

NAFTA CHAPTER ELEVEN: THE NEED FOR MANDATORY PRE- ARBITRATION MEDIATION

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Foreign investment has become a vital instrument for economic development and global prosperity.¹ It permits developing countries to build up local industries and receive funds from foreign investors for the goal of improving the country's infrastructure, while investors obtain financial returns and gain a footing in the markets of the future.² As such, investment treaties have begun to play an increasingly prominent role in the initial decision to invest in a developing nation.³ A prime example of such an investment treaty is Chapter Eleven of the North American Free Trade Agreement⁴ (NAFTA).

Under Chapter Eleven of the North American Free Trade Agreement, the choice for settlement of disputes is arbitration. This paper is going to explore how mediation

¹ Susan D. Franck, "The Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law Through Inconsistent Decisions" (2004-2005) 73 Fordham L. Rev. 1521 at 1524.

² *Ibid.*

³ *Ibid* at 1525.

⁴ The North American Free Trade Agreement, 32 I.L.M. 279, 32 I.L.M. 605 (1993) [hereinafter NAFTA].

could be a more effective means of settling disputes that may arise under NAFTA. Although arbitration is a logical form of dispute settlement, this paper is going to argue that because of the importance of maintaining good relations between investors and sovereigns involved in NAFTA, mediation would be a more sustaining and effectual method of dispute resolution since mediation tends to foster a compromise that will work for both parties rather than focusing on who violated NAFTA. As an example, this paper is going to discuss how mediation would have been a more successful mode of dispute resolution in the *Metalclad* case.⁵

This paper is going to start with a look at NAFTA Chapter Eleven, specifically at the existing dispute settlement mechanism. It will then turn to the current state of arbitration under Chapter Eleven of NAFTA, which will be followed by an analysis of the benefits of international mediation and how it could, and should, fit into NAFTA. Then there will an evaluation of the *Metalclad* case in which it will be shown that mediation would have been a more successful dispute settlement mechanism by comparing arbitration under Chapter Eleven to international forms of mediation.

Unfortunately there is not an abundance of literature written about the inclusion of mediation in investor-state disputes, and it must be recognized that this paper is not proposing that mediation is the perfect solution to what ails Chapter Eleven. In fact, proposing an inclusion of mediation does not address several issues prevalent with Chapter Eleven jurisprudence; namely, the importance of having public interest cases heard in an open forum and the inevitably of power imbalances in the relations of the disputing parties. In fact, mediation does not address such issues at all. Rather, this

⁵ *Metalclad Corp. v. United Mexican States, Award*, ICSID Case No. ARB(AF)/97/1 (2000). See also *The NAFTA Arbitration Reports, Volume 1* (Cameron May, Ltd., 2002).

paper contends that in spite of such issues, mediation is an important tool that needs to be utilized within Chapter Eleven.

NAFTA CHAPTER ELEVEN

The North American Free Trade Agreement is a trade agreement between Canada, the United States and Mexico. The purpose of Chapter Eleven of NAFTA is “to facilitate the flow of investment among the parties by imposing limitations upon the capacity of a host government to impose discriminatory or market distorting measures upon such investments or investors.”⁶ There is a recognition of equal and equitable treatment to foreign investors, not that they should receive superior treatment.⁷ NAFTA broke new ground in trade agreements by incorporating an array of protections in each country for investments and investors of the other two parties, and reinforcing this with the right of private parties to seek international arbitration for alleged breaches of obligations under Chapter Eleven.⁸

It is argued that the merit of Chapter Eleven boils down to the desirability of establishing a balance between the competing interests of the state to regulate in the interests of the welfare of its citizens and the right of the firm to enjoy the fruits of its investments.⁹ It must be kept in mind that governments do remain free to regulate, but

⁶ Michael M. Hart and William A. Dymond, “NAFTA Chapter 11: Precedents, Principles, and Prospects” at 129 in Laura Ritchie Dawson, ed., *Whose Rights? The NAFTA Chapter 11 Debate* (Ottawa, Ontario: Centre for Trade Policy and Law, 2002).

⁷ *Ibid* at 129-130.

⁸ *Ibid* at 130. Under Section A Chapter Eleven of NAFTA provides detailed standards for treatment of foreign investment and arbitration of disputes relating to those standards under Section B. Section A provides investors of the other party with three types of treatment: national treatment, most favoured nation treatment and treatment meeting minimum standards of international law in the event that local treatment does not meet such standards.

such regulations must be consistent with the jointly developed rules set out in NAFTA.¹⁰ Essentially, Chapter Eleven makes it possible for governments to be held accountable, thus perpetuating the balance between the power of the state and the right of the governed to hold the state accountable in law.¹¹

One of the biggest problems, and why mediation would be a better method of dispute settlement, is that many provisions in Chapter Eleven are quite vague which provides the arbitral tribunal with a lot of discretion and a significant amount of scope to interpret and make law.¹² This can be fleshed out through the case law but gives rise to another issue of whether the arbitral tribunals are then acting as law-makers. Mediation would avoid such controversy, which is not to say that mediation is the perfect solution because it is not. For some cases, i.e. public interest cases, the hearings should be in a public forum and in such cases mediation would not serve as the best method for dispute settlement. What this paper does purport to advance is that mediation is a crucial step in maintaining relationships between disputing parties and would do well to be compulsory to the dispute settlement process under Chapter Eleven.

A multi-tiered mechanism for resolution of investment disputes between foreign investors and the host country or host country state enterprises is provided by Section B

⁹ *Ibid* at 150.

¹⁰ *Ibid*.

¹¹ *Ibid* at 150-151.

¹² NAFTA, *supra* note 4. For example, Article 1105 deals with the “minimum standard of treatment.” This concept is not explicitly defined or elaborated upon in the agreement. Former president of the International Court of Justice, Sir Robert Jennings, has taken strong exception to the NAFTA Commission’s Note of Interpretation. In his view, the Note fundamentally twists rather than interprets the intent of Article 1105. His opinion underlines the need for some clearer statement of some of the basic concepts set out in Chapter Eleven. (See statement online at <<http://www.cyberus.ca/~tweiler/naftaclaims.html>>; this opinion was directed towards the *Methanex* tribunal).

of Chapter Eleven.¹³ Investors are provided with substantive rights and guaranteed minimum standards of treatment and an investor-state mechanism for resolving disputes arising from alleged breaches.¹⁴ The disputing parties are urged but, unfortunately, not required to first attempt to settle the dispute by consultation or negotiation.¹⁵ Although conciliation and negotiation are apparently encouraged through the requirement of ninety days notice to the other party prior to filing a claim for arbitration,¹⁶ this is largely under-utilized because under certain circumstances an investor may demand for binding arbitration.¹⁷ To date there has been forty-two claims against all three NAFTA parties totaling twenty-eight billion dollars claimed in damages.¹⁸ There are eleven cases currently in active arbitration, six claims were dismissed meaning the government succeeded and five have resulted in damages to investors totaling thirty-five million dollars awarded.¹⁹ Clearly from these numbers, arbitration may not be the best solution.

¹³ David A. Gantz, “Resolution of Investment Disputes under the North American Free Trade Agreement” (1993) 10 *Ariz. J. Int’l & Comp. L.* 335 at 342.

¹⁴ Jessica S. Wiltse, “An Investor-State Dispute Mechanism in the Free Trade Area of the Americas: Lessons from NAFTA Chapter Eleven” (2003) 51 *Buff. L. Rev.* 1145 at 1150.

¹⁵ NAFTA, *supra* note 4 Article 1118. See also Ralph H. Folsom, Michael W. Gordon and John A. Spanogle, *Handbook of NAFTA Dispute Settlement* (Ardsley, New York: Transnational Publishers, Inc., 1998 in Part One: Analysis, Chapter 2, Michael Wallace Gordon “NAFTA Dispute Panels: Structure and Procedures” at 2-1-2-72 at 2-18.

¹⁶ *Ibid* at 343. Such encouragement is found in NAFTA Articles 1118 and 1119.

¹⁷ *Ibid*. Such circumstances can be found in NAFTA Articles 1116 and 1117 which include: a claim that the government of another NAFTA party has breached an obligation under Section A of Chapter Eleven, a claim that a state enterprise of another NAFTA party has acted in a manner inconsistent with the party’s obligations under Chapter Eleven or Chapter Fourteen in the exercise of its regulatory, administrative or other governmental authority, or a claim that a state monopoly has acted in a manner inconsistent with a party’s obligations under Chapter Eleven where the entity exercises any regulatory, administrative or other governmental authority that the Party has designed to it.

¹⁸ Public Citizen: Protecting Health, Safety & Democracy, Global Trade Watch, online at <http://www.citizen.org/documents/Ch11cases_chart.pdf>. This amount excludes cases where there has been a final award, and includes the Baird and Sun Belt claims, which are disproportionately high. Without Baird and Sun Belt, total claims against all three NAFTA parties is \$5 billion.

THE CONTROVERSY

Chapter 11 is progressively becoming the focal point of the controversy surrounding free trade and its negative effects on the sovereignty of the state and on the environment.²⁰ The increasingly popular judicial review of arbitral awards is argued to violate Chapter Eleven and is contrary to the intent of the drafters of NAFTA.²¹ Not only would the arbitration foster bad feelings, but a judicial review of an award would further foster an irreparable negative shift in important business relations. As mentioned, this paper is purporting to show that such relationships would be better maintained through mediation. It is also argued that the issues of public importance should not be dealt with by way of arbitration, but rather through a public hearing.²² For reasons to be discussed, mediation would not combat this issue.

ARBITRATION UNDER CHAPTER ELEVEN

[A]rbitration refers to a family of processes that share such features as an impartial decision-maker, who enters a binding final award on the basis of proofs and arguments presented by the disputants (or their representatives). It commonly departs from adjudication in that the forum is selected by the parties (either ad

¹⁹ *Ibid.*

²⁰ Wiltse, *supra* note 14 at 1149.

²¹ Charles H. Brower II, "Investor-State Disputes Under NAFTA: The Empire Strikes Back" (2002) 40 Colum. J. Transnat'l L. 43 at 43.

²² Professor Trevor C.W. Farrow, "Regional Integration and Dispute Resolution in the Free Trade Area of the Americas" in Andy Knight et al. eds., *Re-Mapping the Americas: Globalization, Regionalization and the FTAA* (Edmonton: University of Alberta Press, forthcoming). See also Todd Weiler, *infra* note 54 at 705: "More media exposure has led to more interest in the availability of rights to investor-state dispute settlement, among lawyers and business decision-makers alike. Further, the considerable public pressure placed upon the three NAFTA governments to ensure that the process of NAFTA dispute settlement remains open and in the public view, has resulted in government action to virtually guarantee openness and transparency for all future NAFTA cases. With such openness and transparency comes access to past pleadings, which often serve as the primary building blocks of self-words, the intense interest in NAFTA claims has guaranteed the availability of both pleadings and awards, thus contributing to a growth in this area of law by making them more widely available to an interested legal community."

hoc, by contractual undertaking, or by adhesion to a standing procedure) and that the forum is non-governmental. There is also a variation as to whether the arbitrator is constrained to decide in accordance with a prefixed body of norms and whether the norms are public ones or indigenous to a particular setting.²³

As mentioned above, the dispute settlement procedure for investment disputes is set out in Section B of Chapter Eleven. In investor-state cases, investors may choose to proceed under the rules of the ICSID Convention, the ICSID Additional Facility Rules or the UNCITRAL Arbitration Rules.²⁴ Unfortunately, the rules in these instruments are not uniform and leave a lot to the discretion of arbitrators.²⁵ In each case three sets of rules applied by ad hoc tribunal panels may not serve the interests of predictability and uniformity in dispute settlement at even the basic procedural level.²⁶ It is clear from the Chapter Eleven cases litigated to date that there are significant differences in procedure from one case to the next.²⁷ Given the importance of this instrument this is a serious problem that mandatory mediation prior to arbitration can alleviate.

In contrast, it is important to note that arbitral tribunals do not have jurisdiction over disputes relating to the interpretation of one or more of the parties' reservations under Annexes I-IV.²⁸ Rather, the Free Trade Commission created under Chapter Twenty must provide its interpretation, which is binding on the arbitral tribunal, in

²³ Jonnette Watson Hamilton, "Arbitration" in J. Macfarlane, gen. ed., *Dispute Resolution: Readings and Case Studies*, 2d ed. (Toronto: Emond Montgomery Publications Limited, 2003) at 615.

²⁴ NAFTA, *supra* note 4 Article 1120.

²⁵ Remarks by Denyse MacKenzie in "Investment Disputes and NAFTA Chapter 11" (2001) 95 Am. Society Int'l L. Proc. 196 at 201.

²⁶ *Ibid.*

²⁷ *Ibid*

²⁸ Gantz, *supra* note 13 at 345. Each of the NAFTA parties have made general temporary or permanent reservations primarily regarding the granting of national treatment to foreign investors in certain sectors.

writing to the tribunal within sixty days.²⁹ This procedure promotes uniformity, but is unfortunately limited in its scope to strictly interpreting reservations. What the arbitral tribunals can do is grant compensatory damages only plus interest, restitution of property, and the costs of arbitration.³⁰

Like everything in our world, arbitration has its good and bad points. Generally, arbitration has fallen into being a fixture in international investment and trade mainly because it is comparatively favourable to any alternatives,³¹ and avoids application of national laws.³² Arbitration provides a neutral mechanism characterized by private proceedings, expert decision-makers, flexible procedures, relative finality and results that are enforceable.³³ Arbitration also offers neutrality in the choice of law, procedure, and tribunal.³⁴ On the other hand, arbitration is adversarial, costly, time-consuming, and ultimately produces a winner and a corresponding loser.³⁵ In addition, the arbitral process

²⁹ *Ibid.* See also class noted, 1 December 2005, International Business Transactions, Professor Linda C. Reif, *infra* note 39: In 2001, the Commission provided an interpretation, which is binding on Chapter 11 tribunals under Article 1131(2), that stated that “fair and equitable treatment” and “full protection and security” do not require treatment beyond that required by customary international law; breach of another treaty or NAFTA article does not establish a breach of Article 1105(1).

³⁰ NAFTA, *supra* note 4, Article 1135(1). Cited in Brower, *supra* note 21 at 50.

³¹ Clyde C. Pearce and Jack Coe, Jr., “Arbitration Under NAFTA Chapter Eleven: Some Pragmatic Reflections upon the First Case Filed Against Mexico” (2000) 23 *Hastings Int’l & Comp. L. Rev.* 311 at 319.

³² Hamilton, *supra* note 23 at 686.

³³ Pearce and Coe, *supra* note 31 at 319-320. Concerning neutrality, tribunal members must be both impartial and independent of the parties under the international standard. Hearings are not open to the public and the disputing parties can each select one arbitrator and together select the third arbitrator (in event of disagreement the third arbitrator will be appointed).

³⁴ Hamilton, *supra* note 23 at 686. This has become increasingly important because sovereign states do not want to be subject to another jurisdiction’s laws.

³⁵ Pearce and Coe, *supra* note 31 at 343. The authors further argue that this is so even in close cases in which both sides may have had more to gain by constructing a *via media*.

can only be as good as the arbitrators forming the tribunal.³⁶ Franck argues that “rather than creating certainties for foreign investors and Sovereigns, the process of resolving investment disputes through arbitration is creating uncertainty about the meaning of [investment treaty] rights and public international law.”³⁷ She further argues against arbitration due to inconsistent decisions: “inconsistency creates uncertainty and damages the legitimate expectations of investors and Sovereigns.”³⁸

Due to the many downfalls to arbitration, especially the inconsistencies the tribunals have created, there is a dire need for reform. This paper contends that mandatory mediation can aide in the problems plaguing arbitration. Although mediation does not get to the heart of the inconsistency problem, it indirectly can subvert, or even lessen, that problem. The next section on mediation will highlight the benefits, as well as the drawbacks, to the inclusion of mediation in Chapter Eleven of NAFTA.

THE ROLE OF MEDIATION

There are several different types of recognized dispute settlement. The most common, often referred to as diplomatic types, include negotiation between the disputing parties with no third party involved and the other utilizes a third party who cannot impose a legally binding decision on the parties but can, at most, provide recommendations for settlement which the disputants can decide to ignore or agree to implement.³⁹ The

³⁶ *Ibid* at 325.

³⁷ Franck, *supra* note 1 at 1523. Franck recognizes that some public international law rights have been articulated for the first time in investment treaties – namely, the right to ‘fair and equitable treatment’ and a Sovereign’s obligations to ‘observe its commitments,’ and tribunals have applied these standards differently thus making divergent findings on liability.

³⁸ *Ibid* at 1558.

³⁹ Linda C. Reif, Lecture Notes, Law 506: Public International Law, 7 February 2006.

method utilizing a third party can be further broken down into four categories: good offices, inquiry which is a determination of facts only, mediation, and conciliation which is more formal than mediation.⁴⁰ The other type is adjudicative which uses a third party who is empowered to render a decision that is legally binding on the disputants using either arbitration or a standing international court or tribunal.⁴¹ For the purposes of this paper, the focus will be on mediation and arbitration.

Mediation involves the intervention of a skilled and experienced intermediary in a dispute between parties in order to facilitate a negotiated settlement of the substantive issues that comprise the dispute.⁴² Mediation of an international dispute can take many forms. First, the third party may simply encourage the disputing parties to resume negotiations or simply provide them with an additional channel of communication.⁴³ Second, the third party may act as an active participant, authorized and expected to advance fresh proposals and to interpret, as well as transmit, each party's proposals to the other.⁴⁴ Last, the third party may investigate the dispute and present the parties with a set of formal proposals for its solution.⁴⁵ The most common form of third party intervention in international disputes appears to be mediation.⁴⁶

⁴⁰ *Ibid.*

⁴¹ *Ibid.*

⁴² Vasquez, et al., ed., *Beyond Confrontation: Learning Conflict Resolution in the Post-Cold War Era* (Ann Arbor: The University of Michigan Press, 1995) at 40-41.

⁴³ J.G. Merrills, *International Dispute Settlement: Fourth Edition* (United Kingdom: Cambridge University Press, 2005) at 28.

⁴⁴ *Ibid.*

⁴⁵ *Ibid.* This third form of intervention is more commonly known as conciliation, but can be considered a form of mediation in that a mediator generally offers proposals informally and on the basis of information supplied by the parties, rather than independent investigations, although such distinctions tend to be blurred in practice..

Mediation has the potential to be very effective for several reasons. First, and most importantly, when continuing relationships are involved, mediation is particularly suitable to both probe the real issues in dispute and to seek a resolution that might preserve the relationship.⁴⁷ Second, when there are questions of credibility, mediation can sometimes go to the heart of the problem and assist the parties to work through and possibly resolve their different perceptions of the truth.⁴⁸ Third, when there are strong equities on one side, mediation provides a process for allowing that side to confront the other side with fairness issues and as such, mediation promotes an equitable solution.⁴⁹ This last reason can be seen as alleviating the problem of power imbalances between the disputing parties.

Mediation appears to occur most often in international conflict when the dispute is complex, when the parties are at a stalemate but do not want to risk or invest in further escalation, and are willing to consider cooperative behaviours.⁵⁰ Providing a communication channel between the parties and assisting in the development of proposals for settlement of disputes are the functions of mediation.⁵¹ As such, to pursue mediation before resorting to arbitration has the potential benefits of a properly structured mediation which is already provided for in Article 1119.⁵² Institutionalizing pre-

⁴⁶ Vasquez, *supra* note 42 at 40.

⁴⁷ J. Murray, A. Rau & E. Sherman, *Mediation and Other Non-Binding ADR Processes* (Westbury, New York: The Foundation Press, Inc., 1996) at 149.

⁴⁸ *Ibid.*

⁴⁹ *Ibid.*

⁵⁰ *Ibid* at 42-43.

⁵¹ *Ibid* at 43.

arbitration mediation would make involvement in such a process predictable and lessen the fear of perceived weaknesses.⁵³

Further, successful commercial mediations illustrate that relationship and economic advantages can be obtained if mediation is made available to commercial disputants.⁵⁴ Studies have proven that mediation can be very appropriate when the disputants have an ongoing relationship, when the transactions costs need to be minimized and when any solution will have widespread ramifications.⁵⁵ A dispute resolution process which gives disputants responsibilities to voluntarily and expeditiously reach their own mutually satisfactory settlement can be more effective than any solution imposed by a court or an arbitrator.⁵⁶ The biggest obstacle to realizing successful mediation, particular under NAFTA, is the misunderstanding of the process itself.⁵⁷

⁵² Pearce and Coe, *supra* note 31 at 343. They explain that the duty to pursue mediation would be triggered by the filing of the notice of intent to file a claim under Article 1119. The mediator would be selected by ICSID and would be someone whose reputation would merit the respect of both disputants. Further, the potential for the process being abused by an uncooperative disputant would be limited by placing a time limit on the exercise, waivable by the parties. The ninety-day waiting period is already built into the process in Chapter Eleven in which mediation would occur. The three year statute of limitations established in Articles 1116(2) and 1117(2) would be tolled during the mediation process, an effect that can be achieved without substantially amending existing provisions. The added cost detriment would seem to be outweighed by the potential for monumental cost savings in those cases where the process succeeds in settling the dispute.

⁵³ *Ibid.* The authors go on to argue that mediation often clarifies the underlying issues and even partial settlements may lead to a narrowing of the claims that are later presented to the arbitral tribunal which in turn generates efficiencies throughout the arbitral proceedings. The authors contend that the success of this initiative of pre-arbitration mediation will depend upon the quality of the persons appointed to serve as mediators rather than the procedures chosen.

⁵⁴ A. Pirie, "The Lawyer As a Third Party Neutral: Promise and Problems" in P. Edmond, *Commercial Dispute Resolution* (Aurora: Canada Law Book Inc., 1989) at 38. Pirie further argues that it is simply illogical to eliminate mediation as a possible alternative to resolve business problems. For example, if the parties or their lawyers have run into a negotiation road block, it makes sense to consider the services of an experienced mediator who is trained to remove these barriers or find alternative routes to a solution.

⁵⁵ *Ibid.* See also Leonard L. Riskin and James E. Westbrook, *Dispute Resolution and Lawyers* (St. Paul, Minnesota: West Publishing Co., 1987) at 448-461.

⁵⁶ *Ibid.*

ARBITRATION CASE LAW

*Metalclad Corporation v. The United Mexican States*⁵⁸

Metalclad, a U.S. waste disposal company, filed a claim against Mexico under the ICSID Additional Facility Rules on behalf of its wholly owned subsidiary on 2 January 1997.⁵⁹ Metalclad alleged that Mexico had wrongfully refused to permit them to open and operate a hazardous waste facility that they had built.⁶⁰ A construction permit was denied by the municipality and permission to operate the facility was refused, although the facility had received approvals from both the federal and state governments.⁶¹ Metalclad alleged breaches of Chapter Eleven under Article 1105 relating to the minimum standard of treatment and Article 1110 relating to expropriation and sought damages of US\$43,125,000.⁶²

⁵⁷ *Ibid* at 39. Pirie argues that barriers such as high emotions, economic fears or entrenched positions may make it difficult for the parties even to agree to sit down together with a mediator. Often the high costs associated with a litigated solution or the need to maintain a business relationship can be decisive factors in pointing the parties towards mediation. Therefore, understanding the problem is a critical step. It is essential in mediation that both the parties and the mediator are fully aware of the facts, the issues and the interests of the parties which is a difficult task. A careful exploration of what is in dispute can often shed light on why solutions are difficult or identify underlying issues to the conflict that are impeding progress.

⁵⁸ *Metalclad*, *supra* note 5 award 30 August 2000. See also *The NAFTA Arbitration Reports, Volume 1* (Cameron May Ltd., 2003). See also Todd Weiler, "Good Faith and Regulatory Transparency: The Story of *Metalclad v. Mexico*" in Todd Weiler, ed., *International Investment Law and Arbitration: Leading Cases from the ICSID, NAFTA, Bilateral Treaties and Customary International Law* (London: Cameron May Ltd., 2005) at 701-747. Mr. Weiler argues that *Metalclad* stands as a seminal case because it was decided on the cusp of a paradigmatic shift in international economic law, and is thus emblematic of how the seemingly innocuous inclusion of an investor rights protection mechanism in the NAFTA has helped change the dynamic of international economic law and dispute settlement forever, at 702.

⁵⁹ *Ibid*. See also Laura Ritchie Dawson, *Whose Rights? The NAFTA Chapter 11 Debate* (Ottawa: Centre for Trade Policy and Law, 2002) at 212.

⁶⁰ *Ibid*. See also Dawson, *supra* note 59 at 213.

⁶¹ *Ibid*. See also Dawson, *supra* note 59 at 213. Metalclad had been advised by federal officials that it did not need to apply for this permit, but that it should do so in order to maintain good relations with local officials. The municipal officials had conducted a hearing without notice to Metalclad or the provision of any opportunity to make submissions on the matter.

⁶² *Ibid*. See also Dawson, *supra* note 59 at 213.

The arbitral tribunal awarded US\$16.7 million to Metalclad based on their finding that both Articles discussed above were violated.⁶³ Under Article 1105, the tribunal found that the denial of Metalclad's right to operate was improper and resulted from a process which breached Mexico's obligations to provide a minimum standard of treatment.⁶⁴ In regards to Article 1110, the tribunal found that there was an indirect expropriation.⁶⁵ The tribunal also determined that an Ecological Decree issued by the state governor was an additional and separate basis for a finding of expropriation because it would have created an ecological preserve that included the site of Metalclad's hazardous waste disposal facility.⁶⁶ Mexico then appealed this award in the Supreme Court of British Columbia which in turn set aside the awards relating to the breaches of Articles 1105 and 1110 because the tribunal had applied a different standard from that set out in Article 1105.⁶⁷ The end result was that the award was reduced due to the fact that the court left the tribunal's finding of expropriated based on the Ecological decree.⁶⁸

⁶³ *Ibid.*

⁶⁴ *Ibid.*

⁶⁵ *Ibid.*

⁶⁶ *Ibid.*

⁶⁷ *Ibid.* See also Maximo Romero Jimenez, "Considerations of NAFTA Chapter 11" 2 Chi. J. Int'l L. 245, 2001. He argues that the arbitral tribunal misapplied NAFTA provisions and exceeded its jurisdiction in linking transparency issues with domestic legislation. At 248: "From the simple reading of these provisions (Articles 1105 and 102(1)), there is no basis to find a breach of NAFTA Chapter 11 for lack of transparency in the rules and procedures for handling applications for a municipal construction permit in a State Party. It is highly questionable to read NAFTA Article 102(1) as requiring the NAFTA Parties to ensure that the correct position in its administrative and judicial rules and procedures be promptly determined, and to clarify the rules and procedures when there is a misrepresentation on behalf of an investor. In other words, a tribunal is not empowered to create more obligations than those negotiated by the NAFTA Parties in Chapter 11..."

[T]he tribunal equated a simple alleged breach of domestic law... with a breach of Mexico's international law obligations under NAFTA. In my opinion, the tribunal failed to consider that these kinds of acts have to be challenged in the appropriate domestic administrative and judicial for a. A tribunal should not rule upon domestic legislation. The tribunal exceeded its jurisdiction in linking transparency in the legislation and rules of a Party.

This case has been criticized for the creation of new obligations for NAFTA parties beyond those already negotiated by the said arbitral tribunal.⁶⁹ Such a problematic issue would not arise in the course of mediation. Through mediation the disputing parties would have more control over the issues to be determined, how they want them to be resolved and what particular provisions they would use in the relevant instruments, namely under the NAFTA agreement itself. Such control allows the parties to effectively deal with the issues that they consider pivotal to their dispute.

From *Metalclad* it is apparent that arbitration under NAFTA Chapter Eleven is eerily similar to a case tried in the court system. For the business relationships created by NAFTA, this dispute settlement mechanism is not ideal. As identified in the section on mediation, it is very important to maintain business relationships, which is especially true with NAFTA countries for the very reason that they have such an agreement. Such relationships cannot be fostered due to the fact that an increase in the number of reviewing courts adds the possibility for further distortions of the meaning of international investment rights.⁷⁰ Further, it is obvious that arbitration does not work

Another relevant issue is that the tribunal issued an award without clearly setting out all of the arguments and evidence of both parties. It is an international standard that an award must clearly set out the reasons and bases of its evaluation of the arguments and evidence. However, in this award, there are no reasons stated by the tribunal as to why the arguments and evidence presented by one of the disputing parties was not taken into consideration... In my opinion, before rendering its decision, a tribunal should be cautious to consider and include all the reasons for its decision, including an evaluation of the evidence, testimony, and expert reports, in order to avoid a challenge to its decision before the national courts of the place of arbitration.”

⁶⁸ Dawson, *supra* note 59 at 213.

⁶⁹ Jimenez, *supra* note 67 at 251.

⁷⁰ Franck, *supra* note 1 at 1557. Another example of this problem is in *S.D. Myers, Inc. v. Canada*, in *The NAFTA Arbitration Reports, Volume 1* (Cameron May Ltd., 2003). S.D. Myers, which is an Ohio based corporation that processes and disposes of PCB waste, filed a claim against Canada under the UNCITRAL Rules on 30 October 1998. An emergency order changing existing regulations to ban the export of PCB wastes to the U.S. was issued by Canada’s environment minister in November 1995. This ban was subsequently lifted in February 1997 which was followed by the U.S. ultimately closing its border to PCBs

which is evident from the arbitral panel's decision being challenged through chosen domestic courts.

In this case specifically, Metalclad Corporation is going to have ongoing dealings with the municipality in Mexico. And in order to further foster a continuing relationship and promote subsequent relationships, the use of arbitration falls far short of ideal. A system of mandatory mediation would combat this quandary by allowing the parties to sensibly deal with any issues that have arisen and try to work them out together instead of focusing on right and wrong, and who breached what and by what means, etc. With *Metalclad*, mediation would have allowed the parties to identify with each other, see both sides of the proverbial coin, and effectively come to a compromise that would work for both the municipality and Metalclad Corporation. Now, I do recognize that this is an ideal and mediation will not be an end-all perfect solution to all disputes. Because each dispute is unique, differing dispute settlement procedures are more ideal for some situations than others, but for disputes under Chapter Eleven the benefits of a pre-mediation, before resorting to arbitration, can be nothing but beneficial.

What I'm proposing is not an inventive and new phenomenon. In fact, mandatory pre-mediation is already being utilized in NAFTA under Chapter Twenty. It must be

in July 1997. S.D. Myers claimed that Canada breached its obligations under Articles 1102 relating to national treatment, 1105 dealing with the minimum standard of treatment, 1110 relating to expropriation and 1106 dealing with the prohibition of performance requirements by imposing the temporary ban. A partial award was issued to S.D. Myers in that tribunal found Canada breached Articles 1102 and 1105, but found no breach of Articles 1106 or 1110. This decision was then appealed to the Federal Court of Canada who subsequently dismissed the case showing deference to the tribunal. This decision can be found at *Canada (Attorney General) v. S.D. Myers*, [2004] 3 F.C.R. 368, [2004] F.C.J. No. 29, 2004 FC 38.

Of interest in Ian Laird, "NAFTA Chapter 11 meets Chicken Little" (2001) 2 Chic. J. Int'l L. 223 at 229, Laird states 'it should be noted that foreign companies do not lightly sue the governments of their host countries. As can be evidenced by the attempts of the Mexican and Canadian governments to set aside in Canadian domestic courts their losses in *Metalclad* and *SD Myers*, governments do not easily acquiesce when an independent international tribunal exposes an extreme situation in which the claimant has

recognized that Chapter Twenty is not perfect and arising disputes have gone to arbitration. What is important is the relative success of dispute settlement under this chapter and the process which allows such success to occur.

NAFTA CHAPTER TWENTY

Although Chapter Twenty deals with disputes between sovereigns,⁷¹ it remains an important tool for analogy to combat what is erroneous with Chapter Eleven. Under Chapter Twenty, the disputing governments must first attempt consultations then mediation if the consultation fails or if all the issues are not solved.⁷² If a settlement cannot be reached through mediation only then do the disputing States go to arbitration.⁷³ Chapter Twenty provides a mechanism for resolving disputes relating to the application or interpretation of NAFTA itself.⁷⁴ It is a true international law process in that there is no national law influence and, as mentioned, it emphasizes consultation and conciliation

attempted other non-legal routes and been rebuffed. The *SD Myers* case is a typical example of an investor facing the manifest protectionist intent of a government measure and suffering damages as a result.

⁷¹ NAFTA, *supra* note 4 Chapter Twenty Articles 2006-2019. See also Patrick F.J. Macrory, “Chapters 19 and 20 of NAFTA: An Overview and Analysis of NAFTA Dispute Settlement” in Kevin C. Kennedy, ed., *The First Decade of NAFTA: The Future of Free Trade in North America* (Ardsley, New York: Transnational Publishers, Inc., 2004) at 473. Macrory explains that Chapter Twenty is a mechanism for resolving disputes between the governments as to the application of NAFTA and identifies that only five panel decisions have been issued under the Canada-United States Free Trade Agreement (which became incorporated into NAFTA) and only three under NAFTA Chapter Twenty and no appeals were in progress at the time of writing.

⁷² Ralph H. Folsom, Michael W. Gordon and John A. Spanogle, *Handbook of NAFTA Dispute Settlement: Volume 2* (United States: Transnational Publishers, Inc., 1998, 2000) at “NAFTA Chapter 20 Arbitral Panel Summaries and Decisions.” If consultations fail the parties may request the Free Trade Commission (consisting of trade ministers of the three countries and whose function is to oversee the operation of the NAFTA) to “endeavour to resolve the dispute promptly” through good offices, conciliation and mediation. The Commission is to make a non-binding recommendation; in Macrory, *supra* note 71 at 486.

⁷³ *Ibid.*

⁷⁴ Macrory, *supra* note 71 at 485.

with adjudication as a last resort.⁷⁵ It is important to note that the arbitral panel's decisions are strictly advisory and as such are not binding in nature.⁷⁶

This process has apparent benefits in that merely three decisions have been adjudicated and issues closely tripling that amount were resolved before reaching the panel stage.⁷⁷ On the down side, this process has been criticized in that the procedures are not very clear and are complex, they are certain to cause difficulties in implementation, and may address so many different issues that the formulation of jurisprudence will take much longer.⁷⁸ However, it is apparent that these arguments fall

⁷⁵ *Ibid.*

⁷⁶ *Ibid* at 486-487.

⁷⁷ *Ibid* at 489-492. See also NAFTA Secretariat, Decisions and Reports, online: <http://www.nafta-sec-alena.org/DefaultSite/index_e.aspx?DetailID=76>. The three cases that went to arbitration include: *Tariffs Applied by Canada to Certain U.S.-Origin Agricultural Products*, CDA 95-2008-01(1996) – this was the first Chapter Twenty case which involved a claim by the United States that large tariff increases imposed by Canada on imports of dairy products, poultry and eggs in accordance with Canada's rights and obligations under the WTO Agreement on Agriculture, violated Canada's tariff commitments under NAFTA. The panel ultimately rejected the U.S. claim on the ground that rights and obligations under the WTO Agreement were subsumed within NAFTA. The second panel decision, *U.S. Safeguard Action Taken on Broomcorn Brooms from Mexico*, USA-97-2008-01(1998), held that a U.S. safeguard action against broomcorn brooms from Mexico violated Article 803 of NAFTA. *Cross-Border Trucking Services and Investment*, USA-98-2008-01(2000) is the third issue that proceeded to an arbitral panel. On the grounds of safety, the U.S. blocked the right of Mexican trucks to access the U.S. market under Annex 1 of NAFTA. The panel upheld Mexico's complaint (in Macrory at 490).

In 2004 there were eight issues that were settled prior to the need for arbitration, proving that ADR within arbitration clauses works. The eight issues include:

Sugar from Mexico – this issue went to formal WTO consultations;

Uranium – the matter was dropped after Canada received assurances from the U.S. with regards to access to the U.S. market;

Sugar from Canada – Canada negotiated an agreement after consultations;

Small Package Delivery – U.S. requested consultations, but then dropped the matter;

Tomatoes – went through consultations then dropped;

Helms-Burton Act – Canada and Mexico sought consultations regarding the Helms-Burton Act and due to politics the issue never went to arbitration although the Free Trade Commission was unable to resolve the matter;

Farm Products Blockade – Canada requested consultations and the blockade was subsequently lifted; and

Sports Fishing – U.S. requested consultations with Canada over fishing requirements which were subsequently dropped.

⁷⁸ Folsom, et al. v. 1, *supra* note 15 at Part 1, C.1.b.

short due to the success of the process enumerated in Chapter Twenty.⁷⁹ In sum, Chapter Twenty has rarely been used which can be due in part to the economies of the three countries gradually becoming more integrated leading to many potential disputes being settled informally without the need to utilize the formal arbitration mechanism.⁸⁰ This economic integration is a great reason for importing the same formal dispute resolution mechanisms found in Chapter Twenty into Chapter Eleven. Although there are slightly different parties involved, this process works between sovereign states and there is no logical reason to suggest that such a process would not succeed with investor-state disputes.

Concluding Remarks

As recognized, mediation is not the perfect solution to the controversial Chapter Eleven. But, mediation is an appropriate and much needed step in the resolution of disputes under Chapter Eleven. This paper has shown that because of the importance of the relationships between investors and States, mediation must be made a mandatory process in Chapter Eleven. There can be no harm with such an addition, only positive gains. Also, because the arbitral process has become largely akin to the formal court process, mediation is much needed. As mentioned, in business, relationships are a key component to success, so with such a business oriented trade agreement as NAFTA it is critical to preserve and promote business relationships.

⁷⁹ See note 77 for successful consultations and mediations.

Although arbitration does serve its purpose in Chapter Eleven, it should not be the first step and the only solution to arising disputes. Recognizing that not all relationships are the same and that on the surface some may appear unsuitable for mediation, the beneficial tool that mediation provides can only work in both of the disputing parties favour. When looking to the success of Chapter Twenty, the lone conclusion is that the effects of including mediation in the dispute settlement process would be nothing but advantageous.

⁸⁰ Macrory, *supra* note 71 at 500.

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