The Australian
APEC
Study Centre

Issues Paper No. 25

Investor-state arbitration: Canada's experience in NAFTA and the case for its inclusion in the Australia-US FTA

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October 2003

INVESTOR-STATE ARBITRATION: CANADA'S EXPERIENCE IN NAFTA AND THE CASE FOR ITS INCLUSION IN THE AUSTRALIA-US FTA

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INTRODUCTION

The final text to emerge from the Australia-US Free Trade Agreement (AUSFTA) negotiations will likely cover a large swath of economic activity, including foreign investment. Australia and the US enjoy extensive and surprisingly balanced levels of foreign investment in each other's economies. America's total investment position in Australia in June 2002 was AUD$242.1 billion, while Australia's total investment in the US at the same time was AUD$194.2 billion, or approximately 80% of the US total.[2] With an economy that is roughly similar to Australia's in size, composition, per capita GDP, and basic principles, Canada has a similarly balanced and growing investment relationship with the US. American direct investment in Canada at the end of 2002 totalled AUD$246.7 billion, and Canadian direct investment in the US was AUD$222.0 billion, or approximately 90% of the US total.[3] Given the similarities in these investment relationships, Chapter 11 of the North American Free Trade Agreement

[2] Australian Bureau of Statistics, *AusStats: 5352.0 International Investment Position, Australia: Supplementary Country Statistics*, 17 February 2003 (accessed 29 July 2003), available from http://www.abs.gov.au/Ausstats/abs@.nsf/Lookup/C165F929F1F145BBCA256BDE00820C6A. This figure includes both direct and portfolio investments.

[3] Statistics Canada, *The Daily, Wednesday, March 26, 2003: Foreign Direct Investment*, 26 March 2003 (accessed 29 July 2003), available from http://www.statcan.ca/Daily/English/030326/d030326a.htm. This figure is for direct investments and does not include portfolio investments. Australian dollar amounts are based on an approximate exchange rate of CAD$1.00=AUD$1.10. In Canadian dollars, US foreign direct investment in Canada at the end of 2002 was CAD$224.3 billion, with equivalent Canadian investment in the US was CAD$201.8 billion.

(NAFTA), which concerns investment, is in many respects an apposite model for Australia to consider in its present negotiations. If adopted, one particular aspect of NAFTA Chapter 11 that would assist the Australian interest is the mechanism for resolving disputes between investors and states through arbitration. Australia can look to the Canadian experience with it and tailor a similar mechanism that follows its particular situation and objectives. Indeed, the remarkable balance in these two bilateral investment relationships only reinforces the policy rationales for investor-state arbitration.

This paper makes the case for investor-state arbitration between Australia and the US within AUSFTA by drawing an analogy based on Canada's ten-year experience with NAFTA Chapter 11 arbitration. This case is based on three interrelated premises:

1. A hallmark of the Australia-US bilateral investment relationship is its high degree of equality in the amounts invested in each country, and that it is largely irrelevant from a legal and policy perspective that their overall economies are obviously different.
2. Australian investment in the US requires legal mechanisms under AUSFTA to protect it.
3. It is desirable for Australia to protect its investments in the US and to increase the volume of American investment in Australia.

If the final text of AUSFTA will contain provisions regulating the treatment of foreign investment, investor-state arbitration is an appropriate mechanism to ensure that Australia and the US both comply with the terms of that treatment. Compliance is required to ensure that the Australia-US investment relationship proceeds on an equal, non-discriminatory, and transparent basis that reduces non-commercial risks for investors, including Australian investors. Moreover, investor-state arbitration is part of a narrowly tailored set of rules designed to secure this treatment. That narrow tailoring means that the major fears surrounding investor-state arbitration in NAFTA context have been overstated, and thus there is little reason why investor-state arbitration should cause such fears to materialize in the Australian context.

This paper will begin by discussing the general features of NAFTA Chapter 11, which specifies norms for the treatment of NAFTA investors making investments in other NAFTA countries and enforces those norms through investor-state arbitration. The basic principles of arbitration, the differences with domestic litigation, the arbitration process in NAFTA Chapter 11, and its limits are discussed next. Following this is the case in favour of investor-state arbitration in AUSFTA by looking to Canada's experience in NAFTA. The case is divided into two parts. First is a discussion that addresses the misconceptions of investor-state arbitration. The second part describes the benefits that Australia would obtain if AUSFTA were to contain investor-state arbitration. Finally, the paper discusses policy options that are grounded in the

provisions of NAFTA Chapter 11 and Canada's experience that Australia could adopt for AUSFTA.

THE BASICS OF NAFTA CHAPTER 11

General NAFTA Objectives and International Law

NAFTA is an international treaty between Canada, the US, and Mexico that came into force on 1 January 1994. It is a comprehensive agreement that covers most commercial activity, such as trade in goods, agriculture, services, government procurement, intellectual property, and investment, to name a few. It establishes a number of supranational mechanisms to supervise its implementation, including binding arbitration to resolve investor-state disputes.

The main objectives of NAFTA are to eliminate barriers in the trade of goods and services, to promote fair conditions of competition, to substantially increase investment opportunities in the economies of the NAFTA countries, to protect intellectual property rights, to create procedures to implement and enforce the Agreement, and to establish a framework for cooperation between the NAFTA governments on relevant issues.[4] Interpretation of NAFTA must be done in light of both international law and the Agreement's objectives.[5]

The default position under international law is that every sovereign country has control over its borders. Since foreign investment necessarily involves the entry and exit of foreign persons and property, there is no requirement for any country to allow foreign investment to

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[4] Government of Canada, Department of Foreign Affairs and International Trade, *The North American Free Trade Agreement* [hereinafter "NAFTA"], 11 September 2003 (accessed 9 July 2003), available from http://www.dfait-maeci.gc.ca/nafta-alena/agree-en.asp and related links, Article 102.2. The relevant text is:

> Article 102: Objectives
> …
> 2. The Parties shall interpret and apply the provisions of this Agreement in the light of its objectives set out in paragraph 1 and in accordance with applicable rules of international law.

[5] NAFTA, Article 102.1. The relevant text is:

> Article 102: Objectives
> 1. The objectives of this Agreement, as elaborated more specifically through its principles and rules, including national treatment, most-favored-nation treatment and transparency, are to:
> (a) eliminate barriers to trade in, and facilitate the cross-border movement of, goods and services between the territories of the Parties;
> (b) promote conditions of fair competition in the free trade area;
> (c) increase substantially investment opportunities in the territories of the Parties;
> (d) provide adequate and effective protection and enforcement of intellectual property rights in each Party's territory;
> (e) create effective procedures for the implementation and application of this Agreement, for its joint administration and for the resolution of disputes; and
> (f) establish a framework for further trilateral, regional and multilateral cooperation to expand and enhance the benefits of this Agreement.

enter, even if it would be economically beneficial to that country.[6] Of course, very few countries do not allow any foreign investment, and many countries—including the NAFTA countries—actively seek it. Treaties define how foreign investment will be allowed and treated and the rights that foreign investors can claim. NAFTA is one such treaty. Among other things, it specifies the terms under which foreign investors from each of the NAFTA countries will be permitted to operate in each others' countries, restricts the power of NAFTA governments to arbitrarily change those terms, and requires NAFTA governments to follow certain standards of conduct. The specification and enshrining of standards in international law for the treatment of foreign investment increases transparency and predictability for foreign investors, which increases investor confidence overall.

NAFTA Chapter 11's Structure and Coverage

NAFTA Chapter 11 is divided into Sections A, B, and C. Section A comprises Articles 1101 to 1114, which defines Chapter 11's norms. Section B comprises Articles 1115 to 1138 which provides for investor-state arbitration. Section C consists of Article 1139 which defines the terms in use in Chapter 11.

Chapter 11 governs measures taken by NAFTA governments that concern foreign investment by NAFTA investors, which includes laws, regulations, procedures, requirements, and practices.[7] The investors that are covered by Chapter 11 are Canadian, American, and Mexican investors that make a cross-border investment; if no cross-border investment occurs, or if the investment ceases to be cross-border in character, Chapter 11 no longer applies.[8] A wide range of business associations are included under the definition of "investors" under Chapter 11, such as corporations, non-profits, partnerships, proprietorships, and state-owned businesses.[9]

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[6] United Nations Conference on Trade and Development, *Admission and Establishment* (Geneva: United Nations, 1998), 7, 11-12.

[7] NAFTA, Articles 201, 1101.1(a)-(b). The relevant text is:

> Article 201: Definitions of General Application
>
> …
>
> **measure** includes any law, regulation, procedure, requirement or practice… [bold in original].
>
> Article 1101: Scope and Coverage
>
> 1. This Chapter applies to measures adopted or maintained by a Party relating to:
>   (a) investors of another Party;
>   (b) investments of investors of another Party in the territory of the Party….

[8] This follows the "continuous nationality" rule in international law. The rule was applied in the case of *Loewen* v. *United States* in which Loewen, a formerly Canadian company that sued the US under Chapter 11, declared bankruptcy and was bought out by an American company. *Loewen Group, Inc., and Raymond L. Loewen* v. *United States of America*, ARB(AF)/98/3 (ICSID 26 June 2003) (Mason, Mikva, and Mustill Arbs.) [hereinafter "Loewen"].

[9] NAFTA, Articles 201, 1139. The relevant text reads:

> Article 201: Definitions of General Application

"Investment" also has a wide definition which includes nearly every type of asset, such as land, equipment, companies and equity in companies, and certain types of debt, but excludes the definition excludes contracts for the sale of goods, extension of credit, or any other claim to money that does not fall into any included category.[10] Chapter 11 does not draw a distinction between "direct" and "portfolio" investments as this dichotomy is more a question of form rather than substance.

The Primary Norms in NAFTA Chapter 11, Section A

…
enterprise means any entity constituted or organized under applicable law, whether or not for profit, and whether privately-owned or governmentally-owned, including any corporation, trust, partnership, sole proprietorship, joint venture or other association;
enterprise of a Party means an enterprise constituted or organized under the law of a Party… [bold in original].

Article 1139: Definitions
…
investor of a Party means a Party or state enterprise thereof, or a national or an enterprise of such Party, that seeks to make, is making or has made an investment… [bold in original].

[10] NAFTA, Article 1139. The relevant text is:
Article 1139: Definitions
…
investment means:
a. an enterprise;
b. an equity security of an enterprise;
c. a debt security of an enterprise
 i) where the enterprise is an affiliate of the investor, or
 ii) where the original maturity of the debt security is at least three years,
 but does not include a debt security, regardless of original maturity, of a state enterprise;
d. a loan to an enterprise
 i) where the enterprise is an affiliate of the investor, or
 ii) where the original maturity of the loan is at least three years,
 but does not include a loan, regardless of original maturity, to a state enterprise;
e. an interest in an enterprise that entitles the owner to share in income or profits of the enterprise;
f. an interest in an enterprise that entitles the owner to share in the assets of that enterprise on dissolution, other than a debt security or a loan excluded from subparagraph (c) or (d) ;
g. real estate or other property, tangible or intangible, acquired in the expectation or used for the purpose of economic benefit or other business purposes; and
h. interests arising from the commitment of capital or other resources in the territory of a Party to economic activity in such territory, such as under
 i) contracts involving the presence of an investor's property in the territory of the Party, including turnkey or construction contracts, or concessions, or
 ii) contracts where remuneration depends substantially on the production, revenues or profits of an enterprise;

but investment does not mean,
i. claims to money that arise solely from
 i) commercial contracts for the sale of goods or services by a national or enterprise in the territory of a Party to an enterprise in the territory of another Party, or
 ii) the extension of credit in connection with a commercial transaction, such as trade financing, other than a loan covered by subparagraph (d); or
j. any other claims to money,

that do not involve the kinds of interests set out in subparagraphs (a) through (h)… [bold in original].

The primary norms for the treatment of foreign investment Chapter 11, Section A are typical of most free trade agreements and other investment treaties. These norms restrict the conduct of NAFTA governments by requiring that their treatment of other NAFTA investors follow certain rules. The overall themes of these rules are equality of treatment, anti-discrimination, liberalization, and eliminating distortions of competition.

National Treatment

Article 1102 provides for national treatment of other NAFTA investors.[11] The NAFTA governments agree to treat all covered investments from other NAFTA investors in the same manner as they treat their own investors and investments in like circumstances (i.e. investors in the same industry, or investors affected by the same policies, etc.).[12] Furthermore, provinces and states agree to treat foreign NAFTA investors as well as they treat other investors from their own country. For example, the Canadian province of Quebec must treat American and Mexican investors just as well as they treat Quebec investors, even if investors from other Canadian provinces are not as well-treated.[13] National treatment applies at nearly all stages of an investment's life, from the time that an investment is established, to its operation and management, to its final sale and liquidation.

Most-Favoured-Nation Treatment (MFN)

Under Article 1103, a NAFTA government must give other NAFTA investors the best treatment it gives to investors from any other country, including non-NAFTA countries. MFN

[11] NAFTA, Article 1102. The relevant text is:

Article 1102: National Treatment

1. Each Party shall accord to investors of another Party treatment no less favorable than that it accords, in like circumstances, to its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.
2. Each Party shall accord to investments of investors of another Party treatment no less favorable than that it accords, in like circumstances, to investments of its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.
3. The treatment accorded by a Party under paragraphs 1 and 2 means, with respect to a state or province, treatment no less favorable than the most favorable treatment accorded, in like circumstances, by that state or province to investors, and to investments of investors, of the Party of which it forms a part….

[12] United Nations Conference on Trade and Development, *National Treatment* (Geneva: United Nations, 1999), 33-34.

[13] Jon R. Johnson, *International Trade Law* (Toronto: Irwin Law, 1998), 219.

applies to the same stages of an investment and the same factual situations as national treatment in Article 1102.[14]

Standard of Treatment

Article 1104 prescribes the treatment that a NAFTA government must give in case of a conflict between national treatment and MFN. It states that between national treatment and MFN, a NAFTA government must provide the better of the two.[15]

Minimum Standard of Treatment

Article 1105 states that investments of other NAFTA investors must be treated by NAFTA governments fairly and equitably and must receive full protection and security as mandated by international law. In substance, this provision provides a floor for the level of treatment that a NAFTA government must give. Under international law, falling below this floor requires particularly egregious actions by a state.[16]

Performance Requirements

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[14] NAFTA, Article 1103. The relevant text is:

Article 1103: Most-Favored-Nation Treatment

1. Each Party shall accord to investors of another Party treatment no less favorable than that it accords, in like circumstances, to investors of any other Party or of a non-Party with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.
2. Each Party shall accord to investments of investors of another Party treatment no less favorable than that it accords, in like circumstances, to investments of investors of any other Party or of a nonParty [sic] with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.

[15] NAFTA, Article 1104. The relevant text is:

Article 1104: Standard of Treatment

1. Each Party shall accord to investors of another Party and to investments of investors of another Party the better of the treatment required by Articles 1102 and 1103.

[16] United Nations Conference on Trade and Development, *Fair and Equitable Treatment* (Geneva: United Nations, 1999), 39-40; NAFTA, Article 1105. The relevant text of Article 1105 is:

Article 1105: Minimum Standard of Treatment

1. Each Party shall accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security….

The NAFTA governments have interpreted Article 1105 quite restrictively. To breach Article 1105 requires action by a NAFTA country that is at least grossly negligent, such as deliberate criminal activity by a government or an extreme failure to provide basic services. Given the present levels of development of the NAFTA countries, it is unlikely that Article 1105 will be breached. See Government of Canada, Department of Foreign Affairs and International Trade, note 57 *infra*.

Article 1106 prohibits NAFTA governments from imposing certain trade-distorting requirements on other NAFTA investors.[17] Prohibited measures include minimum export percentages, domestic content levels, purchasing local goods and services, technology transfer requirements, foreign exchange balancing requirements, restrictions on domestic sales, and world product mandate requirements. Performance requirements that do not distort trade and are

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[17] Gary Clyde Hufbauer and Jeffrey J. Schott, *NAFTA: An Assessment* (Washington, DC: Institute for International Economics, 1993), 80; Steven Macmillan, *NAFTA Chapter 11—Issues and Opportunities*, July 2002 (accessed 11 July 2003), available from http://www.apec.org.au/docs/fta2mcm.pdf, 3; Johnson, 220-221; NAFTA, Article 1106. The relevant text of Article 1106 is:

Article 1106: Performance Requirements

1. No Party may impose or enforce any of the following requirements, or enforce any commitment or undertaking, in connection with the establishment, acquisition, expansion, management, conduct or operation of an investment of an investor of a Party or of a non-Party in its territory:
   (a) to export a given level or percentage of goods or services;
   (b) to achieve a given level or percentage of domestic content;
   (c) to purchase, use or accord a preference to goods produced or services provided in its territory, or to purchase goods or services from persons in its territory;
   (d) to relate in any way the volume or value of imports to the volume or value of exports or to the amount of foreign exchange inflows associated with such investment;
   (e) to restrict sales of goods or services in its territory that such investment produces or provides by relating such sales in any way to the volume or value of its exports or foreign exchange earnings;
   (f) to transfer technology, a production process or other proprietary knowledge to a person in its territory, except when the requirement is imposed or the commitment or undertaking is enforced by a court, administrative tribunal or competition authority to remedy an alleged violation of competition laws or to act in a manner not inconsistent with other provisions of this Agreement; or
   (g) to act as the exclusive supplier of the goods it produces or services it provides to a specific region or world market.
2. A measure that requires an investment to use a technology to meet generally applicable health, safety or environmental requirements shall not be construed to be inconsistent with paragraph 1(f). For greater certainty, Articles 1102 and 1103 apply to the measure.
3. No Party may condition the receipt or continued receipt of an advantage, in connection with an investment in its territory of an investor of a Party or of a non-Party, on compliance with any of the following requirements:
   (a) to achieve a given level or percentage of domestic content;
   (b) to purchase, use or accord a preference to goods produced in its territory, or to purchase goods from producers in its territory;
   (c) to relate in any way the volume or value of imports to the volume or value of exports or to the amount of foreign exchange inflows associated with such investment; or
   (d) to restrict sales of goods or services in its territory that such investment produces or provides by relating such sales in any way to the volume or value of its exports or foreign exchange earnings.
4. Nothing in paragraph 3 shall be construed to prevent a Party from conditioning the receipt or continued receipt of an advantage, in connection with an investment in its territory of an investor of a Party or of a non-Party, on compliance with a requirement to locate production, provide a service, train or employ workers, construct or expand particular facilities, or carry out research and development, in its territory.
5. Paragraphs 1 and 3 do not apply to any requirement other than the requirements set out in those paragraphs.
6. Provided that such measures are not applied in an arbitrary or unjustifiable manner, or do not constitute a disguised restriction on international trade or investment, nothing in paragraph 1(b) or (c) or 3(a) or (b) shall be construed to prevent any Party from adopting or maintaining measures, including environmental measures:
   (a) necessary to secure compliance with laws and regulations that are not inconsistent with the provisions of this Agreement;
   (b) necessary to protect human, animal or plant life or health; or
   (c) necessary for the conservation of living or non-living exhaustible natural resources.

connected with the receipt of some kind of advantage are expressly permitted, such as requirements to locate in a certain area, provide a service, train and employ workers, expand facilities, or conduct research and development. Other performance requirements relating to health, safety, and environmental measures are also permitted as long as they do not contradict NAFTA.

Transfers of Funds

Article 1109 requires NAFTA governments to allow NAFTA investors to freely transfer funds related to their investments.[18] NAFTA investors must be allowed to use freely convertible currencies to effect these transfers. Limited exceptions to free transferability include insolvency proceedings, securities regulation, criminal penalties, foreign exchange reporting requirements, and civil court judgments.

Expropriation and Nationalization

Article 1110 generally protects NAFTA investors from expropriation, measures tantamount to expropriation, or nationalization by NAFTA governments, whether direct or

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[18] NAFTA, Article 1109. The relevant text is:

Article 1109: Transfers

1. Each Party shall permit all transfers relating to an investment of an investor of another Party in the territory of the Party to be made freely and without delay. Such transfers include:
   (a) profits, dividends, interest, capital gains, royalty payments, management fees, technical assistance and other fees, returns in kind and other amounts derived from the investment;
   (b) proceeds from the sale of all or any part of the investment or from the partial or complete liquidation of the investment;
   (c) payments made under a contract entered into by the investor, or its investment, including payments made pursuant to a loan agreement;
   (d) payments made pursuant to Article 1110; and
   (e) payments arising under Section B.
2. Each Party shall permit transfers to be made in a freely usable currency at the market rate of exchange prevailing on the date of transfer with respect to spot transactions in the currency to be transferred.
3. No Party may require its investors to transfer, or penalize its investors that fail to transfer, the income, earnings, profits or other amounts derived from, or attributable to, investments in the territory of another Party.
4. Notwithstanding paragraphs 1 and 2, a Party may prevent a transfer through the equitable, nondiscriminatory and good faith application of its laws relating to:
   (a) bankruptcy, insolvency or the protection of the rights of creditors;
   (b) issuing, trading or dealing in securities;
   (c) criminal or penal offenses;
   (d) reports of transfers of currency or other monetary instruments; or
   (e) ensuring the satisfaction of judgments in adjudicatory proceedings.
5. Paragraph 3 shall not be construed to prevent a Party from imposing any measure through the equitable, nondiscriminatory and good faith application of its laws relating to the matters set out in subparagraphs (a) through (e) of paragraph 4.

indirect.[19] Permitted expropriations and nationalizations must meet four criteria: they must be for a public purpose; they must be non-discriminatory; they must follow due process of law that satisfies fair and equitable treatment under Article 1105; and they must be accompanied by compensation. Compensation must be at fair market value of the expropriated investment, must be timely, and must be fully realizable and transferable.

Major Exceptions

The above description of the norms of Section A of Chapter 11 is necessarily a brief one, and a full description of its exceptions is therefore outside the scope of this paper. Exceptions to Chapter 11 and to NAFTA as a whole are created through a number of methods such as grandfathering of existing non-conforming measures, reservations, coverage by other provisions of NAFTA, and coverage by other separate agreements. Major sectors and activities that are exceptions to all or part of Chapter 11 include the provision of normal government and social services,[20] foreign investment review for acquisitions in Canada or Mexico,[21] affirmative action programs for Aboriginal peoples and other minorities in Canada and the US,[22] ownership of oceanfront land in Canada,[23] the Mexican energy industry,[24] some multilateral environmental

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6. Notwithstanding paragraph 1, a Party may restrict transfers of returns in kind in circumstances where it could otherwise restrict such transfers under this Agreement, including as set out in paragraph 4.

[19] NAFTA, Articles 1110.1-1110.3, Article 1110.6. The relevant text is:

Article 1110: Expropriation and Compensation

1. No Party may directly or indirectly nationalize or expropriate an investment of an investor of another Party in its territory or take a measure tantamount to nationalization or expropriation of such an investment ("expropriation"), except:
   (a) for a public purpose;
   (b) on a nondiscriminatory basis;
   (c) in accordance with due process of law and Article 1105(1) ; and
   (d) on payment of compensation in accordance with paragraphs 2 through 6.
2. Compensation shall be equivalent to the fair market value of the expropriated investment immediately before the expropriation took place ("date of expropriation"), and shall not reflect any change in value occurring because the intended expropriation had become known earlier. Valuation criteria shall include going concern value, asset value including declared tax value of tangible property, and other criteria, as appropriate, to determine fair market value.
3. Compensation shall be paid without delay and be fully realizable.

…

6. On payment, compensation shall be freely transferable as provided in Article 1109….

[20] NAFTA, Article 1101.4. The relevant text is:

Article 1101: Scope and Coverage

…

4. Nothing in this Chapter shall be construed to prevent a Party from providing a service or performing a function such as law enforcement, correctional services, income security or insurance, social security or insurance, social welfare, public education, public training, health, and child care, in a manner that is not inconsistent with this Chapter.

[21] NAFTA, Annex 1138.2.

[22] NAFTA, Annex II, Schedule of Canada; NAFTA, Annex, II, Schedule of the United States.

[23] NAFTA, Annex II, Schedule of Canada.

[24] NAFTA, Annex III, Section A.

treaties,[25] government procurement,[26] Canadian cultural industries,[27] existing nonconforming measures that are declared and renewed regularly,[28] and national security.[29]

RESOLVING CHAPTER 11 DISPUTES THROUGH INVESTOR-STATE ARBITRATION

General Principles of Arbitration

The general principles of arbitration highlight the differences between it and normal litigation in domestic courts. In most aspects, NAFTA Chapter 11 dispute resolution is like any other arbitration process. A basic discussion of arbitration principles is essential for knowing the room for states and foreign investors to manoeuvre, understanding the policy implications of investor-state arbitration in an FTA, and considering the options available to achieve particular policy ends.

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[25] NAFTA, Article 104.

[26] NAFTA, Article 1108.7. The relevant text is:

Article 1108: Reservations and Exceptions

7. Articles 1102, 1103 and 1107 do not apply to:
   (a) procurement by a Party or a state enterprise; or
   (b) subsidies or grants provided by a Party or a state enterprise, including government-supported loans, guarantees and insurance.

[27] NAFTA, Article 2106, Annex 2106; Johnson, 266-273

[28] NAFTA, Articles 1108.1-1108.3. The relevant text is:

Article 1108: Reservations and Exceptions

1. Articles 1102, 1103, 1106 and 1107 do not apply to:
   (a) any existing nonconforming measure that is maintained by
      i) a Party at the federal level, as set out in its Schedule to Annex I or III,
      ii) a state or province, for two years after the date of entry into force of this Agreement, and thereafter as set out by a Party in its Schedule to Annex I in accordance with paragraph 2, or
      iii) a local government;
   (b) the continuation or prompt renewal of any nonconforming measure referred to in subparagraph (a); or
   (c) an amendment to any nonconforming measure referred to in subparagraph (a) to the extent that the amendment does not decrease the conformity of the measure, as it existed immediately before the amendment, with Articles 1102, 1103, 1106 and 1107.
2. Each Party may set out in its Schedule to Annex I, within two years of the date of entry into force of this Agreement, any existing non-conforming measure maintained by a state or province, not including a local government.
3. Articles 1102, 1103, 1106 and 1107 do not apply to any measure that a Party adopts or maintains with respect to sectors, subsectors or activities, as set out in its Schedule to Annex II.

[29] NAFTA, Article 1138.1. The relevant text is:

Article 1138: Exclusions

1. Without prejudice to the applicability or non-applicability of the dispute settlement provisions of this Section or of Chapter Twenty (Institutional Arrangements and Dispute Settlement Procedures) to other actions taken by a Party pursuant to Article 2102 (National Security), a decision by a Party to prohibit or restrict the acquisition of an investment in its territory by an investor of another Party, or its investment, pursuant to that Article shall not be subject to such provisions.

Arbitration and mediation are the two main types of alternative dispute resolution (ADR). ADR does not oust the jurisdiction of courts. Rather, ADR settles disputes out of normal litigation procedures. Litigation and ADR are on a spectrum that measures the extent of coercive state power that applies to resolving the dispute, with litigation with the most, arbitration in the middle, and mediation with the least.

Arbitration procedure is substantially the same as in regular litigation. Like litigation, it has an adversarial process, the same methods of providing evidence, and a neutral decision-maker or tribunal that produces a binding decision. Arbitral tribunals may be constituted *ad hoc*, or arbitrations may be held at permanent arbitration institutions, just as litigation occurs in courts.[30] Where arbitration differs from litigation in courts is its consensual aspect. Arbitration is voluntary, while litigation is not. The parties to an arbitration must consent in at least four respects: (1) the submission of a dispute to arbitration in the first place; (2) the choice of arbitrator(s); (3) the powers of the arbitrator or arbitral tribunal to decide the outcome of the dispute; and (4) the applicable law and procedural rules for deciding the dispute. Consent for submitting disputes to arbitration is usually given before a dispute arises.

Arbitration may be either domestic or international in nature. Domestic and international arbitrations typically have separate statutory regimes to govern them. Both ultimately depend on domestic law for jurisdiction irrespective of whether the arbitration is domestic or international or whether the parties are private or public. Many jurisdictions, including the NAFTA countries and Australia, have statutory regimes grounded in domestic law for governing domestic and international commercial arbitrations. For international arbitrations, the statutory regime is usually harmonized according to the 1985 *UNCITRAL Model Law for Commercial Arbitration* ("Model Law"), of which Canada, five US states, Mexico, and Australia are signatories.[31] Parties to the Model Law incorporate it into their domestic laws. For example, Canadian jurisdictions have dual statutory structures for domestic and international commercial arbitrations; in Australia domestic arbitration is governed by state statutes and international arbitration by the federal *International Arbitration Act*.[32]

The enforcement of arbitral awards also depends on domestic law. When an arbitral award is rendered, it must be brought to a domestic court that will affirm that award by re-

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[30] Standing arbitration institutions include the International Chamber of Commerce, the International Centre for the Settlement of Investment Disputes, the London Court of International Arbitration, and a number of national and regional arbitration institutions.
[31] United Nations Commission on International Trade Law, *Status of Conventions and Model Laws*, 11 September 2003 (accessed 3 October 2003), available from http://www.uncitral.org/english/status/status-e.htm.
[32] Commonwealth of Australia, *International Arbitration Act* 1974, 2003 (accessed 3 October 2003), available from http://scaleplus.law.gov.au/cgi-bin/download.pl?/scale/data/pasteact/1/712; Asia-Pacific Economic Cooperation,

issuing it as a court order. It is through this re-issuance that an arbitral award acquires its binding character. Courts usually defer to arbitrators on the substance of the decision and are unlikely to alter them except on fairly narrow grounds. Enforcement of international commercial arbitrations is primarily governed by the 1958 *Convention on the Recognition and Enforcement of Foreign Arbitral Awards* ("New York Convention") and the Model Law, both of which are part of domestic law in signatory countries. They typically go further than statutes for domestic arbitration by presumptively forbidding a court from not enforcing the award unless there is proof that one of these situations applies:

- incapacity of the parties or invalidity of an agreement to arbitrate;
- lack of notice of arbitration proceedings or arbitrator appointment, or an inability to present a case;
- all or part of the arbitral award deals with matters outside the agreement to arbitrate (excess of jurisdiction);
- improper composition of the arbitral tribunal;
- incompleteness of the arbitral award;
- incapability of the dispute's subject matter to be arbitrated; or
- the arbitral award is contrary to public policy.[33]

If an award does not fall within one of the above exceptions, it must be enforced as a court order in accordance with domestic judicial processes. An arbitral award made in any jurisdiction where the New York Convention applies can be enforced by any court in any other New York Convention jurisdiction, which includes 133 countries.[34]

The Arbitration Process in Chapter 11, Section B

Section B of Chapter 11 provides the process for the arbitration of disputes between investors and NAFTA governments. It is one of the four methods of dispute resolution in NAFTA. Chapter 11 arbitration differs in two ways from the other methods of dispute

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International Commercial Disputes: A Guide to Arbitration and ADR in APEC Member Economies, 2002 (accessed 3 October 2003), available from http://www.arbitration.co.nz/foreword.asp.

[33] United Nations Conference on International Trade Law, *UNCITRAL Model Law on International Commercial Arbitration* [hereinafter "Model Law"], 2001 (accessed 3 October 2003), available from http://www.uncitral.org/english/texts/arbitration/ml-arb.htm, Articles 5, 34, 36; United Nations Conference on International Trade Law, *Convention on the Recognition and Enforcement of Foreign Arbitral Awards* [hereinafter "New York Convention"], 2001 (accessed 3 October 2003), available from http://www.uncitral.org/english/texts/arbitration/NY-conv.htm, Article 5. Note that individual countries in their domestic legislation to implement these international agreements may alter their precise details.

[34] New York Convention, Article 3; United Nations Conference on International Trade Law, note 31 *supra*.

resolution: first, it involves disputes strictly between private investors and the state, while the other methods involve only NAFTA governments; and second, it covers only disputes that arise from investments covered by Section A of Chapter 11, while disputes in other areas such as anti-dumping, trade in goods, and financial services are covered by their respective dispute resolution methods defined elsewhere in NAFTA.[35]

Most of the basic features of international commercial arbitration apply to Chapter 11 dispute settlement. There are, however, a number of modifications and restrictions created by the NAFTA that are highly important. These modifications and restrictions are apparent when looking at the substance and process of arbitrating Chapter 11 claims.

The Basic Substance of Chapter 11 Claims and Eligibility for Making Them

Articles 1116.1 and 1117.1 create the right of NAFTA investors to make a Chapter 11 arbitration claim.[36] An investor can make a claim for itself regarding an investment in the territory of another NAFTA country, or on behalf of a subsidiary operating in another NAFTA country. According to the text of these Articles, a claim can be made only if these two criteria are met: (1) the norms in Chapter 11, Section A were breached by another NAFTA government; and (2) the investor has suffered damage as a result of that breach. A claim cannot succeed if an investor has suffered no damage, or if the alleged breach does not fall within Section A, or if an investor has suffered damage but not because of a breach of Section A.

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[35] For a diagram that summarizes the dispute resolution methods in NAFTA, see Government of Canada, Department of Foreign Affairs and International Trade, *NAFTA Dispute Settlement Procedures*, 25 November 2002 (accessed 8 July 2003), available from http://www.dfait-maeci.gc.ca/nafta-alena/dispgraph-en.asp. For a detailed summary of NAFTA dispute resolution generally, see United Nations Conference on Trade and Development, *Dispute Settlement Regional Approaches 6.1—NAFTA*, 20 January 2003 (accessed 18 July 2003), available from http://www.unctad.org/en/docs/edmmisc232add24_en.pdf.

[36] NAFTA, Article 1116.1, Article 1117.1. The relevant text is:

Article 1116: Claim by an Investor of a Party on Its Own Behalf

1. An investor of a Party may submit to arbitration under this Section a claim that another Party has breached an obligation under:
   (a) Section A or Article 1503(2) (State Enterprises), or
   (b) Article 1502(3) (a) (Monopolies and State Enterprises) where the monopoly has acted in a manner inconsistent with the Party's obligations under Section A,

   and that the investor has incurred loss or damage by reason of, or arising out of, that breach.

Article 1117: Claim by an Investor of a Party on Behalf of an Enterprise

1. An investor of a Party, on behalf of an enterprise of another Party that is a juridical person that the investor owns or controls directly or indirectly, may submit to arbitration under this Section a claim that the other Party has breached an obligation under:
   (a) Section A or Article 1503(2) (State Enterprises), or
   (b) Article 1502(3) (a) (Monopolies and State Enterprises) where the monopoly has acted in a manner inconsistent with the Party's obligations under Section A,

   and that the enterprise has incurred loss or damage by reason of, or arising out of, that breach.

Only NAFTA investors are eligible to make a Chapter 11 claim. There is no provision in NAFTA that permits governments to make a Chapter 11 claim against an investor or other NAFTA governments.

Consultation and Negotiation

Article 1118 encourages the investor and the NAFTA government involved in a dispute to resort first to mutual consultations and negotiations. The parties are expected to apply reasonable efforts to resolve the dispute amicably before turning to arbitration.[37]

Notice and Submission of Claim to Arbitration

If consultations and negotiations fail, the NAFTA investor can proceed to arbitration. Six months must pass after the events that gave rise to the dispute before a claim can be submitted to arbitration, and a notice that outlines the particulars of the claim must be sent to the disputing government at least 90 days before that submission.[38]

Consent to Arbitrate and Domestic Legal Remedies

The NAFTA governments give consent in writing to submit themselves to Chapter 11 arbitration in Article 1122.1.[39] This consent is ongoing, does not need to be given at the time an arbitration is to proceed, and cannot be revoked without amending the text of NAFTA itself. The investor includes written consent and a waiver of all rights to domestic legal remedies upon submission of a claim to arbitration.[40] Hence, in the event that the same dispute also creates

[37] NAFTA, Article 1118. The relevant text is:

> Article 1118: Settlement of a Claim through Consultation and Negotiation
> The disputing parties should first attempt to settle a claim through consultation or negotiation.

[38] NAFTA, Articles 1119-1120.

[39] NAFTA, Article 1122.1. The relevant text is:

> Article 1122: Consent to Arbitration
> 1. Each Party [i.e. NAFTA government] consents to the submission of a claim to arbitration in accordance with the procedures set out in this Agreement [parentheses added].

[40] NAFTA, Article 1121. The relevant text is:

> Article 1121: Conditions Precedent to Submission of a Claim to Arbitration
> 1. A disputing investor may submit a claim under Article 1116 to arbitration only if
>   (a) the investor consents to arbitration in accordance with the procedures set out in this Agreement; and
>   (b) the investor and, where the claim is for loss or damage to an interest in an enterprise of another Party that is a juridical person that the investor owns or controls directly or indirectly, the enterprise, 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

liability for the disputing government under domestic law, the government is protected from being potentially liable on two fronts and the duplication of claims is avoided.

Tribunal Composition and Rules

NAFTA does not have a standing tribunal for arbitrating Chapter 11 disputes. Each tribunal is established *ad hoc* for each dispute. Articles 1123 to 1125 specify the process for selecting arbitrators on a tribunal[41]. Tribunals generally consist of three arbitrators. The investor and the disputing government each choose one arbitrator. The third arbitrator is the presiding arbitrator and is chosen by agreement between the investor and the disputing government.

Chapter 11 arbitration rules of procedure follow well-known international standards. Article 1120 specifies that an arbitration will be under either the ICSID Convention (International Centre for the Settlement of Investment Disputes), the ICSID Additional Facility, or the UNCITRAL Arbitration Rules, except to the extent modified by Chapter 11.[42] The investor chooses the set of rules that will apply to the arbitration.[43]

A tribunal has the power under Article 1134 to make interim orders.[44] These orders are similar to certain types of injunctions a domestic court can issue in normal litigation. Interim

to the measure of the disputing Party that is alleged to be a breach referred to in Article 1116, except for proceedings for injunctive, declaratory or other extraordinary relief, not involving the payment of damages, before an administrative tribunal or court under the law of the disputing Party.

2. A disputing investor may submit a claim under Article 1117 to arbitration only if both the investor and the enterprise:
   (a) consent to arbitration in accordance with the procedures set out in this Agreement; and
   (b) 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 referred to in Article 1117, except for proceedings for injunctive, declaratory or other extraordinary relief, not involving the payment of damages, before an administrative tribunal or court under the law of the disputing Party.
3. A consent and waiver required by this Article shall be in writing, shall be delivered to the disputing Party and shall be included in the submission of a claim to arbitration.
4. Only where a disputing Party has deprived a disputing investor of control of an enterprise:
   (a) a waiver from the enterprise under paragraph 1(b) or 2(b) shall not be required; and
   (b) Annex 1120.1(b) shall not apply.

[41] NAFTA, Articles 1123-1125.

[42] NAFTA, Article 1120.

[43] The ICSID Convention rules can be chosen only if the disputing government and the investor's home government are both parties to the ICSID Convention. The ICSID Additional Facility is designed for arbitrations in which either the investor or the disputing government is not a party to the ICSID Convention. Because Mexico and the US are parties to the ICSID Convention and Canada is not, the ICSID Additional Facility applies only to disputes where there is a Canadian party.

[44] NAFTA, Article 1134. The relevant text is:

Article 1134: Interim Measures of Protection

A Tribunal may order an interim measure of protection to preserve the rights of a disputing party, or to ensure that the Tribunal's jurisdiction is made fully effective, including an order to preserve evidence in the possession or control of a disputing party or to protect the Tribunal's jurisdiction. A Tribunal may not

orders are intended to protect the rights of disputing investors or governments, preserve evidence, or to protect the tribunal's jurisdiction.

The investor bears the burden of proving a Chapter 11 claim. Although there is no text in NAFTA that specifies the standard of proof, the standard is a relatively high one given the nature of the acts that constitute a breach and the requirement that the investor suffer damage because of that breach.

At different points in the arbitration, a tribunal may make partial awards on different issues. The final award comes at the end and usually determines the outcome.

Neutral NAFTA Governments and the Free Trade Commission

In an arbitration against a NAFTA government, Article 1128 permits the other neutral governments to make submissions to an arbitral tribunal on their view of how the applicable provisions of NAFTA should be interpreted.[45] These submissions may be made after giving written notice to the disputing parties. As well, a neutral government is entitled to receive copies of all the evidence and arguments submitted in a dispute.[46]

The Free Trade Commission can play a critically important role. The Commission consists of cabinet-level representatives from all three NAFTA countries, makes most decisions by consensus, and is responsible for overseeing NAFTA's implementation.[47] It is empowered to

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order attachment or enjoin the application of the measure alleged to constitute a breach referred to in Article 1116 or 1117. For purposes of this paragraph, an order includes a recommendation.

[45] NAFTA, Article 1128. The relevant text is:

Article 1128: Participation by a Party

On written notice to the disputing parties, a Party may make submissions to a Tribunal on a question of interpretation of this Agreement.

[46] NAFTA, Article 1129.

[47] NAFTA, Article 2001.1-2001.4. The relevant text is:

Article 2001: The Free Trade Commission

1. The Parties hereby establish the Free Trade Commission, comprising cabinet-level representatives of the Parties or their designees.
2. The Commission shall:
   (a) supervise the implementation of this Agreement;
   (b) oversee its further elaboration;
   (c) resolve disputes that may arise regarding its interpretation or application;
   (d) supervise the work of all committees and working groups established under this Agreement, referred to in Annex 2001.2; and
   (e) consider any other matter that may affect the operation of this Agreement.
3. The Commission may:
   (a) establish, and delegate responsibilities to, ad hoc or standing committees, working groups or expert groups;
   (b) seek the advice of nongovernmental persons or groups; and
   (c) take such other action in the exercise of its functions as the Parties may agree.
4. The Commission shall establish its rules and procedures. All decisions of the Commission shall be taken by consensus, except as the Commission may otherwise agree.

make interpretations of NAFTA that are binding on arbitral tribunals.[48] Note that the Commission's interpretive power under the NAFTA text appears to be unlimited. This means that the Commission may issue an interpretation that binds a tribunal that can shift the whole outcome of a case, even while it is pending. This gives NAFTA governments the power to shape the contours of Chapter 11 jurisprudence directly, which is a major departure from most international arbitration procedures that do not provide for such powers.

Transparency

There is no text in NAFTA itself that specifically requires or prohibits the publication of documents related to Chapter 11 arbitrations. The text of Annex 1137.4 makes publication optional.[49] However, in an interpretation issued by the Commission, the NAFTA governments voluntarily decided to publish all materials except for confidential or privileged information.[50] Primary research materials for this paper were obtained easily over the Internet.

Final Award and Enforcement in Domestic Courts

Under Articles 1135.1 and 1135.3, a tribunal is limited to awarding money damages or ordering restitution of property against the disputing government.[51] No other possible award can be made, including punitive damages. Costs may be awarded according to the applicable arbitration rules.

The arbitral award must be enforced in the domestic courts of the disputing government.[52] Domestic courts are involved as part of the normal process of enforcing arbitral awards. A court at this stage may be convinced to decline the enforcement of a Chapter 11

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[48] NAFTA, Article 1131.2. The relevant text is:

Article 1131: Governing Law

1. An interpretation by the Commission of a provision of this Agreement shall be binding on a Tribunal established under this Section.

[49] NAFTA, Annex 1137.4.

[50] Government of Canada, Department of Foreign Affairs and International Trade, note 57 *infra*.

[51] NAFTA, Article 1135.1, Article 1135.3. The relevant text is:

Article 1135: Final Award

1. Where a Tribunal makes a final award against a Party, the Tribunal may award, separately or in combination, only:
   (a) monetary damages and any applicable interest;
   (b) restitution of property, in which case the award shall provide that the disputing Party may pay monetary damages and any applicable interest in lieu of restitution.

   A tribunal may also award costs in accordance with the applicable arbitration rules.

…

3. A Tribunal may not order a Party to pay punitive damages.

[52] NAFTA, Article 1136.4.

award if the specific grounds of the Model Law or the New York Convention for doing so are met.

Unless reviewed by a domestic court, Chapter 11 arbitration awards are final and must be complied with promptly. Failure by a government to abide by an award will invoke state-state dispute resolution proceedings.[53]

Limits to Chapter 11 Arbitration Compared to Normal Litigation

Aside from the usual differences between arbitration generally and normal litigation, investor-state arbitration under Chapter 11 has a number of features that circumscribe its scope and provide safeguards from poorly-rendered or overreaching arbitral decisions. Because NAFTA is an instrument of international law, there are different policy considerations that come into play that would otherwise not apply in normal litigation. Chapter 11 arbitration represents the boundary between protecting the rights of foreign investors through a supranational legal mechanism and allowing the state enough flexibility to carry out its usual tasks. Accordingly, the text of NAFTA and the powers of the bodies involved act as limits on arbitral tribunals and their decisions. The extent of these limits demonstrates that Chapter 11 arbitration is not as extensive as some have claimed, especially in comparison to the extensive powers of domestic courts in the course of normal litigation.

First, the jurisdiction of Chapter 11 tribunals is extremely limited. Only (1) a breach of Section A that (2) causes an investor to suffer damage can give rise to a Chapter 11 claim and the jurisdiction of a tribunal.[54] Unlike domestic courts that can usually rule on any matter that comes within the entire body of domestic law, a tribunal can rule only on breaches of Section A that cause damage to an investor. A tribunal cannot rule upon any issue that arises out of matters that do not fall within Chapter 11, Section A. Doing so would contradict the text of NAFTA and would exceed the consent to arbitrate given by NAFTA governments to arbitrate on Section A matters only. This limit has the effect of making outlandish claims inadmissible or liable for dismissal.

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[53] NAFTA, Article 1136.5. The relevant text is:

Article 1136: Finality and Enforcement of an Award

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

[54] NAFTA, Articles 1116 and 1117, note 36 *supra*.

Second, the precedent-setting value of Chapter 11 arbitral awards is extremely limited. Article 1136.1 states that an award binds only the disputing parties in the particular case and has no authority beyond that.[55] While past tribunals may provide guidance, future tribunals are free to ignore the rulings of past ones. This is quite different from domestic courts in which decisions of higher courts must be followed by lower courts and past decisions are either binding or highly persuasive.

Third, the powers of tribunals are also extremely limited. As mentioned above, a tribunal can make interim orders only on explicitly stated grounds and can award only money damages or property restitution.[56] No other powers can be exercised. Unlike domestic courts, a tribunal cannot issue an injunction to force a NAFTA government to repeal a non-conforming measure or halt a non-conforming practice, nor can it award punitive damages to chastise or deter a government and provide a windfall for an investor.

Fourth, neutral governments are allowed to make submissions to a tribunal regarding interpretation as a matter of right. This differs from domestic courts in which non-parties to a trial generally have no automatic right to participate. Neutral governments represent two out of the three NAFTA countries. Because the NAFTA is a bargain struck between these three countries, and because the NAFTA text represents their common intentions, NAFTA should be interpreted and implemented in a way that reflects their intentions, just as a contract should be enforced following the original intentions of the parties. Thus, the views of neutral governments are entitled to a fair amount of weight by tribunals.

Fifth, the Commission's unlimited power to issue binding interpretations is an extention of respecting the intentions of the NAFTA countries. Through its regular meetings and consensus-based decision making, the Commission effectively institutionalizes the ability of the NAFTA countries to fine-tune their collective intentions and express them without having to renegotiate and amend the NAFTA text itself. It is like an ongoing power to make amendments. One such interpretation was issued in August of 2001 that increased the transparency of Chapter 11 arbitrations by making all non-confidential materials public and clarified the meaning of "fair and equitable treatment" in Article 1105.[57] What this means for tribunals is that the law that would apply in an arbitration can change at any point, even while an arbitration is pending. As

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[55] NAFTA, Article 1136.1. The relevant text is:

Article 1136: Finality and Enforcement of an Award

1. An award made by a Tribunal shall have no binding force except between the disputing parties and in respect of the particular case.

[56] NAFTA, Articles 1134-1135, notes 44 and 51 *supra*.

[57] Government of Canada, Department of Foreign Affairs and International Trade, *Pettigrew Welcomes NAFTA Commission's Initiatives to Clarify Chapter 11 Provisions*, 1 August 2001 (accessed 6 October 2003), available from http://webapps.dfait-maeci.gc.ca/minpub/Publication.asp?FileSpec=/Min_Pub_Docs/104441.htm.

well, if the jurisprudence developing around Chapter 11 takes directions that the NAFTA countries find undesirable, the Commission can easily correct it. The Commission's power to effect these changes is greater than the domestic law equivalent for normal litigation which would typically require higher court rulings or new legislation.

Sixth, despite the lack of a formal appeal process within the NAFTA unlike in normal litigation, an arbitral award's enforcement stage in a domestic court is a *de facto* appeal stage. If the grounds specified in the Model Law and the New York Convention are met, the award will not be enforced either in whole or in part. In 2001, the Chapter 11 award in *Metalclad Corporation* v. *United Mexican States* ["Metalclad"] was to be enforced in British Columbia, Canada.[58] It was partially set aside by a BC court on the grounds that the tribunal had exceeded its jurisdiction in a number of areas.[59] While the scope for affecting the final outcome in a domestic court of a Chapter 11 award is more limited than it is at earlier stages, it is nonetheless important to recognize the role of domestic courts to review the award at the enforcement stage.

WHY AUSFTA SHOULD HAVE INVESTOR-STATE ARBITRATION

Misconceptions of Investor-State Arbitration

Popular criticism of NAFTA Chapter 11 tribunals and of investor-state arbitration generally has centred on a number of arguments, especially in the wake of opposition to the Multilateral Agreement on Investment (MAI) negotiations and their eventual failure in 1998. Nationalist arguments in Canada and Australia hold that investor-state arbitration is a tool for American domination.[60] NGOs in North America and elsewhere fear excessive liability of governments and an overall weakening of national sovereignty, thereby reducing the ability of governments to provide public services and regulate business activities.[61] Opponents of

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[58] *Metalclad Corporation* v. *United Mexican States*, ARB(AF)/97/1 (ICSID 30 August 2000) (Lauterpacht, Civiletti, and Siqueiros Arbs.) [hereinafter "Metalclad"].

[59] *United Mexican States* v. *Metalclad Corporation*, 2001 B.C.S.C. 664, paras. 66-80, June 2001 (accessed 6 October 2003); available from http://www.courts.gov.bc.ca/jdb-txt/sc/01/06/2001bcsc0664.htm.

[60] Kenneth Davidson, "Free trade and America? Read the blueprint and weep," *The Age*, 1 August 2002 (accessed 10 October 2003), available from http://www.theage.com.au/articles/2002/07/31/1027926912818.html; Kenneth Davidson, "Howard is sacrificing our interests," *The Age*, 13 June 2002 (accessed 10 October 2003), available from http://www.theage.com.au/articles/2002/06/12/1023864297100.html; The Council of Canadians, *NAFTA's Big Brother: The Free Trade Area of the Americas and the Threat of NAFTA-style "Investor State" Rules*, 2003 (accessed 10 October 2003), available from http://www.canadians.org/display_document.htm?COC_token=23@@e383f5e9679858f5f5ab5a31f4b0375a&id=109&isdoc=1.

[61] Public Citizen and Friends of the Earth, *NAFTA Chapter 11 Investor-to-State Cases: Bankrupting Democracy*, September 2001 (accessed 10 October 2003), available from http://www.citizen.org/documents/ACF186.PDF.

globalization would generally have problems with investor-state arbitration in any respect.[62] However, these criticisms become largely unfounded upon closer examination of the way investor-state arbitration in NAFTA Chapter 11 works for Canada. The same criticisms apply for investor-state arbitration in the AUSFTA negotiations and are just as unfounded as in Canada's situation. With reference both to the Canadian and Australian situations, the following discussion makes the overall point that investor-state arbitration is not nearly as frightening as some of its detractors have made it out to be.

American Pillaging with Investor-State Arbitration?

Among Canadian nationalists, Americans—especially American corporations—are often portrayed as bogeymen that are out to get Canada. In this view, Canada is seen as weak and victimized at the hands of all-powerful and abusive Americans. Nationalist criticisms of Chapter 11 arbitration reflect this view. For example, Maude Barlow, the chair of the nationalist Council of Canadians, states that NAFTA "gave American corporations Chapter 11, the first 'investor-state' clause in any international agreement."[63] The argument is that Americans see Chapter 11 as a tool imposed on Canada to strip away its public assets and sovereignty, for American benefit while Canadians are left helpless. Similar sentiments exist in Australia. A recent report in the Sydney Morning Herald on investor-state arbitration in AUSFTA put enormous emphasis on the possibility of Australian liability, while Kenneth Davidson's columns in *The Age* have made the same point.[64]

This argument is incorrect for both Canada and Australia because the Canada-US and Australia-US investment relationships are not one-sided. Although Canada and Australia combined are smaller than the US, Canadian and Australian arguments against investor-state arbitration and FTAs with the US generally forget just how much leverage Canada and Australia actually exercise. Quite simply, Canada's and Australia's strength is not recognized. Investor-state arbitration is a quasi-judicial instrument to protect a country's investors and their investments when they invest abroad. The "American pillaging with investor state arbitration" argument might have some validity if the Australia-US and Canada-US investment relationships

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[62] For links to the extensive Internet resources available on globalization, see Australian APEC Study Centre, *The Globalisation Guide*, 2002 (accessed 15 October 2003), available from http://www.globalisationguide.org. Of course, if one held wholesale opposition to globalization, investor-state arbitration would be unpalatable irrespective of any particular features it might have.

[63] Maude Barlow, *Who's in Charge of the Global Economy?* Fall 1999 (accessed 10 October 2003), available from http://www.mindfully.org/WTO/Whos-In-Charge.htm.

were asymmetrical, with huge amounts of American investment entering Canada and Australia and little or no investment going to the US. This would result in a large stake of American investment to be protected, and thus a large potential scope for investor-state arbitration to make rulings that favour Americans. However, statistics tell a different story. As stated at the beginning, the total stocks of investment in the Australia-US and Canada-US relationships are remarkably balanced; Australian investment in the US is 80% of US investment in Australia, while Canadian investment in the US is 90% of US investment in Canada.[65] These proportions cannot possibly suggest that these relationships are one-sided in favour of the Americans.

Furthermore, it is irrelevant that the proportionate economic impact of these investment relationships is widely different between Canada, Australia, and the US. It is true that $200 billion of investment would have greater impact on the Australian and Canadian economies than it would to the much larger American economy. However, absolute amounts of investment—*not* relative amounts—generate investment disputes. All else being equal, a $50 million expansion of an oil refinery, for example, will generate the same amount of jobs, have the same number of contracts, have the same nexus with government authorities, and therefore have the same potential for disputes if the refinery expansion were in Canada, Australia, or the US. Moreover, if disputes were to arise, there is little reason why the quality and outcomes of those disputes should be different merely because of the size of the overall economy. Thus, the benefit of investor-state arbitration in NAFTA and in AUSFTA would be relatively equal for Canada, Australia, and the US because of the balanced extent of Canada-US and Australia-US foreign investment.

There are arguments that investor-state arbitration is meant for bilateral investment relationships between developed and developing states. Investor-state arbitration "internationalizes" investment disputes by taking the resolution of these disputes out of the domestic legal sphere and onto the international level. These disputes would be resolved by tribunals specially formed under a particular agreement between the investor and the host state, or at standing arbitration institutions. With developing countries, the rationale for internationalizing investment disputes is that the host state—usually the developing state—did not have domestic legal systems that were functional enough to protect the property rights of the foreign investor from the developed country. Investor-state arbitration was therefore a device to attract foreign investment and create economic growth in the developing state.[66] This view was

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[64] John Garnaut and Catherine Overington, "US trade deal may end in court," *Sydney Morning Herald*, 18 July 2003 (accessed 10 October 2003), available from http://www.smh.com.au/text/articles/2003/07/17/1058035139206.htm; Davidson, note 60 *supra*.
[65] Australian Bureau of Statistics, note 2 *supra*; Statistics Canada, note 3 *supra*.
[66] M. Sornarajah, *The Settlement of Foreign Investment Disputes* (The Hague: Kluwer Law International, 2000), 223-227.

codified and enshrined in a large number of bilateral investment treaties (BITs) signed between developed and developing countries. For example, investor-state arbitration is part of American practice under its *Model Foreign Investment Law*, while a number of Australian BITs contain such clauses.[67] These BITs contemplate a one-way foreign investment relationship with investment flowing from the developed to the developing country.

Despite the original purpose behind investor-state arbitration, NAFTA and the MAI represent a marked shift in American policy. Instead of investor-state arbitration applying primarily to developing country investment relationships, American participation in NAFTA and the MAI negotiations meant that the US was willing to accept being bound by arbitration with other developed countries such as Canada. This is especially true given that the US is the largest single destination for FDI with $1.35 trillion invested in it.[68] It is reasonable to expect American negotiators to know that this extent of investment combined with their participation in investor-state arbitration is essentially an American concession to developed countries as well as the rest of the world: American is allowing non-Americans to sue it. If the Americans had not intended this result in NAFTA, for instance, then it would not have approved of Chapter 11 applying between the US and Canada equally as between the US and Mexico. Indeed, Daniel M. Price, one of the American negotiators of NAFTA Chapter 11, admitted as much; while these types of provisions were historically intended for developing countries such as Mexico, the inclusion of Canada in Chapter 11 was "[j]ust as importantly, the first occasion when two developed OECD countries have made the same commitments to each other that they have demanded of developing countries."[69] This policy stance belies the view of Americans "pillaging" the rest of the world with investor-state arbitration.

Investor-state arbitration is part and parcel of the development of a rules-based system for international economic relationships. Rules-based systems are better for middle powers like Canada and Australia because they treat all states equally, irrespective of size, by removing economic and political power considerations from the resolution of disputes. In short, it is supposed to *stop* Americans from pillaging Australian and Canadian investment in America, provided that the Canada and Australia do the same for American investment. The relatively

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[67] Don Wallace, Jr. and Robert B. Shanks, *Model Foreign Investment Law with Annotations*, annotated by David A. Levy (Washington: International Law Institute, 1996), 21-22; Australasian Legal Information Institute, *Australian Treaties Library: Foreign Investment*, 2003 (accessed 22 August 2003), available from http://www.austlii.edu.au/au/other/dfat/subjects/Foreign_Investment.html.

[68] United Nations Conference on Trade and Development, *World Investment Report 2003—FDI Policies for Development: National and International Perspectives* (Geneva: United Nations, 2003), 257.

[69] Daniel M. Price, "An Overview of the NAFTA Investment Chapter: Substantive Rules and Investor-State Dispute Settlement," 27 *Int'l Law* 727 (1993) at 736; quoted in Timothy Ross Wilson, "Trade Rules: Ethyl Corporation v. Canada (NAFTA Chapter 11) Part II: Are Fears Founded?"6 *NAFTA: L. & Bus. Rev. Am.* 205 (2000) at 224.

equal level of investment in all directions of these bilateral relationships means that Canadians and Australians would benefit from investor-state arbitration just as much as Americans would. Thus, if AUSFTA has investor-state arbitration, it must be emphatically noted that Australians can sue the American government equally as Americans can sue the Australian government. Only perfect American compliance with AUSFTA or Australian unwillingness to turn to investor-state arbitration would prevent Australians from using it to protect their investments in America.

Overzealous Arbitrators?

Opponents of investor-state arbitration often decry the perceived pro-market bias of arbitrators as arbitrators usually have a background in international law, commercial law, business, or diplomacy. Makers of this argument are particularly incensed at the idea that arbitrators are permitted to make decisions affecting public policy and the conduct of government officials in areas that might not be directly related to their expertise through procedures that differ from those in domestic courts. It is an argument similar to the general one levelled against the WTO's dispute settlement mechanism for failing to take other non-trade interests into account.

This argument assumes that domestic judges are somehow "purer" than arbitrators. However, while arbitration shares the same function with domestic courts of resolving disputes, the two are clearly not the same. Arbitrators, at least in NAFTA Chapter 11, are subject to a number of institutional mechanisms of constraint that do not apply to judges in domestic courts. As mentioned above, these include the restriction of tribunal jurisdiction only to breaches of NAFTA itself, the choice of arbitrators by equal and mutual agreement, submissions by neutral NAFTA governments, binding interpretations by the Commission, the limited precedential value of arbitral decisions, and judicial review of arbitral awards by domestic courts. These constraints should be enough to curb decisions by arbitrators that go too far and are much more extensive than those that apply to judges, and they would fail to function only if they were never applied.

Indeed, arbitrators have demonstrated sensitivity to the limits of their role. *Loewen* v. *United States* involved a Canadian funeral home operator that was arguably denied justice during litigation in Mississippi due to a questionable trial and the unavailability of further appeals. In denying Loewen's claim, the tribunal demonstrated reluctance to turn the arbitration into a *de facto* appeal from domestic litigation:

> As we have sought to make clear, we find nothing in NAFTA to justify the exercise by this Tribunal of an appellate function parallel to that which belongs to the courts of the host nation. In the last resort, a failure by [the US] to provide adequate means of remedy [for a foreign investor] may amount to an international wrong but only in the last resort. The line may be hard to draw, but it is real. 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 [parentheses added].[70]

There is little to suggest that arbitrators would not take a similar view within AUSFTA investor-state arbitration. Indeed, having the same safeguards as NAFTA coupled with a growing body of arbitral decisions should hold back future AUSFTA tribunals from going out of bounds.

Opening of the Floodgates?

A common fear concerning investor-state arbitration is that there will be a flood of claims launched against a host state. Foreign investors that are unhappy for whatever reason might sue the host state in large numbers by turning to arbitration as an alternative to domestic courts. Two points refute this fear.

First, as with domestic law, just because people launch lawsuits does not mean that they are going to win. Anyone can sue anyone else for any reason whatsoever. Similarly, anyone can try to launch arbitral proceedings for any reason at all. However, like judges in normal litigation, tribunals have the power to dismiss frivolous claims at the outset. Such claims have been dismissed or severely curtailed.[71] Frivolous claims get headlines, but their dismissal upon actually arriving in front of a judge or tribunal is barely reported.

Second, it must be remembered that the investor bears the burden of proving that a NAFTA government breached Chapter 11, Section A, and that the investor suffered damage as a result. This is a particularly heavy burden to meet given that proving a breach is a difficult practical task and that the threshold level of conduct that would meet the standards of a breach is quite high, as will be discussed below.

Third, the "open floodgates" argument does not stand up to scrutiny when the history of Chapter 11 cases is examined. As the table illustrates, only 22 cases have arisen since NAFTA entered into force on 1 January 1994. Notably, the distribution of cases is relatively equal, with 8

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[70] Loewen, note 8 *supra* at 70-71.
[71] J.C. Thomas, *The Experience of NAFTA Chapter 11 Tribunals to Date: A Practitioner's Perspective*, 1 October 2002 (accessed 10 July 2003), available from http://www.carleton.ca/ctpl/ch11papers/Thomas%20Comments.doc, 3-4.

filed against Canada, 6 against the US, and 8 against Mexico. This indicates that not only has Chapter 11 not opened floodgates, but it has not opened floodgates in any particular NAFTA country. The small number of cases filed combined with their balanced distribution in light of how much foreign investment goes on within NAFTA indicates that the actual use of investor-state arbitration is minuscule. This is especially true when compared to the number of civil lawsuits filed in domestic courts.

In nearly 10 years of investor-state arbitration in NAFTA, no torrent of cases has materialized. Either no floodgates have opened, or the gates have opened with only a trickle flowing. It is reasonable to expect that Australia's experience with investor-state arbitration in AUSFTA will mirror Canada's experience with the actual number of arbitrations turning out to be far less than feared.

NAFTA Chapter 11 Cases Since 1 January 1994 (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/l/c3439.htm (accessed 28 August 2003).

Broad Potential Liability from a Corporate Assault on the State?

Related to the "open floodgates" argument is the fear that investor-state arbitration in any FTA would lead to broad potential liability for the state. The argument is that government activities affect so many areas of the economy that measures to restrain these activities will trigger liability on a large number of fronts. Moreover, once a government is found liable, the measures in question cannot be implemented, nor can future similar measures be introduced. Foreign corporations would stand to benefit from this as public functions performed by

government are restricted or privatized, leaving national sovereignty devoid of meaning. Huge amounts of literature from multiple sources that are primarily leftist and nationalist make this politically strident argument.

The Canadian experience with investor-state arbitration is particularly instructive here. Those making the "corporate assault" argument should demonstrate that the public sector in Canada has diminished because of Chapter 11 arbitration and not due to some other cause. The scope of Chapter 11 arbitration is limited only to breaches of the norms of Chapter 11, Section A, which can essentially be reduced to prohibiting discrimination against foreign investors. It is further limited by the various mechanisms that operate within Chapter 11 and NAFTA generally. NAFTA makes no requirements for governments to create a profitable environment for foreign investors, nor to privatize public functions. In this light, it is difficult to imagine Chapter 11 arbitration wreaking havoc on the private sector at all except where a government acts in a discriminatory fashion against a foreign investor.

By all major accounts, Canada's ability to act as a sovereign state without fear of liability from an arbitral tribunal is unaffected, especially by the alleged threats posed by Americans. Canada retains universal public health care. Canadian education, including higher education, remains largely public. Canadian cultural industries, including the Canadian Broadcasting Corporation, have not been taken over. Americans have not taken away Canadian natural resources. In the past 12 months, Canada pursued high-profile foreign and environmental policy agendas that directly contradict American positions, most notably non-participation in the war on Iraq and ratification of the Kyoto Accord on global warming. These are only a few examples of the ways in which Canada acts like a sovereign country should typically act. If Americans were willing and able to use NAFTA Chapter 11 arbitration to attack Canadian sovereignty in the ten years of NAFTA's existence, they would surely have done so already. That this attack has not happened demonstrates either American unwillingness, inability, or—most likely—both. The endlessly debatable proposition that the Canadian public sector has weakened cannot look to Chapter 11 as the cause.

Often the evidence of a "corporate assault on the state" is based on a pure misreading of actual cases. For instance, the case of *UPS* v. *Canada* is taken as an example of an American company attempting to use Chapter 11 to take over Canada Post's public postal monopoly.[72] In fact, Canada Post operates in two spheres: the public sphere of regular mail, like any other publicly-owned postal service; and the private sphere of for-profit courier service in which it competes with other existing private companies. UPS is challenging Canada Post's activities in

[72] Garnaut and Overington, note 64 *supra*; Davidson, *Howard*, note 60 *supra*.

the commercial and competitive courier market and is *not* challenging the non-commercial public provision of regular postal services.[73] Even if UPS' claim is read in the most reasonably expansive reasonable light, it is clearly not attempting to dislodge Canada Post's monopoly over non-commercial public mail. This is not a comment on whether UPS has a worthwhile case; it may or may not have one and the discussion is outside the scope of this paper. The point here is that public non-commercial activity is not the subject of a Chapter 11 claim, but private commercial activity is, as it was *always* intended to be. It is singularly unhelpful to debate investor-state arbitration when the cases themselves are not fully understood.

The acceptance of restraints that accompany the implementation of any FTA coupled with mechanisms to enforce them, such as investor-state arbitration, necessarily stops governments from doing certain activities without accountability. However, these activities primarily include discrimination against foreign investors. To this extent, state sovereignty is "attacked", but only to that extent and no further.

The Benefits of Investor-State Arbitration

The discussion here turns specifically to Australia. While the preceding discussion looks at what investor-state arbitration in Canada has not done, the question of what it can do for Australia will be addressed. Although the presence of particular legal remedies might be only a secondary factor in foreign investment decisions, unlike other factors such as market access and overall production costs, its latent importance comes to the fore when disputes emerge or when assessing the risks of disputes emerging. At that point, investor-state arbitration's advantages become much more acute.

The protective and procedural benefits of investor-state arbitration for Australian investors would be realized only if offered on a reciprocal basis with the Americans. Any agreed-to reduction on the ability of the US government to act would apply to Australia, and any benefit for Australian investors would apply to American investors as well. Notwithstanding this, the inherent balance in the Australia-US investment relationship means that the gains for investors will be equally distributed, though the discussion will proceed from an Australian perspective.

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[73] Government of Canada, Department of Foreign Affairs and International Trade, *United Parcel Service of America Ltd.* v. *Canada*, *Statement of Claim* [hereinafter "UPS Statement of Claim"], 19 April 2000 (accessed 15 July 2003), available from http://www.dfait-maeci.gc.ca/tna-nac/documents/state-claim.pdf, 4-15.

Protecting Australian Investment in the US at all Levels

The large amount of Australian investment in the US and the relatively equal amount of American investment in Australia are stark reminders that investment provisions in AUSFTA are not a one-way street in favour of Americans. A large portion of Australian investment in the US is ultimately tied to Australian superannuation funds that hold the savings of ordinary Australians. As a result, Australia has a strong interest in ensuring that this investment is protected. Investor-state arbitration performs a protective function by helping to reduce non-commercial risks for Australian investment. The non-commercial risks in question are the risk of arbitrary, discriminatory, expropriatory, and economically distorting measures being taken by the American government.

The size and complexity of American society correspondingly brings a large and complex government that operates on multiple levels with multiple functions: municipal, state, and federal; legislative, executive, judicial, and administrative. American government can act in an almost limitless number of combinations and permutations to the detriment of Australian investors. Furthermore, American government is not monolithic; a wide range of interests that come into play at different levels can yield contradictory results for investors. For example, even if the Bush Administration is pro-business and open to foreign investment, there is no guarantee that the council of a city where an Australian-owned factory is located will be similarly welcoming, or that future political leaders at any level will not turn protectionist. Actions by lower levels of government can often impose the highest costs on investors. Overall, this means that the possibility of abusing Australian investors may be largely unpredictable or even huge.

A major advantage of internationally created rights over domestically created ones is that international rights are more difficult to amend or abrogate. For domestic rights to change merely requires unilateral action by the government that created those rights. For international rights to change, on the other hand, the governments that signed the treaty that enshrines these rights must reopen and renegotiate that treaty to arrive at a mutually satisfactory conclusion, unless the treaty itself provides for some alternative mechanism. Assuming that international rights are fully exercisable and properly enforced, all else being equal, they are more entrenched—and hence more reliable—than substantively similar rights created solely under non-constitutional domestic law.

AUSFTA would create international legal rights for Australian investors through the imposition of a single set of standards on all aspects of American governmental activity. By their international nature, this set of standards cannot be arbitrarily or unilaterally altered. Under

international law, the standards would apply to all levels of government. Article 29 of the 1969 *United Nations Convention on the Law of Treaties* ("Vienna Convention") states that a treaty applies throughout a country's territory unless the treaty specifies otherwise.[74] Australia is a signatory to the Vienna Convention;[75] the US is not, but it views the Vienna Convention as the correct statement of international law on interpretation issues and will abide by the Convention's substantive terms.[76] Therefore, political sub-units of countries, such as states and municipalities, are bound by a treaty's terms. Breach of a treaty by those sub-units results in liability for the national government. From the point of view of Australian investors, the Vienna Convention means that every level of American government in every capacity must respect whatever rights are created by AUSFTA's investment provisions. The operation of Article 29 of the Vienna Convention goes to the extent of an investor's rights, while investor-state arbitration completes the picture by providing for the enforcement of those rights.

Effective Enforcement of Internationally-Created Rights for Foreign Investors

Free trade agreements that contain provisions governing foreign investment create rights for foreign investors. These rights, including MFN, national treatment, non-expropriation, and a ban on performance requirements, among others, are created by international legal instruments like FTAs and BITs. This is because these rights do not necessarily arise concurrently under domestic legal regimes; a host country may or may not grant the same substantive rights to domestic investors, foreign investors, or both. For foreign investors, international legal instruments provide these rights where domestic law would leave investors unprotected.

Investor-state arbitration is an international means for foreign investors to enforce international rights. By definition, all rights are claims supported by law. However, rights need enforcement to have meaning. Rights without an adequate and effective means of enforcement are meaningless. Meaningless rights for investors upset expectations, increase uncertainty, allocate risks in unpredictable ways, and impede the functioning of business. Domestic courts enforce domestic rights, but they typically do not have the jurisdiction to enforce international rights. Thus, a foreign investor cannot turn to the domestic courts of the host country claiming a violation of international rights. The investor can do so only if there is an independent and

[74] *United Nations Convention on the Law of Treaties*, signed in Vienna, 23 May 1969 [hereinafter "Vienna Convention"] (accessed 18 July 2003), available from http://www.jus.uio.no/lm/un.law.of.treaties.convention.1969/doc.html, Article 29.
[75] Juris International, *International Legal Instruments: Vienna Convention on the Law of Treaties,* 27 February 2003 (accessed 2 August 2003), available from http://www.jurisint.org/pub/01/en/421.htm#C.
[76] American Law Institute, *Restatement (3rd) of Foreign Relations Law, Part III Introductory Note* (1987).

concurrent breach of some provision of domestic law. Not every set of circumstances will yield such a breach, even in host countries that have traditionally strong protection for all investors such as the US. A number of government actions may violate an FTA or BIT without a domestic legal breach or even as a result of a provision of domestic law.

For instance, in the US constitutional context, it is well settled that foreign nationals such as Australians must be treated equally in most instances with American nationals under the American doctrine of equal protection under the law. A blanket measure that openly targets non-Americans for worse treatment would likely be a constitutional violation, and hence would be a domestic legal violation that can be dispensed with through American courts without recourse to investor-state arbitration. Where American domestic law becomes much less clear is whether such equality of treatment applies to non-American corporations operating in the US, including Australian corporations, or whether equality must apply in all circumstances.[77] Moreover, some measures that would pass constitutional scrutiny and are non-discriminatory on their face could be applied in an unequal manner or be disguised restrictions, to the detriment of Australian investors. Though there may be doubts about the ability of American domestic law to protect Australian investors, there would be almost no doubt that such measures would be prohibited under AUSFTA if it were to follow NAFTA Chapter 11. Investor-state arbitration to enforce FTA rights would fill this gap.

In the absence of an effective domestic legal remedy, the alternative to investor-state arbitration is to have the foreign investor's home state adopt the investor's claim as its own and use state-state methods. Under classical international law, private parties such as foreign investors have no standing. They cannot not possess or enforce rights, and they certainly cannot be considered the equals of sovereign states. Modern trends have altered the classical position to some degree to create limited standing for private parties. Investor-state arbitration, which is predicated on limited equality between a foreign investor and the host state, could not exist under the classical perspective. Unless investor-state arbitration is created by way of a treaty, however, the classical perspective applies by default and implies state-state methods. For Australians investing in the US, this would mean that any dispute arising out of those investments would have to be adopted by the Australian government and dealt with at an intergovernmental level with the US. This is accomplished in two ways: (1) state-state arbitration through an applicable procedure in AUSFTA, similar to the way WTO disputes or NAFTA state-state disputes are presently adjudicated; or (2) the Australian exercise of diplomatic

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[77] For a fuller discussion on the treatment of non-American corporations under American constitutional law, see Hartwin Bungert, "Equal Protection for Foreign and Alien Corporations: Towards Intermediate Scrutiny for a Quasi-Suspect Classification", 59 *Mo. L. Rev.* 569.

protection of its nationals (i.e. Australian investors) in the US. As with any other government defending its nationals at the international legal level, an Australian government adoption of the claims of its investors is completely discretionary.[78] There is no requirement that Australia adopt every single claim its investors make. This could leave some investors with no remedy whatsoever.

Despite the shared objective of resolving investment disputes, the dynamics involved with using state-state methods are completely different from investor-state arbitration. Although investor-state arbitration would not displace more traditional state-state methods, it offers three main advantages. First, providing Australian investors with their own means to protect their foreign investment interests in the US is cheaper than resorting to state-state methods with no alternatives. Investor-state arbitration is a "do-it-yourself" legal remedy for Australian investors affected by an American government action. With it, Australian investors would not need to rely on Canberra to complain to the US on their behalf. Investors would launch their own claim, hire their own counsel, and pursue their own cases diligently at their own expense. Canberra would not need to expend its resources to determine the merits of claims or to advance claims it decides to adopt.

Second, because investor-state arbitration posits equality of standing between Australian investor and the US, resolving investment disputes becomes de-politicized. It would be a case of an Australian investor fighting on its own against the US with a neutral tribunal determining the outcome as if they were all in court. State-state methods, on the other hand, can elevate investment disputes with a primarily commercial nature into international incidents of a primarily political nature. All possible political considerations between Australia and the US would have to be taken into account, even those that have nothing to do with the dispute itself. As a result, there is a higher likelihood that the dispute's resolution will be suboptimal or distorted, ultimately leaving the investor—a true party to the dispute—to pay the price.

Third, investor-state arbitration is final. The de-politicizing of an investment dispute means that there would be no political reason to reopen its resolution. Finality is an important consideration for investors when disputes must be resolved, but may be a much lower priority for a government when it is a party to the dispute.

The complications of state-state methods for resolving investment disputes were considered by Canada during the NAFTA negotiations in the early 1990s. Before then, Canada had been antipathetic to investor-state arbitration in general, both for foreign investors entering Canada and its own investors going abroad. By the time of the NAFTA negotiations, Canadian

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[78] Ian Brownlie, *Principles of Public International Law*, 4th ed. (New York: Oxford University Press, 1998), 493.

policy changed significantly to recognize the inadequacies of state-state methods and to protect the interests of Canadian that were increasingly seeking investment opportunities abroad. Donald S. Macdonald, a former cabinet minister and chair of a commission that recommended free trade with the US, describes this policy change. It is worth quoting at length:

> The second aspect in which Chapter 11 of NAFTA departs from customary Canadian international practice has been the recognition of the rights of private persons, whether individual or corporate persons, to have status in international proceedings. In general, the Canadian approach would have been in accord with the following statement:
>
> > "Although there is no rule that individuals cannot have procedural capacity before international jurisdictions, the assumption of the classical law that only states have procedural capacity is still dominant and affects the content of most treaties providing for the settlement of disputes which raise questions of state responsibility, in spite of the fact that, frequently, the claims presented are in respect of losses suffered by individuals and private corporations."
>
> Speaking from my own experience, both within and outside government, officials responsible for claims against foreign governments have found themselves caught in a dilemma. First, as Canadian nationals go increasingly out into the world, they are going to get into disputes with foreign governments. The [Canadian] Department of Foreign Affairs and International Trade would prefer not to have to bear the increased burden of espousing cases on behalf of nationals. As every legal practitioner knows, not every claimant is noble, and not every claim is meritorious, and the process of determining which are and which are not can be expensive, both in time and substance. And, secondly, some claims have a capacity to become national or even international incidents, and governments cannot afford to be seen to be indifferent to the interests of the national or nationals in question. Perhaps intervention at an earlier stage leading to noble failure would save the officials much grief later on [parentheses added].[79]

Increased Investor Confidence through Reduced Non-Commercial Risks

Confidence is essential to attracting foreign investment. A key aspect of investor confidence is predictability. Predictability is important because it allows investors to make decisions on the allocation of resources, setting of prices, and future planning. While commercial risks are inherent to all business transactions, the presence of non-commercial

risks—such as the risk of adverse, arbitrary, or discriminatory government action—reduces predictability, makes business planning more difficult, and ultimately reduces investor confidence. A government can reduce non-commercial risks that would be created by its own acts. Minimizing non-commercial risks might not per se be a primary factor in creating an attractive foreign investment environment, but a failure to do so could be a primary factor in making that environment unattractive.

Investor-state arbitration increases investor confidence. The legal systems in Canada, the US, and Australia are undoubtedly sophisticated ones with strong protections for property rights. However, these domestic legal systems alone do not a guarantee that the non-commercial risk presented by government action has actually been minimized or will remain at present levels. By creating international rights for investors, the investment norms contained in international agreements further reduce non-commercial risks associated with arbitrary or discriminatory government conduct. What is important, however, is the willingness to enforce those rights through investor-state arbitration. That willingness is a clear and objective signal that investors' rights will be respected and that they can be more confident in investing in the state that offers it.[80] High investor confidence is a necessary component for an attractive investment environment.

Because of the reciprocal nature of AUSFTA and the similar amounts of foreign investment stocks in both directions of the Australia-US bilateral investment relationship, increased investor confidence through investor-state arbitration would benefit Australia in two ways. First, its inclusion benefits Australians that invest in the US. Australian investors would be more confident in making investments there. As the largest economy in the world, the American investment environment presents nearly infinite opportunities for Australian investors to maximize their returns. Confidence in that environment is bolstered by the uniform application on the entire US economy of international legal standards under AUSFTA norms and investor-state arbitration. Among the ways in which the wider Australian economy is linked to investment returns from the US is through superannuation. Given the extent to which it depends on American investment returns and its wider importance to Australia generally, a mechanism that increases investor confidence in the US can only be helpful.

Second, Australia benefits from increased confidence on the part of Americans investing in Australia because of the reciprocal application of AUSFTA positions. American investors can

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[79] Donald S. Macdonald, "Chapter 11 of NAFTA: What Are the Implications for Sovereignty?" 24 *Can.-U.S. L.J.* 281 (1998), at 288.

[80] United Nations Conference on Trade and Development, *Dispute Settlement: Investor-State* (Geneva: United Nations, 2003), 13.

be assured that Australia is making a strong commitment to protecting their rights, thereby increasing the likelihood of additional American investment. The gains for Australia from additional investment from the US are evident—jobs, competition, and technology transfer, among others—are self-evident.

Although the focus is on the rights of investors, what matters with an increase in investor confidence is not a "shrinking" of the public sphere for the benefit of foreign investors. This is not a zero-sum game. Indeed, the exceptions to the investment provisions in NAFTA text and the experience of the public sphere in Canada demonstrate that such a "shrinking" is not a necessary component of investor confidence. What is important for investor confidence is predictability. Government activity that is arbitrary or discriminatory diminishes confidence; preventing through transparent and enforceable rights promotes confidence. Investor-state arbitration coupled with appropriate investment norms in AUSFTA would do precisely that.

AUSTRALIA'S POLICY OPTIONS FOR INVESTOR-STATE ARBITRATION

Based on the Canadian experience with investor-state arbitration in NAFTA Chapter 11 and its particular mechanisms, several policy options for Australia in AUSFTA can be considered if it were to follow Canada's example in NAFTA. Each policy option would affect the scope and operation of AUSFTA investor-state arbitration differently. The extent to which these policy options are adopted depends on Australia's calculus of how much or how little of a scope it wants to give to investor-state arbitration, how much it wants investor-state arbitration's benefits, how other objectives fit in, and the terms it can obtain from the US in the negotiations.

A few points must be noted. It must be remembered that the following list is far from exhaustive; other options based on existing or additional objectives can be added. It must also be remembered that because of the mutual nature of investor-state arbitration as a legal remedy for both Australian and American investors, any reduction in its scope intended to reduce protections for American investors in Australia automatically does the same for Australian investors in the US, and vice versa.

Most importantly, Australia must recognize that it has more bargaining power against the Americans than many Australians believe. The AUD$194.2 billion of Australian investment in the US means that a large number of American jobs and economic activity depend directly or indirectly on Australia. Australia's true capacity to actively advance its own interests and shape investment measures that maximizes the benefits must not be underestimated.

Including a Duty to Attempt Non-Adversarial Dispute Resolution Methods First

Although it is in the interest of parties to a dispute to do this on their own, Australia could follow NAFTA Article 1118 and create an explicit duty to attempt non-adversarial methods of dispute resolution first, such as consultation and negotiation, before allowing an arbitration to proceed. The effect of this would be to allow cooler heads to prevail and to reduce the total number of cases that could appear before tribunals.

Requiring Exhaustion of Domestic Remedies before Turning to Arbitration

International law has a general rule that a person injured by an act of a state must use that state's domestic courts for redress and must exhaust available local remedies before a claim can be made on the international level.[81] NAFTA Article 1121, which requires a waiver of all domestic remedies for the investor before starting arbitration, is a modification of the general rule. Australia could take a different stance from NAFTA Article 1121 and require investors to exhaust all domestic remedies. This is a double-edged policy option. Requiring exhaustion of domestic remedies would reduce the likelihood of cases ending up before a tribunal, as many investors could obtain justice in domestic courts. However, this could make the bar for eligibility for investor-state arbitration so high as to make arbitration practically illusory. A denial of access to investor-state arbitration would negate its benefits. To avoid this, an exhaustion requirement could be subject to certain limits.

Restricting the Precedent-Setting Authority of Arbitral Decisions

Like NAFTA Article 1136.1, Australia could attempt to limit the precedent-setting authority of arbitral decisions. This would mean that decisions would be binding only on the specific parties and only in respect of the specific case. Future tribunals would not be bound to follow what past tribunals have decided. This option would prevent investor-state arbitration from excessively taking on the character of domestic courts.

Including an Unlimited Power to Issue Binding Interpretations of AUSFTA

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[81] Brownlie, 496-506.

Like the power of the Commission to issue interpretations of NAFTA that are binding on tribunals, Australia could include a similar power in AUSFTA. This power would be exercised jointly by Australia and the US. Like the NAFTA Commission, its purpose would be to allow Australia and the US the opportunity for ongoing expression of their intentions in AUSFTA and to prevent investor-state jurisprudence from developing in unintended directions. As well, it would add a degree of flexibility to AUSFTA that would otherwise not be there due to the inherently inflexible nature of international agreements.

Including a "Loser-Pays" Rule

NAFTA Chapter 11 leaves it to the discretion of tribunals to make awards on how the costs of arbitral proceedings will be borne by the parties. If Australia is concerned enough about minimizing frivolous claims, it could require that the losing party pay the legal costs of the winner under a "loser-pays" rule. This would be a burden that would fall disproportionately on the shoulders of investors, as the resources that governments can marshal for legal proceedings is usually greater than those of private businesses. This burden would seem fair if the right to initiate arbitrations were to belong exclusively to investors as it does in NAFTA Articles 1116 and 1117. The possibility of paying for Australia's legal costs as well as its own would dissuade frivolous investors from launching claims and would encourage existing claimants to reach a settlement rather than protracting the claim.

Tightening the Wording of AUSFTA Investment Norms

Overall, it must be remembered that the acceptability of investor-state arbitration *per se* depends on the acceptability of AUSFTA's investment norms. Investor-state arbitration is merely the means for the enforcement of those norms. If the norms are contentious, then investor-state arbitration will be correspondingly contentious. If Australia wishes to benefit from investor-state arbitration but is not eager about the possibility of certain norms being enforced, then those norms should be redefined at the outset or possibly dropped from the AUSFTA text altogether. For example, defining "expropriation" for which compensation is payable under international investment agreements is conceptually difficult and politically hazardous, especially with the prospect of its enforcement by a tribunal. If this norm is potentially troublesome enough, consideration might be given to defining it extensively or to removing it altogether from the Agreement's final text.

Adding Reservations to AUSFTA

The NAFTA countries all take the view that certain measures, entities, and sectors should be completely set apart from the application of investor-state arbitration, as mentioned above in the discussion on exceptions to Chapter 11. Australia could do the same. In negotiating the text of AUSFTA, Australia could make reservations that would make partial or whole exemptions for measures such as the Pharmaceutical Benefits Scheme (PBS), investment screening for investments above a certain threshold amount, cultural industries, social measures, and so on. This would address fears that socially or politically sensitive sectors and activities would be subject to the jurisdiction of arbitral tribunals.

Using Domestic Courts

After an arbitral award from a Chapter 11 tribunal has been rendered, it becomes like any other arbitral award and must be enforced by a domestic court. At the enforcement stage, investor-state arbitration awards under AUSFTA would have the same character as other arbitration awards and would also be enforced by a domestic court. Such awards can be challenged at that stage, as was done in the NAFTA context by lawyers for Mexico in Metalclad. Australian lawyers can challenge awards that meet the grounds in the New York Convention and the Model Law for challenge, most notably where there is an excess of tribunal jurisdiction or where an award is contrary to public policy.

CONCLUSION

This paper makes the case for including investor-state arbitration in AUSFTA along substantially similar lines to what Canada has had under NAFTA since 1994. The parallels between Canada and Australia in their economies and their bilateral investment relationships with the US make the Canadian example useful in assessing Australia's options.

Investor-state arbitration is not intended to replace domestic courts. Rather, it is a supplement designed to protect the rights of foreign investors that are created by international legal instruments. Although it has a limited purpose as a legal remedy, its specific features coupled with the overall economic importance of foreign investment underscore the advantages

that it present to Australia. Proceeding on the premise that investor-state arbitration in AUSFTA is about protecting Australia's interests in the US just as much as it is about American interests should dispel many fears. The fact that opponents of investor-state arbitration cannot demonstrate unwarranted interference or weakening of Canadian sovereignty because of investor-state arbitration in NAFTA should further dispel fears. Canada's experience with it should allow Australia to craft AUSFTA provisions that would closely serve Australian objectives and its circumstances.

On balance, Australia stands to benefit from investor-state arbitration in AUSFTA. As globalization proceeds apace, taking Canada, Australia, and the US along with it, these countries—indeed, all countries—must adopt measures that will maximize their welfare according to their circumstances. Investor-state arbitration for Australia is one such measure.

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