

NAFTA Chapter 11: The Investor's Weapon of Choice



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INTERNATIONAL TRADE LAW

Covered Topics

1. Background

- a) The NAFTA
- b) NAFTA Chapter 11

2. Chapter 11 Claim Procedure

3. Substantive Investor Protections under Chapter 11



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Background – The NAFTA

What is NAFTA:

- Tri-lateral free trade agreement
- Binding upon U.S.A., Canada and Mexico (“the Parties”)
- For U.S. and Canada, extension of pre-existing FTA
- Coverage:
 - Goods (Tariff and Non-Tariff)
 - Investments
 - IP rights
 - Services
 - Government Procurement



Background – The NAFTA

A snapshot of its scope:

- Created world's largest free trade area
- Links 450 million people producing \$17 trillion in goods and services*
- U.S. had \$918 billion in two-way trade in goods and services with its NAFTA partners in 2010 alone*

*Office of the U.S.T.R.



Background – NAFTA Chapter 11

Designed to:

- Establish a more stable and predictable environment for investors
- Enhance prosperity by increasing FDI
- Ensure that investment policies are held to uniform standards



Background – NAFTA Chapter 11

Mechanism:

- Establishes obligations for the Parties' treatment of NAFTA investors and their investments
- Investors can seek to have these standards enforced by bringing a claim under Ch. 11
- Where a Tribunal determines that Ch. 11's standards have been breached, the investor may be entitled to recover damages



NAFTA Chapter 11 Claim Procedure

Standing:

- In order to commence a Ch. 11 claim, a party must be an “investor of a Party”
 - Can be any citizen (corporate or individual) of any of the three countries, who has an investment in one of the other countries



NAFTA Chapter 11 Claim Procedure

Consent to arbitration and jurisdiction:

- NAFTA Parties bound by general consent to Arbitrate in Article 1122
- Therefore, an investor need only bring a claim to commence arbitration
- Claimant must not pursue other judicial or quasi-judicial remedies, other than for injunctive and other extraordinary relief



NAFTA Chapter 11 Claim Procedure

Applicable arbitral rules:

- Three options for claimants:
 1. ICSID Rules
 2. ICSID Additional Facility Rules
 3. UNCITRAL Rules



NAFTA Chapter 11 Claim Procedure

Appointment of Arbitrators:

- Except where parties agree otherwise, Tribunal comprised of three arbitrators
- One arbitrator appointed by each party, and the third (who is presiding arbitrator) appointed by agreement of the disputing parties



National Treatment

Article 1102: National Treatment

- 1102(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.”
- Same protection is extended in 1102(2) to “investments of investors”
- Article 1102 requires a host state to provide NAFTA investors and investments with treatment that is no less favorable than the treatment they provide to domestic investors and investments in like circumstances.



National Treatment

1. Treatment “no less favorable”

- Host state must provide to qualifying NAFTA investors/investments treatment that is at least as advantageous as that provided to its own investors/investments

2. In “like circumstances”

- To trigger 1102 protection, NAFTA investor/investment must be in “like circumstances” to a domestic investor/investment receiving more favorable treatment:
 - For example:
 - **Same industry**
 - **Same economic sector**
 - **In direct competition**



National Treatment

3. With respect to the establishment, etc.

- Treatment complained of must concern any of the enumerated actions related to the investment:
 - Establishment
 - Acquisition
 - Expansion
 - Management
 - Conduct
 - Operation
 - Sale or other disposition



National Treatment

S.D. Myers Inc. (U.S.) v. Canada, 2000

- U.S. company providing PCB disposal services barred by Canadian border closure from transporting waste across Canada-U.S. border for treatment at its U.S. facilities
- Border closure adversely affected U.S. companies bidding on same remediation contracts as domestic companies who had treatment facilities in Canada
- NAFTA Panel finds violation of Article 1102



National Treatment

Feldman v. United Mexican States, 2002

- Government of Mexico denies tax rebate to foreign-owned re-sellers and exporters of cigarettes
- Tax rebate was available to domestic entities performing the same services
- No legitimate regulatory or public policy justification for the distinction
- NAFTA tribunal finds violation of Article 1102



National Treatment

Corn Products International v. Mexico, 2008

- Mexico imposes tax on producers of high-fructose corn syrup (HFCS)
 - Tax not applied to producers of cane sugar
 - Mexico's domestic sugar industry comprised solely of cane sugar producers
 - Tax had discriminatory effect upon producers of HFCS, all of whom were foreign-owned
 - NAFTA Tribunal finds violation of Art. 1102
-
- Note also: In the *Matter of Cross-Border Trucking, 2001*



Most-Favoured Nation (MFN)

Article 1103: Most-Favored Nation (MFN) Treatment

- 1103(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 of a non-Party with respect to the establishment, acquisition, expansion, management, conduct, operation or sale or other disposition of investments.
- Same protection is extended in 1103(2) to “investments of investors”
 - Imposes the same obligation upon NAFTA Parties as Article 1102, but extends the comparators beyond domestic investors and investments to third-party investors and investments as well
- Same principles apply as in Art. 1102, except that group of possible comparators is broadened to include not only domestic investors, but investors of other non-Parties as well



Most Favoured Nation (MFN)

In the Matter of Cross-Border Trucking, 2001

- Note: also established breach under Article 1102
- U.S. moratorium on issuing motor carrier licenses to foreigners lifted for Canadians, not for Mexicans
- Effectively prevented Mexican nationals from investing in the U.S. industry
- Because the lifting of the moratorium with respect to Canadians gave Canadian companies preferential treatment as compared to Mexicans, NAFTA tribunal found breach of Article 1103



Minimum Standard of Treatment

Article 1105: Minimum Standard of Treatment

- 1105(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.
- Imposes an absolute (rather than comparative, as in 1102 and 1103) baseline or floor with respect to the standard of treatment that must be accorded to NAFTA investors, including:
 - Treatment in accordance with international law
 - Fair and equitable treatment
 - Full protection and security



Minimum Standard of Treatment

- NAFTA FTC Note of Interpretation:
 - Clarifies that the standard set out in Article 1105 refers to a standard established under customary international law, rather than one to be interpreted by reference to the Parties' other treaties



Minimum Standard of Treatment

1. Treatment in accordance with international law:

- Denial of justice
- Arbitrary, grossly unfair treatment
- Outright and unjustified repudiation of obligations

2. Fair and equitable treatment:

- Detrimental reliance upon legitimate expectations
- Certainty, transparency and stability of host state's regulatory regime

3. Full protection and security:

- Protection from discriminatory treatment
- Government's adherence to its own laws and regulations



Minimum Standard of Treatment

GAMI Investments (U.S.) Inc. v. Mexico, 2004

- Mexican government implements laws and regulations meant to stabilize sugar industry, mismanages and fails to enforce them
- Result is that the value of U.S. shareholder's investment in Mexican sugar mill is undermined
- NAFTA Tribunal decides that where this mismanagement amounts to outright repudiation of Mexico's own laws, the government's conduct could establish breach of Article 1105



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Performance Requirements

Article 1106 – Performance Requirements

- 1106(1) No Party may impose or enforce any of the following requirements, or enforce any commitment or undertaking, with respect to 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:
 - To export a given level or percentage of goods or services;
 - To achieve a given level or percentage of domestic content;
 - To purchase, use or accord a preference to goods produced or services provided in its territory, or to purchase goods produced or services provided by persons in its territory
 - [...]



Performance Requirements

“Performance requirements” refers to an array of requirements put in place by a host state concerning the performance of foreign-owned enterprises in its territory

- Art. 1106 sets out those performance requirements that are prohibited under NAFTA, as well as a list of exceptions



Performance Requirements

ADM Inc. (U.S.) v. Mexico, 2007

- Excise tax imposed by Mexican government upon soft drink producers using sweeteners other than cane sugar
- All domestic producers used cane sugar, U.S. producers used high-fructose corn syrup
- NAFTA Tribunal finds excise tax amounts to prohibited performance requirement – to use certain percentage of domestic product and accord a preference to goods produced domestically



Expropriation

Article 1110 – Expropriation

- 1110(1) No Party may directly or indirectly nationalize or expropriate the investment of an investor of another Party in its territory or take a measure tantamount to nationalization or expropriation except:
 - a) for a public purpose;
 - b) on a non-discriminatory basis;
 - c) in accordance with due process of law and Article 1105(1)
 - d) on payment of compensation in accordance with paragraphs 2 through 6



Expropriation

Nationalization:

- Refers to the taking of property by the state on a sector-wide or industry-wide basis

Expropriation:

- Direct
- Indirect



Expropriation

Direct Expropriation:

- Physical taking of an investment, by compulsory transfer of legal title or outright seizure

Indirect Expropriation:

- Measures that result in the effective loss of management, use or control, or result in a significant depreciation in the value of, the assets of a foreign investor



Expropriation

AbitibiBowater (U.S.) v. Canada

- AbitibiBowater announced closure of pulp and paper mill facilities in Newfoundland
- Newfoundland government cancels water and hydroelectric contracts with company in retaliation
- AbitibiBowater alleges expropriation of its investment (and measures tantamount to expropriation)
- Government of Canada settles claim for \$130 million



Expropriation

Metalclad Corp. (U.S.) v. Mexico

- U.S. company purchased hazardous waste transfer station in Mexico
- Mexico's federal government allowed local municipal government to deny necessary permits to investor, preventing it from operating
- NAFTA Tribunal decided that by allowing local government to treat investor in an unfair manner and act outside its sphere of jurisdiction, Government of Mexico engaged in acts tantamount to expropriation in breach of Article 1110

