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Investor Rights in an FTA:  
What Australia Can Learn from Canadian Experience with Chapter 11  
Investor-State Arbitration in NAFTA

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**Executive Summary**

NAFTA provides investors with the right to initiate arbitration if the right of freedom to invest which is provided in the Treaty is not upheld.

Similar provisions in a Free Trade Agreement with the United States would benefit Australian investors.

- It would create a mechanism to enforce the right of freedom to invest created by the FTA and allow Australian investors to initiate arbitration of disputes on their own. Compared to resolution of disputes through diplomatic channels, investor-state arbitration is usually faster, de-politicised, and final.
- There would be no “threat” to Australian sovereignty. All investor-state arbitration provisions that would apply to Australia would apply equally to the US. The difference between US-to-Australia and Australia-to-US investment is relatively small (\$242 billion to \$194 billion, respectively). Any American so-called “threats” to Australian sovereignty are matched just as much by Australian “threats” to American sovereignty.
- Australia’s investments of \$194 billion in the US would be legally protected against mistreatment by any level of American government through arbitration.
- It is a clear signal to Australian investors that they can invest in the US and be confident that their rights will be respected.
- It would increase the confidence of US companies to invest in Australia.

Australia can learn from Canada’s experience with investor-state Arbitration. Fourteen disputes between US and Canadian Companies have been initiated in the 10 years since NAFTA entered into force—eight against Canada, six against the US. Seven were abandoned or dismissed. These lessons can be drawn from this experience:

- Restricting the precedent-setting authority of arbitral decisions
- Including a binding interpretation power
- Including a “Loser Pays” rule

- Requiring the use of domestic courts
- Reserving certain matters along the lines of NAFTA
- Using applicable domestic law

### **General NAFTA Chapter 11 Coverage**

NAFTA Chapter 11 has been in force since 1994. It covers investors of NAFTA parties and their investments. “Investors” are defined as any business association, including individuals, non-profits, and government-owned enterprises. “Investments” means most types of assets (e.g. debt, equity, real estate, equipment) with limited exceptions (e.g. contracts for the sale of goods, short-term loans).

An investor must make an investment in the territory of another NAFTA country in order to be covered by Chapter 11. Investments made in the investor’s home country are not covered. If the nationality of an investor changes to that of the host country through a change of citizenship or merger and acquisition, the investor ceases to be covered.

### **Chapter 11 Dispute Resolution Through Arbitration**

Investor-State disputes under Chapter 11 can be brought to arbitration only by investors or government-owned enterprises on their own behalf against NAFTA countries where their investments are located. Governments cannot start an arbitration against an investor under this Chapter. (Disputes between governments are covered by other Chapters.) The governments give prior and standing consent in the NAFTA to submit themselves to Chapter 11 arbitration. Arbitral procedures follow well-established international standards with some modifications. Arbitrators are independent and are chosen with the consent of the parties. They are usually jurists with extensive experience in handling arbitrations.

Investors that start arbitration give up all rights to use any other method of resolving the dispute, including recourse through their home country’s or the host country’s domestic laws.

Investors can take a government to arbitration only if a breach of NAFTA Chapter 11 is alleged and if the investor suffered damage as a result. No other grounds are permitted. The investor bears the burden of proving that the breach and damage occurred. This is a heavy burden because in most circumstances egregious and discriminatory treatment causing damage is required for a breach.

Arbitral decisions are binding. Arbitral awards consist only of money damages and/or return of property. Successful cases are enforced through the *New York Convention* (to which all NAFTA governments are signatory) and applicable domestic laws.

### **Limits on the Scope of Chapter 11 Arbitration**

#### **Limits on the Precedent-Setting Value of Arbitral Decisions**

Although arbitral decisions are binding, they are binding only in the specific case and on the parties involved. Unlike decisions of domestic appeals courts, arbitral decisions do not

require a government to make any changes to laws or require future arbitral tribunals to follow them.

### Neutral Government Appearances Before a Tribunal

Any time there is a Chapter 11 arbitration against a NAFTA government, the other governments are permitted to make submissions to the tribunal outlining their governments' positions on how the NAFTA should be interpreted. Government lawyers have regularly made such submissions to tribunals.

### FTC Issuance of Binding Interpretations

The Free Trade Commission (FTC) consists of cabinet-level representatives from the NAFTA countries. It makes decisions by consensus. It has the power to issue interpretations of the NAFTA that are binding on arbitral tribunals. These can be issued at any time, even while a case is pending. No appeal is available to an investor from such interpretations. One such interpretation was issued on 31 July 2001 on the meaning of "fair and equitable treatment" in Article 1105, which applied in a number of Chapter 11 cases.

### Review of Arbitral Awards by Domestic Courts

The domestic laws of NAFTA governments allow domestic courts to set aside arbitral awards if they exceed the tribunal's jurisdiction or if they are against public policy. In effect, these laws provide an appeal mechanism for governments. *Metalclad v. United Mexican States* was a case where the arbitral award was partially set aside by a domestic court.

### Misconceptions of Investor-State Arbitration

#### Americans "Squashing" Australia?

All investor-state arbitration provisions that would apply to Australia would apply equally to the US. If the difference between US-to-Australia and Australia-to-US investment is relatively small (\$242 billion to \$194 billion, respectively at June 2002), and if Australians and Americans have the same rights against each others' governments, investor-state arbitration can hardly be an asymmetrical arrangement of power. Any American so-called "threats" to Australian sovereignty are matched just as much by Australian "threats" to American sovereignty.

#### Open Floodgates for Frivolous Cases?

Just as frivolous lawsuits without merit are regularly dismissed without even going to full trial, so too are frivolous Chapter 11 cases. Tribunals can dismiss such cases at the earliest stages of an arbitration. FTC interpretations can easily prevent frivolous cases from slipping through. In any event, only 22 cases have been brought to arbitration under Chapter 11 in the ten years of its existence. This is minuscule in light of the massive amount of intra-NAFTA investment and the number of lawsuits brought to domestic courts in that time.

#### Broad Potential Liability?

The potential liability of NAFTA governments under Chapter 11 turned out to be far smaller than was expected by Chapter 11 opponents. Chapter 11 has not upset normal governmental functions, nor has it resulted in a foreign takeover of domestic authority. This is because of the heavy burden that investors must bear to prove a breach. As shown in the table below, none of the 22 cases brought to arbitration have been entirely upheld. Importantly, the grounds under Chapter 11 for an investor to sue a government are fewer and narrower than what is available under domestic law.

### Overzealous Arbitrators?

Arbitrators do not go out of their way to usurp domestic jurisdiction. Indeed, arbitrators have been careful not to exceed their limited authority and have been sensitive to the potential political consequences of their decisions. As one tribunal noted:

Too great a readiness to step from outside into the domestic arena...will damage both the integrity of the domestic judicial system and the viability of NAFTA itself. (*Loewen v. United States*, Final Award 70-71)

Even if arbitrators exceed their bounds, domestic arbitration laws handled by domestic courts can restrain the effects of those decisions.

### Arbitral Cases Since Chapter 11 Came into Force (as of August 2003)

	Entirely Dismissed	Mostly Dismissed	Entirely Upheld	Mostly Upheld	Pending	Settled	Abandoned	TOTAL
Against Canada	0	1	0	1	1	1	4	8
Against USA	3	0	0	0	3	0	0	6
Against Mexico	1	1	0	1	5	0	0	8
All Cases	4	2	0	2	9	1	4	22

Sources: Government of Canada, Department of Foreign Affairs and International Trade <http://www.dfait-maeci.gc.ca/tna-nac/NAFTA-en.asp> (accessed 27 August 2003); US Department of State, <http://www.state.gov/s/1/c3439.htm> (accessed 28 August 2003).

### Why Should the Australia-US FTA Have Investor-State Arbitration?

#### Enforcement of Internationally-Created Rights for Investors

Rights without enforcement mechanisms are meaningless. Rights created under domestic law for persons and businesses are enforced by domestic courts. However, rights created by *international* law for persons and businesses cannot be enforced by domestic courts because those rights are outside the jurisdiction of those courts. The holders of such rights (e.g. an Australian investor's right to national treatment in the US) must have a mechanism for enforcement. Investor-state arbitration is the only mechanism that can accomplish this. Investors who complain of a breach of their rights under an FTA cannot turn to domestic courts unless there is an independent breach of some domestic law, which is often not the case. Failure to include investor-state arbitration in an FTA that creates rights for investors may leave those investors with "empty" rights that cannot be protected.

Additionally, under classical international law, a foreign investor that is in a dispute with a host country has to make a complaint to the home country and have it dealt with through diplomatic channels. Investor-state arbitration would allow Australian investors to deal with such disputes on their own. They can hire their own counsel and pursue their own cases diligently on their own behalf and at their own expense. Compared to diplomatic channels, investor-state arbitration is usually faster, de-politicised, and final.

#### Protecting Australian Investments

Australia's investments of \$194 billion in the US would be legally protected against mistreatment by any level of American government through arbitration. Even if the Bush Administration is investor-friendly, there is no guarantee that lower levels of government or

future governments will be the same. Arbitration ensures that the infinite and unpredictable ways in which American governments at all levels can act toward Australian investors are made to conform to a single standard that disallows abuse and protects Australian investors.

### Increased Investor Confidence

Investor-state arbitration is already included in Australian bilateral investment treaties (BITs) with other countries and is a longstanding part of American BIT practice. Investor-state arbitration for the Australia-US FTA effectively creates BIT provisions with the US. There are over 1100 BITs in force globally. Having a BIT with Australia's largest source of foreign investment is a clear signal to Americans (and to Australia's future FTA partners) that Australia is an investor-friendly country. It is also a clear signal to Australian investors that they can invest in the US and be confident that their rights will be respected.

## **What Australia Can Learn from Canada's Experience with Investor-State Arbitration**

### Restricting the Precedent-Setting Authority of Arbitral Decisions

NAFTA Chapter 11 restricts arbitral decisions to be binding only in that specific case and on the specific parties. The Australia-US FTA can do the same. Such a provision would allow domestic laws to remain unchanged, and would also allow future tribunals to ignore the decisions of past ones. Notably, it would also prevent tribunals from turning into domestic appeals courts.

### Including a Binding Interpretation Power

Like the NAFTA FTC, a body consisting of Australian and American trade representatives can be given the power to issue interpretations of the FTA that will be binding on tribunals. Decisions of that body can be made by consensus. The binding interpretations can apply to any arbitral case at any time and cannot be appealed.

### Including a "Loser Pays" Rule

NAFTA Chapter 11 allows an arbitral tribunal to decide how to distribute the costs of an arbitration. Australia could go further by requiring the losing side of an arbitration to pay the legal costs of the other. Investors making clearly frivolous or meritless claims would be scared off by the prospect of paying Australia's legal costs in the claim in addition to their own costs.

### Requiring Use of Domestic Courts

In most cases, NAFTA Chapter 11 does not require a foreign investor to use the host country's domestic courts. Australia could require such an investor to seek redress in its domestic courts first before allowing an arbitration to proceed.

### Adding Reservations to the FTA

The NAFTA governments reserved certain laws, measures, industries, and future state actions from the application of Chapter 11, including arbitration. These reservations cover matters such as investment review, certain benefits for domestic producers, and sensitive industries. Australia could do the same where it believes it is necessary.

### Using Applicable Domestic Law

As stated above, Canadian domestic laws governing international arbitration are effectively an appeal mechanism for arbitral decisions. These laws are part of standard international practice. In Australia, the *International Arbitration Act* follows this by allowing courts to set aside arbitral decisions when a tribunal has gone outside its bounds or if an arbitral decision

is against public policy. Australia may use this Act in its courts to restrict the scope of arbitral decisions made against it.

## Annex

### **Applicable Bodies in NAFTA Chapter 11 Arbitration**

#### Arbitral Tribunal

- usually 3 arbitrators
- investor and disputing government appoint one arbitrator each and agree on the presiding arbitrator
- makes arbitral decisions

#### Domestic Courts

- role limited to enforcing Chapter 11 arbitral decisions
- plays no role in arbitral decisions except when challenged on limited grounds set by the *New York Convention*

#### Free Trade Commission (FTC)

- consists of Canadian, American, and Mexican cabinet members and/or their representatives responsible for international trade
- makes decisions by consensus
- can issue interpretations of the NAFTA that are binding on arbitral tribunals

#### Neutral NAFTA Governments

- can make non-binding written submissions to tribunals on their positions, with advance notice to the disputing parties
- submissions not binding unlike FTC interpretations, but may be taken into account by tribunals

#### New York Convention

- international treaty providing for worldwide enforcement of arbitral decisions

### **Arbitration Steps**

#### Consent

- NAFTA governments' ongoing and prior consent to arbitrate contained in NAFTA text

#### Consultation and Negotiation

- disputing investor and host government attempt to settle the claim through consultation and negotiation amicably without arbitration

#### Notice of Arbitration

- if consultation and negotiation fail, investor delivers to the disputing host government notice of intent to arbitrate specifying information about the claim
- notice delivered at least 90 days before claim submitted to arbitration

### Submission of Arbitration Claim

- claim submitted to arbitration under applicable arbitration rules
- investor gives up all rights in writing to using any other method of resolving the dispute
- notice of the dispute delivered to other NAFTA governments

### Arbitration Proceedings

- arbitration proceedings held following applicable arbitral rules
- neutral NAFTA governments may make submissions to the tribunal after giving advance notice
- proceedings usually consist of several hearings with interim rulings made

### FTC Interpretation

- binding FTC interpretations may be issued at any time
- past interpretations apply to future tribunals

### Final Arbitral Award

- claim may be dismissed, upheld, or upheld in part

### Publication of Arbitral Documents

- documents relating to the arbitration may be made public

### Domestic Court Enforcement

- successful arbitral award taken to court for enforcement
- if challenge in court is unsuccessful, court makes order enforcing the award
- arbitral awards enforceable worldwide under the *New York Convention*