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BY FREDERICK M. ABBOTT*

Today is an exciting day for NAFTA and integration specialists for several reasons. First, the NAFTA and the process of North American integration are raising challenging legal and social questions that push the boundaries of international law. We certainly hoped that the integration process would be dynamic, and the evolution of Chapter 11 shows the NAFTA's dynamism. Second, a number of the issues we are addressing are not squarely in the box of matters foreseen by the drafters of the NAFTA, and are raised because of the involvement of the private bar in implementing the Agreement. This is a positive development. Third, we have the honor of the presence of colleagues from Canada and Mexico, which again demonstrates the value of the regional integration process and expands the horizons of our knowledge.

The general subject matter of today's proceedings is the operation of the investment chapter of the NAFTA, Chapter 11, with particular reference to its dispute settlement mechanism. We are by now beyond starting each NAFTA conference with an overview of what it is and what it attempts to accomplish, and I will limit myself to a more focused discussion of the subject matter.

NAFTA has three principal mechanisms for settling disputes,

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though if the supplemental agreements on the environment and labor are included, then several more. The general dispute settlement mechanism is in Chapter 20, a traditional state-to-state ad hoc arbitration system with panel decisions referred to the Parties for political implementation, and with the possibility that a Party may elect to suffer the withdrawal of concessions rather than strictly comply. The second mechanism is the Anti-Dumping and Countervailing Duty (AD/CVD) dispute settlement arrangement found in Chapter 19. This mechanism is only directed to complaints alleging a failure to correctly apply national AD/CVD law. However, the decisions of panels are directly binding on national administrative authorities, subject only to appeal on abuse of process grounds. There is provision for the participation of private parties involved in the underlying action in this procedure, though it is somewhat indirect. The third, and the subject of today's proceedings, is the investment dispute mechanism found in Chapter 11.

By way of historical background, the Canada-United States Free Trade Agreement (CUSFTA) incorporated rules regarding foreign direct investment that are similar to the NAFTA rules, but it did not establish a separate dispute settlement mechanism.[1] In the CUSFTA, a dispute between Canada and the United States regarding the treatment of a private investor was to be resolved by reference to the general dispute settlement procedure, similar to the NAFTA Chapter 20 procedure.[2]

The NAFTA establishes detailed rules regarding the treatment of investors and investments of the Parties, primarily based on the principles of national and most-favored-nation treatment, but including specific provisions regarding matters such as preclusion of performance requirements and ownership limitations—subject always to the exceptions set forth in the Annexes to the Agreement. When the basic rules of Chapter 11 and the Annexes are read together, and in light of the general exemption for state and provincial non-conforming measures, the rules of Chapter 11 in fact become highly complex. It is worthwhile to note, however, that Chapter 11 recognizes the right of Parties to adopt environmental regulations

1. Canada-United States Free Trade Agreement, Jan 2, 1988, Can.-U.S., arts. 1608, 1806-07, 27 I.L.M. 281, 376, 384-85 [hereinafter CUSFTA].

2. *Id.* art. 1608. During the CUSFTA negotiations, Canada agreed to amend its foreign investment review legislation to provide additional flexibility for U.S. investors. Canadian decisions under this review procedure were exempted from CUSFTA dispute resolution.

that are consistent with the Agreement, and exhorts against attempting to attract investment by offering to lower or waive environmental standards. It is also critical to note that the rules of Chapter 11 must be read in conjunction with various other parts of the NAFTA, including, without limitation, the Technical Standards and Sanitary and Phytosanitary (SPS) rules, the rules regarding the relationship of the NAFTA to other agreements, and the rules regarding the treatment of capital movements.

Chapter 11 prohibits Parties from expropriating the investments of investors, unless this action is taken in accordance with principles derived from customary international law, such that the takings must be non-discriminatory, for a public purpose, and accompanied by effective compensation.

Pursuant to Chapter 11, private investors of Parties have the right—though not the obligation—to pursue third party arbitration against the host government to a NAFTA investment in the International Centre for the Settlement of Investment Disputes (ICSID) (including its Additional Facility) or under United Nations Commission on International Trade Law (UNCITRAL) rules.[3] The NAFTA obligates the Parties to make adequate provision for the enforcement of resulting arbitral awards.[4] Private persons may seek enforcement of awards by national courts under international agreements to which the Parties may belong.[5] Note, however, that these agreements allow some scope to national courts to refuse to recognize and enforce awards based on considerations of overriding public policy, so that the enforcement of an arbitral award rendered by ICSID or under UNCITRAL rules is not automatic.[6] An arbitral award may provide for the payment of monetary damages or restitution of property (which may be avoided by a Party by payment of compensation), but it may not direct a government to amend its legislation.[7] If a Party fails to comply with an award, it is subject to

3. North American Free Trade Agreement, Dec. 8-17, 1993, Can.-Mex.-U.S., 32 I.L.M. 605 (entered into force Jan. 1, 1994) [hereinafter NAFTA], art. 1120.

4. *Id.* art. 1136.

5. *Id.* art. 1136(6) (referring to the ICSID Convention, the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, and the Inter-American Convention on International Commercial Arbitration).

6. *See* Convention on the Recognition and Enforcement of Foreign Arbitral Awards, art. v (codified as 9 U.S.C. §§ 201-208 (1970)).

7. *See* NAFTA, *supra* note 3, art. 1135.

NAFTA Chapter 20 dispute settlement proceedings.[8]

Issues regarding the NAFTA Chapter 11 investment dispute mechanism are part of a larger context of issues that arose in connection with the transformation of the GATT dispute settlement mechanism into the WTO Dispute Settlement Understanding, and were reflected in the breakdown of the OECD negotiations on a Multilateral Agreement on Investment (MAI) and the Seattle Ministerial Conference (SMC). These issues relate to multilateral and regional governance: who is authorized to make decisions, and how are those decisions made and carried out on behalf of international society? In short, there are increasing public demands for transparency, democratic representation and accountability that, on the one side, are legitimate and useful but, on the other side, are creating tremendous stresses on multilateral governance mechanisms. At the moment, we are reaching something of a crisis point reflecting the inability of governments to make and execute policy—a situation that demands close attention and creative solutions.

The incorporation of Chapter 11 Dispute Settlement into the NAFTA was undertaken as part of a system of investment guarantees that Mexico anticipated would encourage foreign direct investment (FDI) because of concerns that would reasonably be held by prospective investors. As noted earlier, bargaining bilaterally in CUSFTA, the United States and Canada had achieved a different solution involving traditional state-to-state resolution of investment disputes.

The United States has historically been very reluctant to subject its own justice system to outside examination. This has been a major impediment to the ratification of human rights treaties—with particular focus on the preservation of state criminal law discretion, as well as on vague constitutional rights deprivation fears. Had the U.S. Congress perceived (or been advised of) any appreciable risk that Chapter 11 would be used to address domestic regulatory processes in a manner beyond the accepted scope of review under the SPS and Technical Barriers provisions, it would have balked—as it did toward even the hint of authority-in-fact over environmental regulation (or non-regulation). I observe also that Mexico may have constraints on its treatment of foreign investors based on its constitution and incorporation of the Calvo doctrine.

8. *Id.* art. 1136(5). This may result in a recommendation that the Party comply with the award.

This is not to be critical of the United States, which by most accounts would be deemed to have one of the most secure legal systems in terms of protecting individual rights and property rights. The fear of outside interference is not easily reconcilable with the facts of internal U.S. adherence to good governance practices.

The tables have been turned on the United States in two different contexts: the Loewen context in which defects in the administration of justice are alleged, and the Methanex context in which the rights of the states to legislate substantially unfettered from compensatory claims are challenged in the environmental context. Each represents a distinct challenge to traditional notions of U.S. sovereignty, and the reaction may help to define the boundaries of the North American integration process.

In Europe, states are routinely challenged at the regional level in both contexts; although in Europe the willingness of states to accept these challenges has involved an evolutionary process. Developments in the environmental arena are chronicled in my article *Regional Integration and the Environment: The Evolution of Legal Regimes*,[9] and now center on the legal concept of "proportionality" of member state legislation by which the European Court of Justice (ECJ) tests legitimacy. In the European Union (EU), there is also a central regulatory authority, the European Commission.

In Europe, there are frequent human rights-related challenges to national legislation and action in the context of the Council of Europe's European Court of Human Rights, and in certain contexts before the ECJ.

The notion of international or regional challenge to national government action fundamentally presupposes an adequate set of rules by which national action may be evaluated. It may indeed be questioned whether the NAFTA rules on the environment—or due process—are adequate to the task they are potentially faced with under Chapter 11. It would certainly be very unfortunate if NAFTA rules acted as a blunt instrument by which business enterprises could challenge environmental regulations. Moreover, it is not clear that the rules of customary international law on expropriation are sufficiently well evolved to address the kinds of complex claims that might be envisioned either as due process or takings claims. Recall that most takings adjudications have involved gross abuses and that

9. *See generally* Frederick M. Abbott, *Regional Integration and the Environment: The Evolution of Legal Regimes*, 68 CHI.-KENT L. REV. 173 (1992).

the most extensive body of recent case law, involving the Iran Claims Tribunal, mainly addressed clear government takings, with the legal issues largely directed at levels of compensation.

The first wave of Chapter 11 challenges brings to mind the law of unintended consequences, but more seriously reveals again the benefits of granting access to legal remedies to private parties. This is a key feature of the EU experience, in which private party action played a critical role in developing ECJ jurisprudence across a wide range of issues that may never have been raised—or raised much later—by the Commission against the member states, or by member-state-to-member-state action.

The question under NAFTA is whether we have the proper institutions to serve the ECJ-type function. It is very questionable whether we do. Are we comfortable with three private arbitrators ruling on critical questions of public health, even if their decisions only involve compensation, and not changes to legislation? I suspect not, because there are no adequate provisions for transparency, continuity or appellate review (except under New York Convention public policy exceptions).

One solution to a potential Chapter 11 legitimacy problem would be to constitute an Appellate Body composed, for example, of the Chief Justices of the three nations' Supreme Courts. Another would be to place greater reliance on direct NAFTA effect, and encourage the wider participation of national courts in resolving investment disputes. The solution does not involve placing greater authority in the hands of executive authorities.

At the moment, if we look at the Loewen case, we take comfort from the fact that Judge Abner Mikva, formerly of the Court of Appeals for the Federal Circuit, is sitting as the U.S. nominated arbitrator, and such distinguished jurists certainly help to legitimize the system. It is not clear, however, that an ad hoc approach is adequate to satisfy what will be increasing public demands on the system.

Ideally, NAFTA judicial bodies would cautiously evolve a sophisticated system of jurisprudence that would serve as a guide on investment issues; but the ICSID process, which is an ad hoc arbitration process, is not designed for stare decisis rules.

If matters go wrong, the legislators will act—and they should. The title of my remarks, *Equality Before the Law*, is intended to ask whether the United States is prepared to accept the same types of rules that it is willing to impose on its trading partners. Both the EU

and the United States are having trouble digesting the consequences of their own rule-making and dispute settlement system at the WTO. Challenges to legitimacy are coming from a wide range of other groups and governments. Issues are raised in the context of democracy deficit, accountability (who elected or appointed the decision-makers, and to whom are they accountable), and transparency.

It may be that the good judgment of ICSID arbitrators will sufficiently act as a barrier against over-intrusion into areas of national regulatory discretion. The arbitrators in the DESONA case certainly showed such good judgment. It may well be that clarification should be made to Chapter 11 that changes in the regulatory environment may not be challenged as expropriations, and that challenges in the regulatory context may only be brought under Chapter 20. It would be preferable that due process challenges be referred to a judicial authority such as a commission of Supreme Court Justices.

I have been a strong proponent of regional integration undertaken with a reasonably strong institutional structure. The NAFTA investment chapter attempted to provide financial risk guarantees that would be attractive to the investment community, but did not build a framework strong enough to accommodate social policies. As such, there is a need to limit how far the scope of investment-related review should extend until the juridical framework of the NAFTA is made more complete.

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