad: An Elementary Principle of International Law Under Attack*, 69 AM. J. INT’L L. 359, 359 (1975) (quoting *Western Maid*). Professor Lillich defended diplomatic protection as the only available means to enforce State responsibility “until the international community grants alien claimants access to effective international machinery guaranteeing third-party determination of wealth deprivation disputes.” Lillich, *supra*, at 364. Diplomatic protection may not be the best means, however, particularly when its exercise seems unlikely and a mechanism for direct claims is possible.

investors. That is a fine argument for not putting investment provisions in FTAs between developed countries at all, but in this context it proves too much. If an agreement between developed countries contains investment protections, those protections should be enforceable. But how?

One may divide the inquiry into two parts. First, who should have authority to enforce investment protections? Should enforcement be limited to the investor's home state, or should the investor itself be allowed to press a claim? Second, if the investor should be allowed to press its own claim, what is the proper forum to hear the dispute in the first instance? Should agreements between developed countries waive the local remedies rule and allow foreign investors to proceed immediately to international arbitration, or should they require such investors to exhaust domestic remedies?

This Article argues that investors should be allowed to bring direct claims to enforce investment agreements between developed countries, but that they should first be required to bring those claims in the domestic courts of the host state.

A. *The Advantages of Direct Claims*

Diplomatic protection has strengths and weaknesses. One strength lies in screening out frivolous or dishonest claims. A U.S. State Department official once observed: "The tendency of individual claimants to press unsound claims—for any loss sustained in a foreign country—and in grossly exaggerated form is well known."¹⁵³ An espousing state, by contrast, is constrained by the fear of losing credibility and thereby jeopardizing other claims that it might wish to make.¹⁵⁴ On the other hand, this screening role imposes a substantial burden on states, which "are pressured to prosecute, or at least investigate, a great number of frivolous claims that would not otherwise be pressed if the responsibility and cost of prosecution remained with the individual investor."¹⁵⁵

Although diplomatic protection spares foreign investors the expense of prosecuting their own claims, it generally does not serve them well. Governments will often be tempted to sacrifice an investor's interests "to some overriding policy of fostering friendly

153. 8 MARJORIE M. WHITEMAN, DIGEST OF INTERNATIONAL LAW 1223 (1967) (quoting Memorandum prepared by Marjorie M. Whiteman, Assistant Legal Advisor, Department of State, "Comments on Report on 'International Responsibility', by Dr. Garcia-Amador, Special Rapporteur, International Law Commission," (Dec. 18, 1956)).

154. *Id.*

155. Charles N. Brower & Lee A. Steven, *Who Then Should Judge?: Developing the International Rule of Law under NAFTA Chapter 11*, 2 CHI. J. INT'L L. 193, 197 (2001); see also Lauterpacht, *supra* note 40, at 458 (suggesting that "the heavy cost of international litigation would act as an effective deterrent against rash or malicious recourse to the machinery put at the disposal of private persons").

relations.”¹⁵⁶ As a former Legal Advisor to the Department of State candidly admitted, “the Department’s decision with respect to espousal is likely to be influenced, not only by the merits of the case, but by the Department’s concern for offending a foreign state and creating a potential irritant in its dealings with that state.”¹⁵⁷

Finally, diplomatic protection tends to increase “international friction.”¹⁵⁸ One need not agree with Professor Brierly that equating the economic interests of private parties with those of the entire nation is the greatest threat to peace in the modern world¹⁵⁹ to recognize that converting private claims into diplomatic disputes injects unnecessary irritants into foreign relations.¹⁶⁰

In comparison, direct claims offer a number of advantages. “Because the most directly affected parties are involved, both the costs and potential rewards of the process fall to the persons or entities that control it.”¹⁶¹ This promotes not just sensible choices about whether to bring or to defend a claim, but also “efficient decisions about the design and subsequent conduct of arbitral proceedings.”¹⁶² Most importantly, allowing direct claims tends to depoliticize the settlement of investment disputes, allowing foreign investors to press their claims without worrying that government officials may sacrifice them in the interests of foreign relations; it also smoothes those relations by allowing home states to remain neutral in disputes between their nationals and other states. As Professor Caron has noted, the trend towards direct claims “is desirable politically because it reduces the significance of the state as a world actor in areas where the sensitivities of the state need not be implicated.”¹⁶³

156. Jessup, *supra* note 46, at 908.

157. *The Foreign Sovereign Immunities Act: Hearings Before the Subcomm. on Courts and Administrative Practice, S. Comm. on the Judiciary*, 103d Cong. 83–84 (1994) (testimony of Abraham D. Sofaer) [hereinafter Sofaer Testimony]; see also David J. Bederman, *International Law Advocacy and its Discontents*, 2 CHI. J. INT’L L. 475, 483–84 (2001) (“Individual grievances have tended to be subordinated to the greater good of the state in its pursuit of common foreign policy objectives.”); Brower & Steven, *supra* note 155, at 197 (“[T]he exigencies of time, money, political priorities, and the whims of individual bureaucrats may cause a government to downgrade, or even ignore, meritorious claims.”).

158. Lauterpacht, *supra* note 40, at 454.

159. See *supra* note 42 and accompanying text.

160. See Sofaer Testimony, *supra* note 157, at 83–84. Problems with diplomatic protection that arose historically from an imbalance of power, see *supra* note 43 and accompanying text, do not seem as pronounced in the context of disputes between two developed countries.

161. Caron, *supra* note 49, at 155.

162. *Id.*

163. *Id.* at 154–55.

B. *Requiring Exhaustion of Local Remedies*

While allowing foreign investors to bring direct claims has a number of advantages, there is no reason the initial forum for such claims must be an international tribunal. Decisions to waive the local remedies rule and allow immediate recourse to international arbitration have been made in situations where the courts of a host state were not trusted,¹⁶⁴ and the same path need not be followed where both states have well-functioning domestic court systems. It is also worth recalling that in the United States, at least, there is a long history of allowing private parties to raise claims under commercial treaties in domestic courts.¹⁶⁵ If investment agreements between developed countries were enforceable in domestic courts, and if foreign investors were required to exhaust their local remedies before resorting to an international tribunal, a number of advantages would be gained: (1) sovereignty would be better protected than under NAFTA Chapter 11, (2) the appellate processes of domestic courts would be able to correct errors, and (3) a single forum would be able to hear and resolve all claims arising from an investment dispute. After discussing these advantages below, this Article responds briefly to a few anticipated objections.

1. Preserving Sovereignty

Chief among the advantages to the host state would be the preservation of sovereignty. Sovereignty, in this context, does not mean complete freedom to do as a state wishes, for such freedom is inconsistent with the notion of investor protection by treaty. Rather it means respect for the internal processes of the state, and for its courts in particular “on the assumption that they are capable of doing justice.”¹⁶⁶ Sovereignty would be best preserved by requiring that an investor present not just its domestic-law claims to a domestic court, but its international claims as well.¹⁶⁷ Domestic courts are perfectly

164. See *supra* notes 52–55 and accompanying text.

165. See *supra* notes 72–76 and accompanying text.

166. BORCHARD, *supra* note 23, at 817.

167. Most international tribunals have held that if a party can raise its international claims before a domestic tribunal, then it must do so in order to exhaust its domestic remedies. See *Certain Norwegian Loans (Fr. v. Nor.)*, 1957 I.C.J. 9, 41–42 (July 6) (separate opinion of Judge Lauterpacht) (stating that French bondholders should have raised international law claims in Norwegian courts); *Finnish Ships Arbitration (Fin. v. U.K.)*, 3 R.I.A.A. 1479, 1502 (1934) (“[A]ll the contentions of fact and propositions of law which are brought forward by the claimant Government . . . must have been investigated and adjudicated upon by the municipal Courts . . .”). But see *Elettronica Sicala S.p.A. (ELSI) (U.S. v. Italy)*, 1989 I.C.J. 15, 45–46 (July 20) (holding that raising only domestic-law claims was sufficient to satisfy

capable of handling international claims,¹⁶⁸ and they will be more “capable of doing justice” and thus of avoiding recourse to an international tribunal if they have jurisdiction over all of the legal claims that a dispute may generate.

Domestic courts may be particularly useful in avoiding recourse to international tribunals when breaches of the treaty arise from the actions of relatively low-level officials, particularly those outside of the federal hierarchy.¹⁶⁹ In *Loewen*, for example, the NAFTA Chapter 11 tribunal found “that the conduct of the trial by the trial judge was so flawed that it constituted a miscarriage of justice amounting to a manifest injustice as that expression is understood in international law.”¹⁷⁰ The only way for the United States to correct this breach of NAFTA was through domestic appeals, and the *Loewen* tribunal sensibly required exhaustion.¹⁷¹ “[I]t would be very strange if a State were to be confronted with liability for a breach of international law committed by its magistrate or low-ranking judicial officer when domestic avenues of appeal are not pursued,” the tribunal noted, because “domestic appeal or review, if pursued, might have avoided any liability on the part of the State.”¹⁷² Although *Loewen*’s exhaustion requirement is limited to judicial decisions,¹⁷³ requiring exhaustion makes just as much sense for other measures that violate investment agreements.¹⁷⁴ As Professor Borchard noted nearly a century ago, “if the injury is committed by an individual or minor official, the exhaustion of local remedies is necessary to make certain that the wrongful act or denial of justice is the deliberate act of the

the local remedies rule so long as “the substance of the claim . . . is essentially the same”).

168. See *infra* notes 202–04 and accompanying text.

169. This is a problem that stretches beyond the context of investment treaties, as efforts to ensure state and local compliance with the Vienna Convention on Consular Relations have vividly demonstrated. See *Jogi v. Voges*, 425 F.3d 367 (7th Cir. 2005) (allowing suit for damages against state officials who violated the Vienna Convention); *Medellin v. Dretke*, 371 F.3d 270, 279–80 (5th Cir. 2004), *cert. dismissed as improvidently granted*, 125 S. Ct. 2088 (2005) (denying certificate of appealability to raise breach of the Vienna Convention).

170. *Loewen Group, Inc. v. United States*, Award (NAFTA Ch. 11 Arb. Trib. June 26, 2003), 42 I.L.M. 811, 819 (2003).

171. See *id.* at 834–46.

172. See *id.* at 837.

173. For non-judicial breaches of Chapter 11, tribunals have held that NAFTA Article 1121 waives the local remedies rule. See *supra* notes 105–06 and accompanying text.

174. See Andrea K. Bjorklund, *Waiver and the Exhaustion of Local Remedies Rule in NAFTA Jurisprudence*, in *NAFTA INVESTMENT LAW AND ARBITRATION: PAST ISSUES, CURRENT PRACTICE, FUTURE PROSPECTS* 253, 285 (Todd Weiler ed. 2004) (“From a policy perspective . . . it is difficult to distinguish the desirability of requiring a decision of the highest body within a court system from requiring a final decision from the highest official in an administrative system.”).

State.”¹⁷⁵ To the extent such injuries can be redressed within the domestic court system, sovereignty is preserved.

In federal systems, like those of the United States and Australia, preserving sovereignty also means preserving state sovereignty.¹⁷⁶ Again, this does not mean that the state should be shielded from scrutiny under the treaty, but rather that such scrutiny should occur if possible in a familiar forum where the state has the best opportunity to present its case. In the United States, the issue is complicated by the Supreme Court’s Eleventh Amendment jurisprudence. The Eleventh Amendment shields states from being sued without their consent under federal law, either in federal¹⁷⁷ or state courts.¹⁷⁸ The Eleventh Amendment, however, permits suits against local governments¹⁷⁹ as well as suits against state officers for injunctive relief.¹⁸⁰ At present, state governments do not seem disposed to waive their immunity to suits by foreign investors,¹⁸¹ but this stance is shortsighted. Requiring foreign investors to bring treaty claims against the state in state court first¹⁸² may well be a better way of preserving state sovereignty than to allow the same claims to proceed directly to an international tribunal. A state that consents to be sued directly may defend itself directly. The domestic court would

175. BORCHARD, *supra* note 23, at 817.

176. For accounts of the Australian experience reconciling treaty obligations with federalism, see Bill Campbell, *The Implementation of Treaties in Australia*, in INTERNATIONAL LAW AND AUSTRALIAN FEDERALISM 132–59 (Brian R. Opeskin & Donald R. Rothwell eds., 1997), and Brian R. Opeskin & Donald R. Rothwell, *The Impact of Treaties on Australian Federalism*, 27 CASE W. RES. J. INT’L L. 1 (1995).

177. See *Seminole Tribe v. Florida*, 517 U.S. 44 (1996) (holding that the Eleventh Amendment prohibits Congress from holding a state liable in federal court).

178. See *Alden v. Maine*, 527 U.S. 706 (1999) (concluding that Congress did not have the power under the U.S. Constitution to hold states liable in state court for private claims for damages). On the question of whether the Court’s Eleventh Amendment decisions extend to claims under treaties, see Carlos Manuel Vázquez, *Treaties and the Eleventh Amendment*, 42 VA. J. INT’L L. 713 (2002), and Susan Bandes, *Treaties, Sovereign Immunity, and “The Plan of the Convention”*, 42 VA. J. INT’L L. 743 (2002).

179. *Lincoln County v. Luning*, 133 U.S. 529, 530 (1890) (stating that the jurisdiction of the courts to hear suits against counties is “beyond question”); see, e.g., *Asakura v. City of Seattle*, 265 U.S. 332 (1924) (applying the U.S.-Japan Treaty of Commerce and Navigation in a suit against the city).

180. *Ex parte Young*, 209 U.S. 123 (1908) (enjoining an officer of the state); see, e.g., *Jordan v. Tashiro*, 278 U.S. 123 (1928) (applying the U.S.-Japan Treaty of Commerce and Navigation in a mandamus action against state officials). If investment treaties were judicially enforceable, they could also be raised in disputes between private parties. In a situation like *Loewen*, for example, the foreign investor would be able to challenge the punitive damages verdict on appeal not just as a violation of due process but as a violation of NAFTA.

181. See NCSL Free Trade Policy, *supra* note 123 (“Provisions must be made to deny any new private right of action in U.S. courts or before international dispute resolution panels based on international trade or investment agreements . . .”).

182. A state would not have to consent additionally to be sued in federal court. See *supra* notes 177–78 and accompanying text.

be more familiar terrain, and if the state or locality loses, there is the possibility of appeal, which is lacking under NAFTA.¹⁸³

2. Allowing Appeals

Because domestic court systems allow appeals, they are more likely to get the answers right in the end.¹⁸⁴ Despite the utmost good faith, judges and arbitrators all make mistakes. Arbitrators' mistakes, though, are largely insulated from review. Their awards may not be set aside for mere errors of fact or law, but only for more fundamental flaws in the arbitral process.¹⁸⁵ Within a domestic court system, errors of law and fact may be corrected on appeal. Of course, additional appeals mean additional costs, both in money and in time.¹⁸⁶ But from the host state's point of view, when important public policies like environmental protection are at stake, additional efforts to get the answer right are likely worth the costs.

Allowing appeals may also help to discourage weak and frivolous claims, which was one of the principal advantages of diplomatic protection.¹⁸⁷ Any system of dispute resolution that requires an investor to bear its own costs of litigation will perform this function to some extent.¹⁸⁸ But a domestic court system with its process of appeals should perform this function better, not because it is more expensive but because investors with weak and frivolous claims will see that their chances of prevailing are lower. "An investor that doubts its chances of success in a domestic appeal may nevertheless be willing to gamble on getting a sympathetic Chapter 11 tribunal

183. For more on the advantages of an appellate system, see *infra* notes 184–89 and accompanying text.

184. See W. MICHAEL REISMAN, SYSTEMS OF CONTROL IN INTERNATIONAL ADJUDICATION AND ARBITRATION 4 (1992) ("It is arguable that the more hierarchical layers of protection a bureaucracy has, the more likely it is to get things right."); Bjorklund, *supra* note 174, at 285 ("[B]y the time an issue reaches an appellate court, it is normally more crystallized and the chances of it being decided correctly are greater.").

185. The precise grounds are contained in the arbitration law of the jurisdiction that is asked to set aside or to decline enforcement of an award. Most arbitration laws, however, conform to Article V of the New York Convention, which lists limited grounds for refusing enforcement. See United Nations Convention on the Recognition and Enforcement of Arbitral Awards, art. V, June 10, 1958, 21 U.S.T. 2517, 330 U.N.T.S. 38.

186. REISMAN, *supra* note 184, at 4–5.

187. See *supra* notes 153–54 and accompanying text.

188. See Lauterpacht, *supra* note 40, at 458 ("[T]he heavy cost of international litigation would act as an effective deterrent against rash or malicious recourse to the machinery put at the disposal of private persons."); Brower & Steven, *supra* note 155, at 197 ("[A] great number of frivolous claims . . . would not otherwise be pressed if the responsibility and cost of prosecution remained with the individual investor").

whose decision will be largely insulated from review.”¹⁸⁹ An investor faced with the prospect of appeals to correct an aberrant initial decision is more likely to forego its weak or frivolous claims.

3. Providing a Single Forum

A final set of advantages from requiring exhaustion arises from the fact domestic and international claims are often intertwined. The system created by NAFTA Chapter 11 requires an investor to at some point choose between its domestic and international claims, because both claims cannot be raised in the same forum.¹⁹⁰ This choice is fraught with peril. In *Waste Management*, for example, a U.S. investor was faced with repeated non-payment of invoices under a concession agreement by a Mexican city and its guarantor, a state-owned bank.¹⁹¹ It tried to pursue its domestic-law claims in domestic courts and arbitral tribunals and a Chapter 11 claim before a NAFTA tribunal, but the NAFTA tribunal dismissed the claim because the investor had not given up its domestic remedies.¹⁹² After the investor abandoned its domestic remedies and refiled its Chapter 11 claims, a second NAFTA tribunal ruled that the city’s breaches of the concession agreement amounted only to violations of domestic law, over which the tribunal lacked jurisdiction.¹⁹³ Clearly investors like *Waste Management* would benefit from being able to raise both international and domestic claims in a single forum.¹⁹⁴

There would also be a benefit to the host state to the extent that it was spared from having to defend the same measure in two different forums. NAFTA allows investors up to three years to pursue domestic claims in domestic courts before they must waive those remedies as a precondition to filing a Chapter 11 claim.¹⁹⁵ In two cases filed against the United States, Canadian investors took advantage of this requirement and filed suits in federal court challenging on domestic law grounds the same measure they subsequently alleged to be violations of NAFTA.¹⁹⁶

189. William S. Dodge, *Loewen v. United States: Trials and Errors Under NAFTA Chapter Eleven*, 52 DEPAUL L. REV. 563, 575 (2002).

190. See *supra* notes 109–13 and accompanying text.

191. See *Waste Mgmt., Inc. v. Mexico*, Award (NAFTA Ch. 11 Arb. Trib. June 2, 2000), 40 I.L.M. 56 (2001).

192. *Id.* at 66–70.

193. See *Waste Mgmt., Inc. v. Mexico*, Final Award, (NAFTA Ch. 11 Arb. Trib. Apr. 30, 2004), 43 I.L.M. 967 (2004).

194. Cf. *Loewen Group, Inc. v. United States*, Award, (NAFTA Ch. 11 Arb. Trib. June 26, 2003), 42 I.L.M. 811, 837 (2003) (“[I]n the general run of cases, domestic appeal or review would offer more wide-ranging review as they are not confined to breaches of international law.”).

195. See *supra* note 108 and accompanying text.

196. See, e.g., *Grand River Enters. Six Nations, Ltd. v. Pryor*, No. 02 Civ. 5068(JFK), 2003 WL 22232974 (S.D.N.Y. Sept. 29, 2003), *vacated in part on*

Finally, in the event that domestic courts were unable to resolve the dispute and resort to an international tribunal became necessary, the international tribunal would benefit from the domestic court's development of the facts and the law, particularly those domestic-law issues on which the tribunal lacks expertise.¹⁹⁷ In *Metalclad*, for example, whether denial of a construction permit violated NAFTA Article 1105 depended in part on whether the municipality had authority under Mexican law over hazardous waste matters. The tribunal held that the municipality lacked such authority,¹⁹⁸ but it clearly would have benefited from an analysis of the issue by the Mexican courts.¹⁹⁹ In *Azinian*, by contrast, the question of whether a municipality had grounds under Mexican law to repudiate a concession contract had been adjudicated by the Mexican courts, and the tribunal was able to rely on their decisions in rejecting the investor's expropriation claim.²⁰⁰ Of course, the domestic court's decision would not bind the tribunal even on questions of domestic law,²⁰¹ but the court's analysis would improve the tribunal's understanding of that law.

4. Responses to Some Anticipated Objections

Against these advantages of requiring first resort to domestic courts with respect to both domestic law and treaty claims, may be set a number of objections, which this Article will briefly address. First, it might be argued that domestic courts lack expertise in

reconsideration, No. 02 Civ. 5068 (JFK), 2004 WL 1594869 (S.D.N.Y. July 15, 2004) (challenging state laws on commerce clause, antitrust, equal protection, due process, and First Amendment grounds); *Glamis Imperial Corp. v. U.S. Dep't of the Interior*, No. Civ. A. 01-530 (RMU) 2001 WL 1704305 (D.D.C. 2001) (arguing that failure to approve mining operation violated federal regulations, statutes, and the Establishment Clause of the First Amendment).

197. See *Certain Norwegian Loans (Fr. v. Nor.)*, 1957 I.C.J. 9, 97 (July 6) (dissenting opinion of Judge Read) ("It is important to obtain the ruling of local courts with regard to the issues of fact and law involved, before the international aspects are dealt with by an international tribunal.").

198. See *Metalclad Corp. v. Mexico*, Award, (NAFTA Ch. 11 Arb. Trib. Aug. 30, 2000), 40 I.L.M. 36, 48-49 (2001).

199. *Metalclad and Mexico* both submitted expert opinions on the question, but predictably, those opinions did not agree. See *id.* at 48.

200. *Azinian v. Mexico*, Award, (NAFTA Ch. 11 Arb. Trib. Nov. 1, 1999), 39 I.L.M. 537, 551-53 (2000).

201. Under customary international law, the decisions of domestic courts are not binding on international tribunals. See, e.g., *Amco v. Indonesia*, Award (Nov. 20, 1984), 1 ICSID Rep. 413, 460 (1993), *sustained in relevant part*, *Amco v. Indonesia* (Decision on the Application for Annulment, May 16, 1986), 1 ICSID Rep. 509, 526-27 (1993) ("An international tribunal is not bound to follow the result of a national court."). See generally Dodge, *supra* note 105, at 365-70.

international law.²⁰² As a general matter, it is true that domestic judges have less expertise in international matters than international arbitrators, but that does not mean that domestic judges are incapable of interpreting and applying international law. U.S. judges have long been called upon to interpret and apply the provisions of commercial treaties protecting investors.²⁰³ The same is true of customary international law.²⁰⁴ Moreover, domestic judges are liable to have a correspondingly greater expertise than international tribunals on issues of domestic law. Given the advantages discussed above in having all claims resolved in a single forum and the sovereignty interests in having the initial forum be a domestic one, the expertise objection should not carry much weight.

A second objection is that domestic courts in different states might interpret the provisions of a treaty differently, resulting in a lack of uniformity. Again, this objection has some merit, but less than meets the eye. First, U.S. courts give "considerable weight" to the court decisions of other states construing the same treaty,²⁰⁵ even if they do not always follow them.²⁰⁶ Second, one must bear in mind that the interpretations of arbitral tribunals are not always consistent either.²⁰⁷ Finally, the state parties to a treaty may promote uniformity, either by presenting their views to the domestic courts,²⁰⁸

202. Jack J. Coe, Jr., *Domestic Court Control of Investment Awards: Necessary Evil or Achilles Heel Within NAFTA and the Proposed FTAA?*, 19 J. INT'L ARB. 185, 202-03 & n.120 (2002). In the context of domestic court review of Chapter 11 awards, Professor Coe has referred to the domestic courts' lack of expertise as the problem of "expertise inversion." *Id.*

203. See *supra* notes 72-76 and accompanying text.

204. See *The Paquete Habana*, 175 U.S. 677, 700 (1900) ("International law is part of our law, and must be ascertained and administered by the courts of justice of appropriate jurisdiction as often as questions of right depending upon it are duly presented for their determination.").

205. *Air France v. Saks*, 470 U.S. 392, 404 (1985).

206. See, e.g., *Olympic Airways v. Husain*, 540 U.S. 644, 655 n.9 (2004) (declining to defer to other signatories' interpretation of the term "accident" in Article 17 of the Warsaw Convention).

207. To address this problem, a number of writers have suggested establishing an appellate body for investment disputes. See, e.g., Susan D. Franck, *The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law Through Inconsistent Decisions*, 73 FORDHAM L. REV. 1521 (2005); Charles H. Brower, II, *Structure, Legitimacy, and NAFTA's Investment Chapter*, 36 VAND. J. TRANSNAT'L L. 37, 91-92 (2003); William S. Dodge, *Investment Disputes and NAFTA Chapter Eleven: Remarks*, 95 AM. SOC'Y INT'L L. PROC. 207 (2001).

208. See *Sumitomo Shoji America, Inc. v. Avagliano*, 457 U.S. 176, 185 (1982) ("Although not conclusive, the meaning attributed to treaty provisions by the Government agencies charged with their negotiation and enforcement is entitled to great weight.").

or through more formal mechanisms that allow the state parties to issue binding interpretations of a treaty's text.²⁰⁹

A third objection is that creating two classes of countries—those whose legal systems have to be exhausted, and those whose legal systems do not—is insulting to less developed countries and diplomatically awkward. But in truth these two classes of countries already exist. BITs currently allow investors from developed countries to avoid the domestic courts of less developed countries, while the AUSFTA experience shows that developed countries are unlikely repeat the mistake of NAFTA and allow themselves to be sued directly, at least without requiring exhaustion first. Providing a meaningful forum for direct claims against developed countries would, in fact, lessen the difference in treatment between developed and less developed countries that currently exists. One might ease the diplomatic awkwardness by including in investment treaties a provision similar to Article 26 of the ICSID Convention that would allow each country to decide for itself whether to require exhaustion.²¹⁰ The United States, Canada, and Australia might decide to require exhaustion, thinking that such a requirement would be unlikely to discourage foreign investors. Less developed countries might strike the balance differently. The important point is that if each country were allowed to choose for itself, it would have little cause to complain of differential treatment.

V. CONCLUSION

Allowing direct claims by investors offers a number of advantages. It depoliticizes investment disputes to the ultimate benefit of both states and investors. But requiring investors to bring their claims—domestic and international—in domestic court first also offers a number of advantages. It preserves the sovereignty of the state, provides for the correction of errors, and allows for the resolution of all claims in a single forum. In the context of investment agreements between developed countries, it should be possible to combine the advantages of direct claims with those of the local

209. See, e.g., NAFTA, *supra* note 3, art. 1131(2) ("An interpretation by the Commission of a provision of this Agreement shall be binding on a Tribunal established under this Section.").

210. ICSID Convention, *supra* note 48, art. 26, 4 I.L.M. at 536 ("A Contracting State may require the exhaustion of local administrative or judicial remedies as a condition of its consent to arbitration under this Convention."). As noted above, this option has been rarely utilized. See *supra* note 52 and accompanying text. Such a provision would also provide a solution to the problem posed by agreements like NAFTA or the proposed Free Trade Area of the Americas to which both developed and developing countries are party, by allowing some states to require exhaustion of their legal systems and other states to waive exhaustion.

remedies rule. Developed states need not choose between NAFTA's world of immediate resort to international tribunals and AUSFTA's world of ghostly protection for foreign investors. It is possible to have the best of both worlds.