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## Shifting Grounds: Judicial Review under NAFTA Chapter 11 and the Ratification of ICSID

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A thesis submitted in partial fulfillment of the requirements for the Master of Laws degree in Law

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**Shifting Grounds: Judicial Review under NAFTA Chapter 11 and  
the Ratification of ICSID**

By

Nolan Downer

Graduate Program in Law

A thesis submitted in partial fulfillment  
of the requirements for the degree of  
Master of Laws

The School of Graduate and Postdoctoral Studies  
The University of Western Ontario  
London, Ontario, Canada

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## ABSTRACT AND KEYWORDS

*NAFTA is much more than a free trade agreement. Under Chapter 11 of the treaty, a multi-lateral investment agreement was introduced which was unprecedented in scope. For the first time, private investors from any NAFTA country were provided with an independent right of action directly against a host government. The objective underlying Chapter 11 was to facilitate foreign investment among NAFTA countries by providing assurances to investors that their investments would be protected against undue regulatory interference. As such, a central consideration as to the effectiveness of Chapter 11 is the speed, impartiality, and efficiency with which investment disputes are settled. This requires that courts charged with reviewing Chapter 11 investment arbitrations operate consistently and with a high degree of deference. This thesis examines the jurisprudence relating to the judicial review of Chapter 11 arbitrations with an eye towards the consistency and deference applied. To the extent that courts do demonstrate inconsistency and lack of deference, this thesis explores whether Canada ought to ratify the ICSID Convention as a means of precluding judicial review and facilitating FDI flows among NAFTA countries. To answer this question, this thesis examines some of the problems inherent in ICSID, along with the levels of consistency and deference applied by ICSID's annulment committees vis-à-vis the North American courts. Through such an analysis, this thesis endeavours to recommend a policy course for the Harper Government to pursue as it relates to NAFTA Chapter 11 and the ratification of the ICSID Convention, and proposes some further alternatives.*

**Keywords:** investment arbitration, judicial review, NAFTA Chapter 11, ICSID

## **ABBREVIATIONS**

**BIT:** Bi-lateral Investment Treaty

**CEMSA:** Corporación de Exportaciones Mexicanas S.A. de C.V

**CAA:** Commercial Arbitration Act (British Columbia)

**FAA:** Federal Arbitration Act

**FDI:** Foreign Direct Investment

**ICAA:** International Commercial Arbitration Act (British Columbia)

**ICSID:** International Centre for the Settlement of Investment Disputes

**ICSID Convention:** Convention on the Settlement of Investment Disputes between States and Nationals of Other States

**ICC:** International Chamber of Commerce

**NAFTA:** North American Free Trade Agreement

**New York Convention:** 1958 Convention for the Recognition and Enforcement of Foreign Arbitral Awards

**P & F analysis:** Pragmatic and Functional analysis

**SDMI:** SD Myers Inc.

**UNCITRAL:** United Nations Commission on International Trade Law

**WTO:** World Trade Organization

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## INTRODUCTION

The North American Free Trade Agreement (the “NAFTA”) is unique in that it is much more than a free trade agreement removing tariff barriers among member countries. Rather, under Chapter 11, NAFTA also serves as a multi-lateral investment treaty, with a mechanism put in place which allows for the settlement of investment disputes between investors and host nation-state governments. Essentially, it provides a private cause of action by foreign investors against host countries for perceived undue regulatory interference or economic favouritism. The objective underlying NAFTA Chapter 11 is to foster a stable climate for investment, and thereby facilitate economic growth by encouraging foreign investment among NAFTA member countries. For this to occur, investors have to be confident that their investments will be protected from undue interference when investing in a foreign country, and a key consideration in this regard will be the effectiveness of the dispute settlement mechanism established under NAFTA Chapter 11. Moreover, investors must be confident that the decisions arrived at under NAFTA Chapter 11 are upheld, as the awards are subject to judicial review from the relevant courts of jurisdiction. In Canada, therefore, it is important that our domestic courts review investment disputes under NAFTA Chapter 11 consistently and fairly so as to attract investment from the United States and Mexico. Likewise, our investors require

reciprocal assurances that there will not be undue interference by courts in the United States and Mexico. For NAFTA Chapter 11 to function properly and maintain its legitimacy, this is imperative. Accordingly, the degree of deference demonstrated by the reviewing courts is of great importance in establishing investor confidence, and in facilitating the effectiveness of the unique dispute settlement mechanism established under NAFTA Chapter 11.

Recently, Canada ratified the *Convention on the Settlement of Investment Disputes between States and Nationals of Other States* (the “ICSID Convention”), which allows disputes under NAFTA Chapter 11 to be submitted to the International Centre for the Settlement of Investment Disputes (the “ICSID”). At its core, the ICSID provides an arbitral infrastructure that allows for the settlement of investment disputes, and it is explicitly listed as an option for dispute settlement under NAFTA Chapter 11. Moreover, the ICSID provides an internal review mechanism that is ostensibly narrow in scope, and completely precludes judicial review of any kind. Theoretically, therefore, ratification of the ICSID Convention could serve as a means by which the potential concerns inherent in judicial review are circumvented, and through which stability and effectiveness could be achieved under NAFTA Chapter 11.

The question posed in this thesis arises from the degree to which the courts in Canada and the United States have shown deference to arbitral decisions made under NAFTA Chapter 11. Further, to the extent that there have been inconsistencies and interventionist tendencies on the part of reviewing courts towards NAFTA Chapter 11 decisions, this thesis queries whether Canada should ratify the ICSID Convention to assuage investor concerns and facilitate FDI flows from our NAFTA partners. With respect to the ICSID,



the answer is no. While there were some early concerns with respect to the state of judicial review of decisions rendered under NAFTA Chapter 11, particularly in Canada, these have been largely alleviated in more recent decisions. More importantly, the ICSID has not shown itself to be a viable means by which to preclude judicial review. In fact, the decisions rendered under its “ad hoc committees” have been less deferential than those rendered by reviewing courts in the United States and Canada, despite widespread concerns in this regard. Moreover, ICSID is structurally flawed and effectively incapable of amendment. Accordingly, to the extent there are some lingering concerns with respect to the state of judicial review in Canada and the United States towards decisions rendered under NAFTA Chapter 11, ICSID is not the answer, and the ICSID Convention should not be ratified.

The structure of this thesis is divided into five chapters, as follows:

Chapter I will explore the background and underpinnings of investment arbitration. I chart the growth of investment arbitration, from its roots in international commercial arbitration, with which it shares much of the same underpinnings, including UNCITRAL Model Law as adopted into various statutes. The paper then segues into the rise of investment arbitration and the rationale for its inception and continued use, namely to facilitate FDI flows by encouraging investor confidence. Alongside this, I examine the emergence of the ICSID and its potential role in the adjudication of investment disputes. I also delve into the uniqueness of the ICSID as a means of precluding judicial review vis-à-vis the traditional route of ad hoc arbitration reviewed by domestic courts of jurisdiction. I highlight the ostensibly narrow grounds for review under the ICSID with the grounds for review using UNCITRAL Model Law and contrast the functioning under

each system. The chapter then explores the structural underpinnings of the NAFTA, and more particularly, Chapter 11. The unprecedented nature and scope of the NAFTA Chapter 11 is examined, along with its specific provisions, which allow for investment disputes to be adjudicated under the UNCITRAL Rules, the ICSID Additional Facility Rules, or the ICSID itself, presenting the choice at issue in this paper.

Chapter II introduces NAFTA Art. 1136(3)(b), which expressly stipulates that a tribunal decision can be appealed to the domestic courts at the place of arbitration. I then lay out the background for judicial review in Canada, highlighting the grounds for review applied using UNCITRAL Model Law as incorporated into domestic statutes. I also highlight the evolving nature of administrative review in Canada, which provides for *standards* of review, and which has unfortunately crept into some of the jurisprudence. The chapter then canvasses the relevant Canadian jurisprudence with an eye towards the level of deference and consistency applied by Canadian courts to the review of arbitral decisions rendered under NAFTA Chapter 11, starting with *Mexico v. Metalclad*, which represented the first test of Chapter 11 review in Canada. I highlight the factual background to the *Metalclad* decision, along with some of the controversy relating to the perceived lack of deference demonstrated by the Court, as parts of the Tribunal decisions were overturned. I systematically lay out the ways in which the Court in that case exceeded its jurisdiction and expanded the ostensibly narrow grounds for review beyond that which was intended, and highlight various inconsistencies within the decision itself. I explore the ways in which the *Metalclad* decision had the potential to undermine investor confidence, along with the effectiveness of NAFTA Chapter 11 as a vehicle for dispute settlement.

Moving on from *Metalclad*, Chapter II proceeds to canvass the more recent jurisprudence, including *Mexico v. Karpa*, which was considered both by the Ontario Superior Court of Justice and the Ontario Court of Appeal, along with *Canada (Attorney General) v. S.D. Myers*, which was decided by the Federal Court of Canada. I demonstrate that these decisions, while not wholly deferential and partially inconsistent, did represent somewhat of a repudiation of *Metalclad*. I argue that these decisions serve as a strong affirmation of the deference to be applied by Canadian courts to decisions rendered under NAFTA Chapter 11, and should serve to restore investor confidence that judicial review in Canada will operate within the confines of the grounds for review as stipulated. I close out the chapter with somewhat of a caution by discussing the *Dunsmuir v. New Brunswick* decision, which once again altered the state of administrative law in Canada. However, I argue that given that the Canadian decisions have largely rejected the use of administrative review to the review of Chapter 11 decisions, this should not be overly concerning to the investment community. I also discuss the recent Court of Appeal decision in *Mexico v. Cargill* which largely clarified how the grounds for review under UNCITRAL Model Law as adopted by statute intersect with the standards of review under Canadian administrative law, along with a reaffirmation of the deference to be applied towards NAFTA Chapter 11 decisions. Accordingly, the core argument to be extracted from Chapter II of the thesis is that despite some early hiccups and some lingering inconsistencies, the state of judicial review in Canada towards Chapter 11 decisions is largely deferential such that the objectives underlying NAFTA Chapter 11 will be advanced.

Chapter III then shifts the analysis south, to an examination of the state of judicial review in the United States towards decisions rendered under NAFTA Chapter 11. In the U.S., there is only one decision which directly addresses the review of a NAFTA Chapter 11 decision, *International Thunderbird Gaming Corporation v. United Mexican States*. However, unlike the situation in Canada, the U.S. courts conflate the review of investment arbitration with the review of commercial arbitration, and accordingly, the analysis is broadened somewhat into the realm of commercial arbitral review. With respect to *Thunderbird*, the grounds for review are analyzed, along with the deferential posture cited by the Court that is ostensibly applied to the review of arbitral decisions in general. The analysis then extends into an additional ground for review applied in the U.S. and imputed into any review of an arbitral decision; “manifest disregard of the law.” I argue that a deferential posture is adopted throughout the decision, and that it is more deferential than that employed by Canadian courts or under ICSID. As such, I argue that *Thunderbird* suggests that U.S. courts will be quite deferential to decisions rendered under Chapter 11, and highlight some academic commentary to this effect.

Chapter III then broadens its analysis to the review of commercial arbitration in general for further insight into the posture that U.S. courts will adopt in the review of NAFTA Chapter 11 decisions, as no distinction between the review of investment arbitration under the treaty and run-of-the-mill commercial arbitration has been applied thus far by U.S. courts. I highlight the leading decisions in this regard, and conclude that the decisions further reinforce the notion that U.S. courts will operate in a deferential manner, particularly given that there has been a move towards doing away with the “manifest disregard of the law” standard in its entirety in some of the commercial

arbitration review cases. While I do point to a potentially new standard emerging – one of “public policy” – I argue that it is unlikely to creep into the review of NAFTA Chapter 11 awards. As such, I conclude Chapter III by arguing that the state of review in the United States is consistent and largely deferential, and indeed, even moreso than that applied by Canadian courts. In this regard, I conclude that the jurisprudence available thus far suggests that North American courts are cognizant of the importance of deference towards decisions rendered under NAFTA Chapter 11, and that investors can be confident that their disputes will be fairly adjudicated and reviewed.

Notwithstanding the deference demonstrated by North American courts, there are some lingering inconsistencies, as discussed earlier, and particularly in Canada. As such, now that Canada has ratified the ICSID Convention, judicial review of NAFTA Chapter 11 decisions could be precluded, thereby allowing for greater deference. To this end, Chapter IV explores the deference demonstrated by the internal ICSID annulment committees towards investment decisions rendered under the ICSID so as to determine whether the ratification of the ICSID Convention could serve to facilitate greater deference. I chart the background and function of the ICSID, and then examine the major decisions rendered under the auspices of the annulment committees. I highlight the grounds of review, and then examine their application, starting with the *Klockner v. Government of Cameroon* decision, which was the first instance of the use of the annulment mechanism under ICSID. Unfortunately, the committee annulled the award in that instance in a manner similar to the *Metalcad* decision, employing various legal gymnastics to apply a review standard outside the scope of annulment. I argue that this undermined the effectiveness of ICSID as a dispute settlement mechanism, and highlight

a series of subsequent decisions reinforcing the lack of deference demonstrated by the annulment committees. I demonstrate that while several decisions rendered in the 1990's and early 2000's did point to an increased level of deference, the annulment committees took a step backwards in the most recent round of annulment decisions, resulting in a state of flux which stands in stark contrast to the deference demonstrated by North American courts in the most recent decisions. I argue that this state of flux has undermined the ICSID as an institution for the settlement of investment disputes, and cite several tangible consequences arising from this lack of deference, suggesting that the ICSID is losing its legitimacy. I also argue that the ICSID as an institution has failed to adequately address these problems, and indeed, seems to deny the problem. To this end, I critique a recent "Background Paper on Annulment for the Administrative Council of ICSID" which was drafted in response to some of the aforementioned concerns, and use some statistical analysis to highlight the shortcomings of the Background Paper. I conclude Chapter IV by stating that annulment committees under the ICSID have not shown themselves to be deferential, and that the ICSID appears to be fatally flawed as an institution in terms of the efficient resolution of investment disputes. The paper then concludes with Chapter V, which contrasts the deference shown by North American courts towards investment arbitration with that the lack of deference shown by the annulment committees under the ICSID. Chapter V also weighs the advantages and disadvantages of ICSID as against those found under ad hoc arbitration. I argue that in light of the shortcomings of the ICSID highlighted in the preceding chapter, and in light of the largely deferential posture adopted by North American courts to decisions rendered under NAFTA Chapter 11, the recent ratification of ICSID by the Harper government

will not serve to facilitate greater defence. I then lay out several alternatives which could further facilitate the effectiveness of the review of NAFTA Chapter 11 decisions, including the implementation of a permanent appellate body under the NAFTA. I also explore the desirability of establishing an even broader international appellate body, but argue that it would be too large an undertaking at this juncture and that a NAFTA appellate body would serve as an effective interim measure to further facilitate the efficient review of NAFTA Chapter 11 decisions.

At its core, therefore, the thesis argues that while there have been some inconsistencies in the judicial review of NAFTA Chapter 11 decisions, the courts have settled on a posture that is largely deferential. The ICSID, by contrast, has not proven itself to be an effective institution in the review of investment awards. As such, the recent ratification of ICSID by the Harper government as a means of precluding judicial review under NAFTA Chapter 11 will not be effective in facilitating deference towards decisions rendered under NAFTA Chapter 11.

## **CHAPTER I:**

# **BACKGROUND TO INTERNATIONAL COMMERCIAL ARBITRATION, INVESTMENT ARBITRATION, AND ITS INTERPLAY WITH THE COURT SYSTEM**

## **1.1 INTRODUCTION**

Investment arbitration operates as a subset of international commercial arbitration, but has more recent roots. Indeed, it is the investment arbitration infrastructure set up in the latter half of the 20<sup>th</sup> century which underlies NAFTA Chapter 11, and an understanding of the structure and functioning of the associated institutions is essential to appreciate the complexities of investment arbitration and judicial review thereof. Accordingly, this thesis will briefly examine the rise of international commercial arbitration in the 20<sup>th</sup> century.

## **1.2 GROWTH OF INTERNATIONAL COMMERCIAL ARBITRATION**

As the nature of commercial arbitration became increasingly internationalized at the dawn of the 20<sup>th</sup> century, a new set of problems was introduced. Foremost amongst these were the inconsistencies with respect to how agreements to arbitrate were recognized in different domestic legal jurisdictions. In response, a landmark international agreement was concluded in 1923 under auspices of the League of Nations; the *1923 Geneva*



*Protocol on Arbitration Clauses*.<sup>1</sup> The *Protocol* bound signatory nations to recognize the validity of an arbitration agreement stipulating that matters be settled in different contracting states. This was followed by the *Geneva Convention for the Execution of Foreign Arbitral Awards*<sup>2</sup> in 1927, and dealt with the recognition and enforcement of foreign arbitral awards, which had heretofore been problematic.<sup>3</sup> Together, these two agreements were significant in the development of international commercial arbitration, as they were widely adopted and were generally considered to be quite effective. Alongside these developments, the International Chamber of Commerce (“ICC”) set up an international Court of Arbitration in 1923.<sup>4</sup> These agreements and institutions reflect the fact that while commercial arbitration between entities of different states is transnational in character, the enforcement and recognition of the arbitral awards is a matter of domestic jurisdiction, and the growth of these institutions served to ensure that domestic practices in contracting states were consistent with agreed upon norms. It is in this sense that the term “international commercial arbitration” is used.

Notwithstanding these nascent attempts at creating an institutional and legal framework for transnational commercial arbitration, the actual number of commercial arbitrations between firms of different countries remained rather small, and real growth in the field did not occur until after World War II. Indeed, the “gold standard” in modern international commercial arbitration was not established until many years later, with the *1958 Convention for the Recognition and Enforcement of Foreign Arbitral Awards* (“the

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<sup>1</sup> *1923 Geneva Protocol on Arbitration Clauses*, 27 LNTS 157. Signed September 24, 1923. Entered into force July 28, 1924.

<sup>2</sup> *Geneva Convention for the Execution of Foreign Arbitral Awards*. 92 LNTS 302. Signed September 26, 1927. Entered into force July 29, 1929.

<sup>3</sup> *United Nations Conference on Trade and Development* (UNCTAD), Project on Dispute Settlement in International Trade, Investment and Intellectual Property. Course on Dispute Settlement (2003) – Module 5.1, 21. <available from: [http://www.unctad.org/en/docs/edmmisc232add20\\_en.pdf](http://www.unctad.org/en/docs/edmmisc232add20_en.pdf)> [“UNCTAD”]

<sup>4</sup> *Ibid*, at 21.

New York Convention”).<sup>5</sup> The *New York Convention*, *inter alia*, merged the provisions found in the 1923 *Protocol* and the 1927 *Convention* into a single document. Moreover, it significantly strengthened the enforceability of over and above that provided for under the 1927 *Convention*. Under the *New York Convention*, arbitral awards were made worthy of enforcement in foreign courts provided that enforceability was not negated by a narrow set of exceptions. As originally conceived by the ICC, however, domestic courts were not to have control over the enforcement of international arbitral awards. Rather, the process was to be internationalized such that the ICC or some equivalent organization would oversee enforcement. Nevertheless, this has not occurred, and the domestic courts of various nation-state governments maintain a significant role in governing international commercial arbitration.<sup>6</sup>

The role of domestic courts in governing various aspects of international commercial arbitration was also facilitated by the widespread adoption of a set of procedural rules put forth by the *United Nations Commission on International Trade Law* (UNCITRAL) in 1976. UNCITRAL was established by the U.N. General Assembly “to promote the progressive harmonization and unification of international trade law,” and the rules were designed for use in ad hoc arbitrations, occurring outside the ambit of any arbitral institution.<sup>7</sup> As part of this, UNCITRAL promotes the adoption and use of “model law” which serves to provide national governments with a uniform set of laws to be copied and incorporated into domestic arbitration statutes. Foremost amongst these was the

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<sup>5</sup> *United Nations Convention on the Recognition and Enforcement of Foreign Arbitral Awards*, done at New York, June 10, 1958, 21 U.S.T. 2517, T.I.A.S. No. 6997, 330 U.N.T.S. 38 [“*New York Convention*”].

<sup>6</sup> *Ibid.*, at 23.

<sup>7</sup> UNCTAD, *supra* note 3 at 24.

development of what is termed UNCITRAL Model Law in 1985,<sup>8</sup> which remains in widespread use. Essentially, the Model Law provides a framework of internationally accepted arbitration standards and procedures for incorporation into domestic statutes, such as Canada's *Commercial Arbitration Act*,<sup>9</sup> and has been widely adopted. This widespread adoption has allowed for a harmonization of domestic laws covering commercial arbitration, thus creating a form of law that is international in character, but enforceable domestically.

### 1.3 INVESTMENT ARBITRATION

Alongside the foregoing developments there has also been a newer and rapidly growing subset of international commercial arbitration: investment arbitration, which is the focus of this thesis. In many respects, investment arbitration operates as a distinct form of arbitration in its own right, with its own institutions and with specific provisions allowing for it under agreements such as the NAFTA. This is due to the fact that investment arbitration does not involve two commercial entities, but rather an investor and a nation-state government. In this respect, it is a unique breed of arbitration. Despite this, investment arbitration shares many aspects of international commercial arbitration, including in many instances, the use of the same infrastructure and procedures as well as a similar interplay with the courts with respect to set aside procedure.

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<sup>8</sup> *UNCITRAL Model Law on International Commercial Arbitration*, 21 June 1985, (1985) 24 I.L.M. 1302. [“*UNCITRAL Model Law*”]

<sup>9</sup> *Commercial Arbitration Act*, [1985, c. 17 (2<sup>nd</sup> supp.)]

Since its inception, the rise of investment arbitration has been facilitated by mutual recognition on the part of both investors and host governments of its advantages.<sup>10</sup> Investors investing in a foreign country, for instance, want assurances that their investments will be safe from undue government interference and that they will have adequate recourse should such interference occur. In earlier years, if a foreign government adversely impacted an investor's investment through a perceived violation of international law, the investor's primary option would be to lobby their own State to initiate a claim on their behalf at the International Court of Justice, since private parties lacked standing before the ICJ in their own right – provided both parties recognized the jurisdiction of the ICJ.<sup>11</sup> However, even if their government did initiate such a claim and achieved a favourable result, enforcement was extremely difficult.<sup>12</sup> The investor's only other option in this regard would be to challenge the host government in its own domestic courts, and such courts would naturally be suspected of harbouring a bias in favour of their own government's interests. On the flipside, nation-state governments recognize the purported benefits of foreign direct investment (FDI) in achieving economic growth, and therefore, had a desire to attract such investors. In this respect, they had a vested interest in assuaging investor concerns, and a natural means to do so was to submit any disputes to non-biased arbitration. Recognizing this need, numerous countries have signed bilateral investment treaties ("BIT's"), with the first major one being signed in 1959.<sup>13</sup>

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<sup>10</sup> W. Michael Reisman, "Systems of Control in International Adjudication and Arbitration: Breakdown and Repair" (London: Duke University Press, 1992), 42.

<sup>11</sup> Susan D. Franck "Legitimacy Crisis in Investment Treaty Arbitration: Privatizing Public International Law through Inconsistent Decisions." *73 Fordham L. Rev.* 1521 (2004-2005), 1536.

<sup>12</sup> *Ibid*, at pg. 17.

<sup>13</sup> *Treaty for the Promotion and Protection of Investments*, Protocol, Federal Republic of Germany-Pakistan, Nov. 25, 1959, 457 U.N.T.S. 24.

This was a novel approach, as it created a private enforcement mechanism whereby corporations and investors could hold actual nation-state governments to account for their obligations under international law should a perceived violation thereof adversely affect their investments. It was hoped that such agreements would create a mutually beneficial arrangement whereby a stable environment for investment would encourage and facilitate FDI flows. Today, BIT's worldwide number in the thousands,<sup>15</sup> and have provided a framework upon which investment clauses such as NAFTA Chapter 11 – a form of multi-lateral investment treaty - have modeled themselves.

Alongside the emergence of BITs, the World Bank established the *Convention on the Settlement of Investment Disputes between States and Nationals of Other States* ("ICSID Convention")<sup>16</sup> in 1965, after which investment disputes could be submitted to the *International Centre for the Settlement of Investment Disputes* ("ICSID"). Initially as its primary focus, ICSID endeavoured to facilitate economic growth in newly developing countries by providing foreign investors with the confidence required to invest in such countries.<sup>17</sup> As stated by the ICSID Tribunal in *AMCO v. Indonesia*: "Thus, the Convention is aimed to protect, to the same extent and with the same vigour the investor and the host State, not forgetting that to protect investments is to protect the general interest of development and of developing countries."<sup>18</sup> Over time, however, ICSID arbitration has emerged a major player in the settlement of international investment disputes. While ICSID is usually used in the resolution of disputes arising under a BIT, it

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<sup>15</sup> David Williams, "Challenging Investment Treaty Arbitration Awards - Issues Concerning the Forum Arising from the Metalclad Case." *2003 Business Law International* 156 (2003), 158.

<sup>16</sup> *Convention on the Settlement of Investment Disputes between States and Nationals of other States*, 18 March 1965, 575 U.N.T.S.515; 4 I.L.M. 532 (1965). ["*ICSID Convention*"]

<sup>17</sup> Reisman, *supra* note 10 at pg. 47.

<sup>18</sup> *Amco v. Indonesia* (Decision on Jurisdiction), 25 September 1983, 1 ICSID Reports 389 at 400.

is a requirement that both parties to a particular dispute have adopted or are operating within a legal jurisdiction that has adopted ICSID. Absent this, the parties to the investment dispute are precluded from availing themselves of the support infrastructure provided for under ICSID. As a result, the *Additional Facility Rules*<sup>19</sup> were created under ICSID in 1978, and provide a set of rules upon which parties to an investment arbitration can rely. Specifically, the Additional Facility Rules are to be relied upon when only one of the parties to the dispute belongs to an ICSID contracting state. When neither party to a dispute is associated with a contracting state, then the UNCITRAL Arbitration Rules will generally be relied upon. However, neither the Additional Facility Rules nor the UNCITRAL Arbitration Rules furnish the extensive institutional support provided for under actual ICSID arbitration.

Another unique aspect of ICSID arbitration is that its awards are not subject to judicial review. Instead, ICSID features an internal review mechanism, whereby an ad hoc three person committee is appointed by the ICSID to review the award.<sup>20</sup> Such annulment proceedings are limited in scope, and are not intended to operate as a review of the legal merits of a particular decision. In fact, an award can only be reviewed on a narrow set of five specifically enumerated grounds, allowing for annulment if:<sup>21</sup>

- 1) The original tribunal was not properly constituted;
- 2) The arbitral tribunal manifestly exceeded its powers;
- 3) That there was corruption on the part of a member of the Tribunal;
- 4) There was a serious departure from a fundamental rule of procedure;

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<sup>19</sup> *International Centre for the Settlement of Investment Disputes: Additional Facility Arbitration Rules*, (1982) 21 I.L.M. 1458.

<sup>20</sup> *ICSID Convention*, *supra* note 16, art. 52, 4 I.L.M. at 541.

<sup>21</sup> *ICSID Convention*, *supra* note 16, art.52(1), 541.

5) The award does not state the reasons upon which it was based.

Based on a plain reading of the grounds for annulment, mistakes of fact or law will not be sufficient to have an ICSID award annulled. In effect, therefore, annulment review under the ICSID is structured so as to minimize opportunities for review in exchange for finality of outcome, which is in accordance with the advantages inherent in arbitration as compared to the inefficiency and unpredictability of relying on domestic courts. Despite this, it will be shown in Chapter IV that earlier cases interpreted these five enumerated grounds for annulment broadly, to the point that an analysis on the substantive merits of a decision was allowed for. And while some subsequent review decisions have held unequivocally that the five enumerated grounds are to be construed narrowly - precluding any review on the merits<sup>22</sup> - there has been a recent return to a less deferential posture. While submission to the ICSID is indeed voluntary, once agreed upon, both parties are fully bound by the ICSID's jurisdiction. Moreover, disputes settled under the ICSID are fully enforceable in the domestic courts of all signatory nations.

In stark contrast to the streamlined, self-contained procedures found within the ICSID, non-ICSID investment arbitration is subject to a haphazard and sometimes unpredictable judicial review. In such instances, the investment arbitration will have occurred under the Additional Facility Rules, Courts of International Arbitration, or on an ad hoc basis using UNCITRAL Model Law – with the same set-aside procedures as is used for international commercial arbitration. Such arbitrations are not subject to an internal annulment review, and operate under a different procedural framework. Specifically, enforcement of any award is sought in the local national court system, and there could be greater

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<sup>22</sup> See *Wena Hotels v. Arab Republic of Egypt*, (2002) 41 ILM 896 (ICSID) and *Aguas Aconquiiia & Vivendi v. Argentina*, (2002) 41 I.L.M. 1135 (ICSID).

opportunities for attacking specific awards depending on the applicable jurisdiction. Given that judicial review of any award will normally occur at the place of arbitration, disputes can arise over the arbitral *situs*, as the review is governed by the local arbitration law – with differing standards and scopes of review from jurisdiction to jurisdiction, as will be demonstrated in Chapters II and III. In some jurisdictions, an award can be set aside on issues of law, in others on procedural integrity, and still in others on the actual merits (fact and law) of the decision itself.<sup>23</sup> In Canada, for instance, the criteria set out for setting aside an award made in any international commercial arbitration seated in Canada is borrowed directly from UNCITRAL Model Law. Under Model Law Art. 34(2), as incorporated into the applicable domestic statutes, awards may be set aside only if there is:<sup>24</sup>

- 1) Incapacity of a party or invalidity of the arbitration agreement;
- 2) Lack of notice to a party or denial of opportunity to present its case;
- 3) Excess of jurisdiction;
- 4) Arbitral procedure not in accordance with agreement;
- 5) Subject matter that is not arbitrable;
- 6) An award against public policy.

The enumerated grounds of review appear to preclude any evaluation as to the merits of an award, or as to the law applied, and Canadian courts have interpreted these provisions quite narrowly granting extensive deference.<sup>25</sup>

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<sup>23</sup> Franck, *supra* note 11, at pg. 1551.

<sup>24</sup> *UNCITRAL Model Law*, *supra* note 8, Art. 34(2).

<sup>25</sup> See *Corporacion Transnacional de Inversiones S.A. de CV v. STET International Spa* (1999), 45 O.R. 3d 183 aff'd (2000) 49 O.R. (3d) 414 (Ont. C.A.): There is a strong presumption that a tribunal operated within its powers; Arbitral tribunals entitled to extensive judicial deference: *Quintette Coal Ltd. v. Nippon Steel Corp.* (1990) 47 B.C.L.R. (2d) 201 (S.C.) aff'd [1991] W.W.R. 219(Ont. C.A.).



Challenges to non-ICSID investment arbitrations, however, are not limited to judicial review at the place of arbitration as described above. Indeed, further challenges can be made at the enforcement stage, and this can include a court challenge in any jurisdiction where a party is attempting to enforce upon another party's assets. In this respect, the standard of review is fairly streamlined, as most signatory nations have adopted the criteria for review set out under the New York Convention. These criteria include:<sup>26</sup>

- 1) The parties to the arbitration were under some incapacity or the agreement was otherwise invalid;
- 2) The losing party was not given proper notice of the arbitration proceedings or was otherwise unable to present its case;
- 3) The award addresses issues beyond the scope of the submission to arbitration;
- 4) The arbitral procedure was not in accordance with the parties' agreement or contradicted the law of the place of arbitration;
- 5) The award has not become binding on the parties or has been set aside by a court in the country where the award was made;
- 6) The subject matter of the dispute is not capable of settlement by arbitration;
- 7) The recognition would be contrary to the public policy of the country of enforcement.

In effect, therefore, an order setting aside an award at the place of arbitration provides a barrier to enforcement under the New York Convention – although the barrier is not insurmountable. Interestingly, many legal jurisdictions have applied similar criteria to the judicial review of the award itself, and there does appear to be some overlap.<sup>27</sup> In this regard, a single award could be reviewed twice by courts in different jurisdictions using

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<sup>26</sup> *New York Convention*, *supra* note 5, Art. V.

<sup>27</sup> Williams, *supra* note 15, at pg. 1552.

nearly identical criteria – once in a motion to set aside the award at the place of arbitration, and once again at the enforcement stage. This is especially problematic when one considers that the criteria enumerated above do appear to grant some leeway for a review on the merits of an award, opening a route of double appeal into what is intended to be a streamlined process. In contrast to ICSID investment arbitration, therefore, it can be said that opportunities for extensive review hinder the finality of outcomes under non-ICSID arbitration, which would appear to run counter to the perceived benefits of resorting to non-judicial arbitration. Nevertheless, this has not manifested itself in any major decisions, and is primarily an academic concern. It is in this context that NAFTA Chapter 11 operates, and this will be the focus of the following section.

#### **1.4 NAFTA AND CHAPTER 11**

NAFTA<sup>28</sup> was signed on December 8, 1993 and by some measures represents the largest trade bloc in the world today. After it entered into force in January, 1994, it significantly altered the economic relationships between its three signatory nations – Canada, the United States and Mexico. However, referring to NAFTA as a mere free trade agreement is understating its scope and significance. While it did indeed remove most tariffs and barriers to trade between the three countries, it also laid out an extensive set of regulations governing matters ranging from the protection of intellectual property to the settlement of disputes. Foremost amongst these is NAFTA Chapter 11, which essentially operates as a multi-lateral investment treaty creating binding obligations between the NAFTA governments and investors from any of the other signatory nations.

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<sup>28</sup> *North American Free Trade Agreement*, 32 ILM 289, 605 (1993). (“NAFTA”)

Broadly speaking, some of the key provisions under NAFTA Chapter 11 are similar to many of the provisions found under the WTO Agreement with respect to national treatment, most-favoured nation treatment and other disciplines. Unlike the WTO provisions, however, NAFTA Chapter 11 allows for a cause of action directly against a host government from a foreign investor. Under the WTO Agreement, by contrast, parties to disputes must both be nation-state governments, and investment disputes must be trade-related. In this respect, Chapter 11 goes beyond the WTO Agreement and extends investor protections found under bi-lateral trade agreements to the plurilateral space. Specifically, under NAFTA Art. 1102 dealing with national treatment, a government cannot give preferential treatment to its own investors vis-à-vis the investors of another Party.<sup>29</sup> Following on this, NAFTA Art. 1103 – the most-favoured-nation clause – dictates that a host government cannot give preferential treatment to investors of any particular non-NAFTA country vis-à-vis investors of another Party.<sup>30</sup> With respect to these two provisions, NAFTA Art. 1104 further requires that the standard of treatment to be applied is whichever standard is greater under Articles 1102 and 1103 respectively.<sup>31</sup>

Another key provision is found under NAFTA Art. 1110,<sup>32</sup> and this is where many disputes have arisen under NAFTA Chapter 11. This provision deals with expropriation, and precludes a host government from expropriating the investment of another Party. More importantly, expropriation under Art. 1110 is broadened to include measures “tantamount to expropriation.” This ambiguous term has been subject to much debate,

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<sup>29</sup> *Ibid*, Art. 1102.

<sup>30</sup> *Ibid*, Art. 1103.

<sup>31</sup> *Ibid*, Art. 1104.

<sup>32</sup> *Ibid*, Art. 1110.

and its parameters have yet to be fully defined, but suffice to say that it is sufficiently broad that regulatory measures interfering with the profits of a foreign investor can fall under its ambit, as will be discussed later in the paper. Still, such expropriation is allowed for provided that it is done for a public purpose, on a non-discriminatory basis, in accordance with due process of domestic and international law, and on payment of compensation.

With respect to any actual disputes arising under NAFTA Chapter 11, the matter will go to an arbitration tribunal using either ICSID, the Additional Facility Rules or UNCITRAL Rules.<sup>33</sup> This diversity arises because of the patchwork of adherence to international arbitration agreements among NAFTA member countries. In the case of an arbitration, the panel is made up of three arbitrators, with each party choosing one arbitrator. The third arbitrator is neutral, and presides over the proceedings. Arbitrations under both the Additional Facility Rules and the UNCITRAL Rules can be appealed to the court system, unlike ICSID arbitrations.

## 1.5 CONCLUSION

Having provided this broad sketch of the background to international commercial arbitration, investment arbitration, the NAFTA, and criteria for judicial review, it is now necessary to look at the actual jurisprudence which underlies NAFTA Chapter 11, and how the courts have operated under the framework described in this chapter. The paper

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<sup>33</sup> *United Nations Conference on Trade and Development* (UNCTAD), Project on Dispute Settlement in International Trade, Investment and Intellectual Property. Course on Dispute Settlement (2003) – Module 6.1, 28.<available from: [http://www.unctad.org/en/docs/edmmisc232add24\\_en.pdf](http://www.unctad.org/en/docs/edmmisc232add24_en.pdf)>

will then contrast the jurisprudence involving the judicial review of Chapter 11 arbitration with the decisions arrived at under the ICSID review mechanism, and will demonstrate that while opportunities for review are greater outside of ICSID, the reviewing courts in North America have generally been more deferential to NAFTA Chapter 11 decisions than the annulment committees under the ICSID. Moreover, there are several serious structural flaws within the ICSID that cannot realistically be remedied. As such, this paper will argue that Canada is better off not ratifying the ICSID, and instead maintaining the system of judicial review of NAFTA Chapter 11 awards already in place, with an eye towards more fundamental reforms.

## CHAPTER II:

### JUDICIAL REVIEW OF NAFTA CHAPTER 11 ARBITRATIONS IN CANADA

#### 2.1 INTRODUCTION

As was discussed in Chapter I, the interplay between commercial arbitration and the judiciary is both complex and multi-faceted. In many respects, this dynamic is one of mutual necessity in that arbitrations fill a niche left open by the court system, and in return the crowded court system gets somewhat of a reprieve. Moreover, excessive judicial intervention can serve to undermine the purported benefits of arbitration itself, namely speed, expertise and party autonomy. In light of this drawback, court systems and statutes worldwide have generally adopted a very deferential approach to the decisions of arbitral tribunals. It is in this context that the dispute settlement mechanism under NAFTA Chapter 11 was established, with the primary means for settling disputes being an arbitration panel composed of experts in the field.<sup>34</sup> Under NAFTA Art. 1136(3)(b), however, there is a provision recognizing the ability of parties to appeal a tribunal decision to the domestic courts at the place of arbitration.<sup>35</sup> It reads:

3. A disputing party may not seek enforcement of a final award until:

...(b) in the case of a final award under the ICSID Additional Facility Rules or the UNCITRAL Arbitration Rules

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<sup>34</sup> Although Chapter 11 disputes arising in Mexico can be taken directly to the Court system.

<sup>35</sup> *NAFTA*, *supra* note 28, Art. 1136(3)(b).

- (i) three months have elapsed from the date the award was rendered and no disputing party has commenced a proceeding to revise, set aside or annul the award, or
- (ii) a court has dismissed or allowed an application to revise, set aside or annul the award and there is no further appeal.

At first glance, such appeals could prove to be beneficial to the arbitral process, since they provide assurance that arbitral decisions are sound and could provide recourse for aggrieved parties should the tribunal patently disregard the relevant law. Such an argument, however, is premised on the notion that any arbitral decision would be reviewed competently and consistently by the relevant court of jurisdiction. Further, it requires that the court not adopt an overly assertive posture in second guessing arbitral decisions (especially in the arbitral tribunal's core area of expertise) as it would provide incentives for frivolous appeals and thus undercut the effectiveness of the arbitral mechanism available under NAFTA Chapter 11. In Canada, the relevant jurisprudence on this point has been mixed, starting with a controversial decision in 2001, *Mexico v. Metalclad Corp.*, where a Chapter 11 arbitral decision was partially overturned.<sup>36</sup> Decisions since *Metalclad*, however, have been more deferential, notwithstanding some inconsistencies in the review standard applied. This chapter will explore the relevant jurisprudence, and highlight the deficiencies in the *Metalclad* decision, and how they have been largely rectified in more recent decisions.

## 2.2 BACKGROUND

NAFTA Chapter 11 provides for arbitrations using either ICSID, the ICSID Additional Facility Rules or the UNCITRAL Ad Hoc Arbitration Rules. Due to Canada only recently

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<sup>36</sup>*Mexico v. Metalclad Corp.*, [2001] B.C.J. No. 950 (B.C.S.C.). [*"Metalclad"*]

ratifying the ICSID, no NAFTA arbitrations have occurred under ICSID as ICSID requires both parties to have adopted the Washington Convention, and Canada is only a recent signatory, while Mexico remains a non-signatory. This is significant, as ICSID precludes judicial review of any kind and uses its own internal appeal mechanism.<sup>38</sup>

With respect to the Additional Facility Rules and UNCITRAL, any attempt at judicial review will occur at the place of arbitration, irrespective of the nationalities of the parties in dispute – notwithstanding issues of enforcement. In fact, such review is expressly contemplated under NAFTA Art. 1136(3)(b), which states that a party may not seek enforcement of a final award until “a court has dismissed or allowed an application to revise, set aside or annul the award and there is no further appeal” within the 120-day period allowed for.<sup>39</sup> In light of this provision, the appeal will use the review criteria set out under the relevant commercial arbitration statutes in the place of arbitration, the majority of which reference the UNCITRAL Model Law and the review criteria established therein. Indeed, under all the relevant Canadian jurisprudence to date, NAFTA Chapter 11 decisions have been reviewed under Art. 34 of the Model Law as incorporated into the respective statutes. As stated in Chapter I, such awards are reviewed under the following criteria:

- 1) Incapacity of a party or invalidity of the arbitration agreement;
- 2) Lack of notice to a party or denial of opportunity to present its case;
- 3) Excess of jurisdiction;
- 4) Arbitral procedure not in accordance with agreement;

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<sup>38</sup> Any review of an ICSID award is conducted by an ad hoc 3 person committee selected by ICSID. The review criteria are set out under Article 52 of the ICSID Convention, and ostensibly preclude a review on the legal merits of a decision.

<sup>39</sup> *NAFTA*, *supra* note 28, Art. 1136(3)(b).



- 5) Subject matter that is not arbitrable;
- 6) An award against public policy.

At first glance, these express bases for review would appear to provide at least a modicum of consistency from case to case and jurisdiction to jurisdiction. Indeed, while there have been slight variations in statutory review criteria – along with some inconsistent application of common law judicial review principles – the ultimate outcome of the decisions have been largely deferential. In the investment arbitration context, such deference is critical, as there is the potential for widely divergent review standards from jurisdiction to jurisdiction, which can encourage forum shopping. As stated by Susan Franck in her paper addressing the subject:<sup>40</sup>

“As more courts begin to consider vacatur or challenge to enforcement, an increase in the number of reviewing courts adds the possibility for further obfuscation of the meaning of international investment rights. First, there is an increased risk of politicizing the oversight of arbitral awards. As issues of international and domestic policy “loom large” there is a real possibility that national courts will be tempted to use local law to vitiate an award. Second, because of the lack of uniformity and the patchwork nature of the oversight, clever investors will strategically pick forums to favour their interests.”

Franck proceeds to summarize her argument as follows:

“With an increase in the number of courts where awards can be attacked, and the lack of any centralizing authority, there is a strong possibility that domestic courts will be unable to harmonize the impact of inconsistent decisions. Should reviewing courts choose to promote incoherent and indeterminate decisions, the legitimacy of the arbitration system will be further undermined.”<sup>41</sup>

It is in this context that the current chapter will first look at the *Metalclad* decision from the British Columbia Supreme Court and examine the deference applied so that it can be contrasted with subsequent jurisprudence.

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<sup>40</sup> Franck, *supra* note 11, at pg. 1557.

<sup>41</sup> *Ibid*, at pg. 1557.

The potential for inconsistency of review in Canada is compounded by the fact that this discussion also occurs in the context of what is already a confusing and ill-defined set of criteria for judicial review under Canadian administrative law. Prior to the 1970's, Canadian courts generally approached judicial review from a strictly jurisdictional perspective. Under this "preliminary question doctrine," Canadian courts would limit their analysis to whether the tribunal or administrative body had operated within the scope of its jurisdiction. If the court found that the body had operated outside of this jurisdiction, it would simply substitute its own judgment. Strictly speaking, this approach is not altogether problematic, but in practical terms the courts would expand the parameters of jurisdictional analysis to the point that the term became meaningless, with administrative decisions being overturned on grounds completely separate from what would be considered "jurisdictional" in the traditional sense.

Recognizing the problem, the Supreme Court of Canada stepped in with several major decisions in the late 1970's that would transform Canadian judicial review. Most notable among these was the landmark 1979 decision, *Canadian Union of Public Employees, Local 963 v. New Brunswick Liquor Corp.*<sup>42</sup> In that case, the Supreme Court introduced a much more deferential approach to administrative review than had prevailed under the "preliminary question doctrine." Specifically, the Court opined that if a tribunal or administrative body had been operating within its jurisdiction and within its core area of expertise, and was protected by a privative clause, the administrative decision should not be overturned unless "so patently unreasonable that its construction cannot be rationally supported by the relevant legislation and demands intervention by the court upon

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<sup>42</sup> *Canadian Union of Public Employees Local 963 v. New Brunswick Liquor Corp.*, [1979] 2 S.C.R. 227 (SCC). ["CUPE"]

review.”<sup>43</sup> This introduced additional factors for consideration beyond those that were ostensibly jurisdictional, and called for the adoption of a more deferential posture in the presence of such factors.

While the *CUPE* decision can therefore be seen as a mark of growing curial respect for independent decision-making in modern Canadian administrative law, it did not do away with the notion that the administrative body must be operating strictly within its jurisdiction. Indeed, on such questions, the *CUPE* decision was clear that tribunals would still be accorded little to no deference – in other words they must be correct. This “correctness standard” was confirmed by the Supreme Court of Canada in the 1988 decision, *U.E.S., Local 298 v. Bibeault*,<sup>44</sup> where it was stated that “the jurisdiction conferred on administrative tribunals and other bodies created by statute is limited, and ... such a tribunal cannot by a misinterpretation of an enactment assume a power not given to it by the legislator.”<sup>45</sup> The *Bibeault* decision also gave rise to the “pragmatic and functional” (“P & F”) analysis, whereby a host of factors would be considered in calibrating the appropriate standard of review - and thus expanded on *CUPE*. Such factors include the wording of the statute conferring jurisdiction on the tribunal, the broader purpose of the statute, the tribunal’s purpose, expertise, and the nature of the issue at play.<sup>46</sup>

Subsequent to *Bibeault*, therefore, the decisions of administrative bodies could be reviewed under either of the standard of correctness – with no deference – or the standard of patent unreasonableness with strong deference. Indeed, this would remain the law for

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<sup>43</sup> *Ibid*, at para. 17.

<sup>44</sup> *U.E.S. Local 298 v. Bibeault*, [1988] 2 S.C.R. 1048 (SCC). [“*Bibeault*”]

<sup>45</sup> *Ibid*, at para. 118.

<sup>46</sup> *Ibid*, at para. 123.

another decade, until the Supreme Court of Canada introduced a third standard – reasonableness *simpliciter* – in *Canada (Director of Investigation and Research, Competition Act) v. Southam Inc.*<sup>47</sup> In terms of deference, the new standard lay between correctness and patent unreasonableness, and was designed to accommodate matters that called for a more flexible approach. Essentially, whether a decision would be accorded a standard of reasonableness *simpliciter* or patent unreasonableness would depend on the obviousness and immediacy of the defect.<sup>48</sup>

This three pronged approach was clarified a year later in the *Pushpanathan v. Canada (Minister of Citizenship and Immigration)*,<sup>49</sup> where the P & F analysis was effectively crystallized. Essentially, a four-step test was introduced where the court would consider:<sup>50</sup>

- 1) the presence or absence of a privative clause;
- 2) the expertise of the tribunal;
- 3) the purpose of the Act; and
- 4) the nature of the problem (ie: question of fact or law)

None of these factors would be determinative in and of themselves, but rather would be considered in totality, and given differing weight depending on the facts of the case. In this respect, the three pronged approach was a flexible test that would be used to arrive at one of three standards of review – correctness, reasonableness *simpliciter*, or patent unreasonableness.

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<sup>47</sup> *Canada (Director of Investigation and Research, Competition Act) v. Southam Inc.*, [1996] S.C.J. No. 116 (SCC). [“*Southam*”]

<sup>48</sup> *Ibid*, at para. 57.

<sup>49</sup> *Pushpanathan v. Canada (Minister of Citizenship and Immigration)*, [1998] 1 S.C.R. 982 (SCC). [“*Pushpanathan*”]

<sup>50</sup> *Ibid*, at paras. 29-37.

It is under the new *Pushpanathan* standard that most of the relevant cases involving the judicial review of NAFTA Chapter 11 arbitrations have been decided. As will be demonstrated, however, not only was the test not suited to the review of investment arbitrations but the test itself is fundamentally flawed. Nevertheless, the reviewing Courts have come to recognize these deficiencies in their analysis. The next section will examine the relevant cases in this regard.

### 2.3 METALCLAD v. MEXICO

The *Metalclad* ruling set off a firestorm of controversy when the decision came down from the B.C. Supreme Court in May 2001. Its novelty lay in the fact that it was the first NAFTA tribunal decision to use the ICSID Additional Facility Rules, and it was the first Chapter 11 decision to be judicially reviewed. What set off the controversy, however, was the lack of deference shown by the B.C. Supreme Court towards the tribunal's decision. Not only was the tribunal's ruling partially overturned, but the Court appeared to substitute its own judgment on matters within the tribunal's core area of expertise. To many commentators, this was an ominous sign that the judicial posture adopted towards NAFTA Chapter 11 tribunal decisions would be assertive, interventionist, and counter-productive to the efficient resolution of investment disputes.<sup>51</sup>

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<sup>51</sup> See: Todd Weiler, *NAFTA Investment Law and Arbitration: Past Issues, Current Practice, Future Prospects* (Transnational Publishers: New York, 2004), 379; Todd Weiler, *International Investment Law and Arbitration: Leading Cases from the ICSID, NAFTA, Bilateral Treaties and Customary International Law* (London: Cameron May, 2005), 717-719; Hector Olasolo, "Have Public Interests Been Forgotten in NAFTA Chapter 11 Foreign Investor/Host State Arbitration? Some Conclusions from the Judgment of the Supreme Court of British Columbia on the Case of Mexico v. Metalclad", 8 *NAFTA: Law and Business Review of the Americas* (2002), no. 1/2, pg. 204; David Williams, Q.C., "Challenging Investment Treaty Arbitration Awards – Issues Concerning the Forum Arising from the Metalclad Case," 2003 *Bus. L. Int'l* 156 (2003), pg. 168.

By way of background, the facts of the case arose from a dispute between Metalclad Corp., an American corporation, and Mexico.<sup>52</sup> Metalclad Corp. had purchased a piece of land in Mexico to operate as a hazardous waste landfill. At the federal level, Mexican authorities had approved the project on several occasions and represented to Metalclad Corp. that no further permits would be required. At the local level, however, there was fierce resistance to the project, ostensibly out of environmental concerns. After an investment of several million dollars by Metalclad into the property to ready it for service as a landfill, the local municipality sought and obtained a court order blocking completion of the project.<sup>53</sup> While the court order was ultimately overturned, the state government stepped in and issued an ecological decree precluding any further development at the site, and cited the protection of a rare species of cacti as the reason behind the decree. Metalclad subsequently filed a Chapter 11 claim against the Mexican government for compensation to cover its investment loss.<sup>54</sup>

In August of 2000, the NAFTA tribunal ruled against Mexico by stating that Mexico had breached its NAFTA minimum treatment obligations under Art. 1105 since it had not provided fair and equitable treatment consistent with international law. Specifically, the repeated representations from Mexican federal authorities that Metalclad Corp. was cleared to go ahead with its project and the obfuscation of state and municipal authorities constituted a failure “to ensure a transparent and predictable framework for Metalclad’s business planning and investment.”<sup>55</sup> The tribunal further found that Mexico had

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<sup>52</sup> *Metalclad Corporation v. The United Mexican States*, (ICSID Case No. ARB(AB)/97/1). [“*Metalclad Tribunal Decision*”]

<sup>53</sup> *Ibid.*

<sup>54</sup> Under Chapter 11 of the NAFTA, the Federal government is responsible and liable for any breach of NAFTA provisions by a lower level of government.

<sup>55</sup> *Metalclad Tribunal Decision*, *supra* note 54.

breached its obligations under NAFTA Art. 1110 when the local authorities deprived Metalclad Corp. of the economic benefit of its investment, thus constituting action that was “tantamount to expropriation” and requiring full compensation. In light of these findings, the Tribunal awarded compensation to Metalclad Corp. in the amount of \$16,685,000.00.<sup>56</sup>

Following the Tribunal decision, the Mexican government sought an appeal at the B.C. Supreme Court since the original arbitration had been conducted in Vancouver. The decision on judicial review was rendered by Mr. Justice Tysoe on May 2, 2001. One of the key issues for determination was which arbitration statute to apply in calibrating the standard of review. The statutes in question were British Columbia’s *International Commercial Arbitration Act*<sup>57</sup> (“ICAA”) whose statutory language was borrowed from UNCITRAL Model Law with its associated narrow scope of review - limited essentially to egregious procedural defects - or British Columbia’s *Commercial Arbitration Act* (CAA), which provides for a broader standard of review encompassing a re-evaluation of factual and legal findings.<sup>58</sup> At issue in the determination was whether the dispute fell within the parameters of traditional international commercial arbitration, in which case the *ICAA* applied, or whether it was more regulatory in nature, in which case the *CAA* applied. In citing the definition of “commercial” provided for under UNCITRAL Model Law, Tysoe J. opined that investing is an inherently commercial activity, and that the regulatory issues involved were merely ancillary, thus placing the review within the more

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<sup>56</sup> *Metalclad Tribunal Decision*, *supra* note 54.

<sup>57</sup> *The International Commercial Arbitration Act*, S.B.C. 1986, C. 14 (Re). [“ICAA”]

<sup>58</sup> *Commercial Arbitration Act*, R.S.B.C. 1996, C. 55. [“CAA”]: Under s. 31, the court is explicitly granted the authority to review questions of law and set aside an arbitral award if such a determination would prevent a miscarriage of justice, is important to a body or class of persons to which the applicant is a member, or if the point of law is of general or public importance.

narrow confines of the *ICAA*.<sup>59</sup> Along these lines, counsel for Metalclad Corp. had argued strenuously that any review on the merits that extended beyond a purely procedural review would undermine the efficiency of the arbitral process and encourage forum shopping. From this perspective, therefore, the application of the *ICAA* would appear to have been a clear victory for Metalclad Corp., as the *ICAA* and the UNCITRAL Model Law upon which it is mirrored preclude judicial review of the relative merits of the tribunal's decision. As will be demonstrated, however, the Court engaged in some clever legal gymnastics that extended the scope of review far beyond what one would consider to constitute a purely procedural review.

In effect, the Court opted to extend the standard of review on two fronts – excess of mandate/jurisdiction and public policy. With respect to the former, the Court ruled that the tribunal was wrong to have imputed transparency obligations into NAFTA Art. 1105, and had essentially created an artificial basis for liability in finding Mexico in breach of these obligations. In light of this, the B.C. Supreme Court set aside the portion of the award dealing with this matter on the part of the Mexican government. The Court stated: “Hence, the Tribunal made its decision on the basis of transparency. This was a matter beyond the scope of submission to arbitration because there are no transparency obligations in Chapter 11.”<sup>60</sup> Essentially, therefore, the Court applied a standard of “correctness” here, as it simply re-evaluated whether the Tribunal was right or wrong to have imputed such transparency obligations into Art. 1105, and allowed for no margin of error.

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<sup>59</sup> *Metalclad*, *supra* note 36, at para. 46.

<sup>60</sup> *Ibid*, at para. 70.



With respect to matters affecting public policy, the Court for a standard of “patent unreasonableness” being read into the decision by stating that a patently unreasonable error on the part of the tribunal could potentially put the decision in conflict with Canadian public policy, although Tysoe declined to rule on this point given that he saw no patently unreasonable error.<sup>61</sup> This position is internally inconsistent from two perspectives. First, the Court entertained the application of a standard of “patent unreasonableness” after having explicitly rejected the use of traditional Canadian administrative review and its associated use of the P & F approach first articulated in *Pushpanathan*. Specifically, the Court stated:<sup>62</sup>

“...with respect to the ICAA, it is my view that the standard is set out in ss. 5 and 34 of the Act and that it would be an error for me to import into that Act an approach which has been developed as a branch of statutory interpretation in respect of judicial tribunals created by statute...the “pragmatic and functional approach cannot be used to create a standard of review not provided for in the ICAA.””

The underlined portion of the preceding quote is curious given that Tysoe J. declined to rule out the application a standard taken directly from the pragmatic and functional approach - “patent unreasonableness” – into his reading of the public policy ground for annulment found under the *ICAA*. In the end, however, the Court found that no patently unreasonable error had occurred when the tribunal ruled that the Mexican ecological decree was tantamount to expropriation, thus withholding a final determination as to whether such an error could constitute grounds for setting aside the award. Nonetheless, the standard was applied, and appears to directly contradict earlier statements in the case.

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<sup>61</sup> *Ibid*, at para. 97: The Court left it an open question whether a finding of a patently unreasonable error would violate BC public policy because it had determined that there was no error in the Tribunal decision that rose to such a level. By making such a determination, however, the Court re-evaluated the Tribunal’s decision.

<sup>62</sup> *Ibid*, at para. 54.

Another area where “public policy” concerns were used to extend the scope of review was with respect to matters involving allegations of deception and corruption. Specifically, the tribunal ruled against Mexico in its allegations that Metalclad had engaged in corruption and that it had used deceit to overstate the damages to which it was entitled. In this respect, the Court stated that “[it had] reviewed the evidence from the arbitration relating to the alleged corruption...and [it was] not persuaded that Mexico proved any corruption in which Metalclad participated.”<sup>63</sup> The Court later added that it was “not persuaded that Metalclad claimed expenses which it knew it had no legal justification to receive.”<sup>64</sup> Essentially, because the truth of such allegations would run counter to “public policy,” the Court called for a re-examination of the evidentiary record leading to the Tribunal’s decision. While the Court ultimately upheld the Tribunal’s evidentiary findings with respect to these allegations of corruption and deception, it is clear that an evidentiary review was undertaken. In the words of one investment scholar:<sup>65</sup>

“...despite its initial assertions, the Supreme Court not only reviewed whether or not the findings of the Arbitral Tribunal could be considered reasonable on the basis of the available evidence, it also proceeded to assess the whole evidence contained in the record of the arbitral proceedings in order to newly decide Mexico’s claim on Metalclad’s improper acts, as if it were a continental European Court of Appeal. Unfortunately, the Supreme Court did not let us know what the standard of proof it used to reject Mexico’s claim.”

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<sup>63</sup> *Ibid*, at para. 110.

<sup>64</sup> *Ibid*, at para. 117.

<sup>65</sup> Hector Olasolo, "Have Public Interests Been Forgotten in NAFTA Chapter 11 Foreign Investor/Host State Arbitration? Some Conclusions from the Judgment of the Supreme Court of British Columbia on the Case of Mexico v. Metalclad", 8 *NAFTA: Law and Business Review of the Americas* (2002), no. 1/2, pg. 204.

Interestingly, however, with respect to the one area where a thorough review was called for – procedural matters – it is ironic that the court adopted a much more deferential approach than it applied to other areas of the decision. Specifically, Mexico tried to argue that the Tribunal’s consideration of the ecological decree as the basis for the expropriation claim constituted a breach of the agreed upon procedure. Mexico’s argument here was premised on the notion that because the decree was put forth subsequent to Metalclad Corp.’s claim based on its license revocation, it constituted a separate claim and should have been considered separately from the main claim. In rejecting this argument, the Court held that the Tribunal was correct to treat it as an “ancillary or additional claim,” as provided for under the ICSID Additional Facility Rules, and Mexico had ample opportunity to defend itself in this regard. Some might say Judge Tysoe dismissed the procedural argument rather flippantly given Mexico’s extensive reliance on this line of argument, simply stating that “no error has been demonstrated in the arbitral procedure as a result of the Tribunal considering the claim based on the ecological decree.”<sup>66</sup> In fact, the Court’s deference on procedural matters went a step further when it addressed the issue as to whether the Tribunal’s failure to consider all of the arguments put forth by Mexico constituted a procedural breach. With respect to this issue, the Court stated that “the failure of the Tribunal to explicitly deal with all of Mexico’s arguments is not sufficiently serious to justify the exercise of the Court’s discretion to set aside the award.”<sup>67</sup> Therefore, after implicitly acknowledging that the Tribunal did fail to properly address all arguments provided by Mexico, the Court held that this procedural error was not sufficient to overturn the Tribunal. Though not

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<sup>66</sup> *Metalclad*, *supra* note 36, at para. 91.

<sup>67</sup> *Ibid*, at para. 128.

explicitly defined, this standard of review is more deferential – by definition – than the standard applied with respect to “excess of jurisdiction” under NAFTA Art. 1105, where the Court essentially substituted its reading of NAFTA Art. 1105 for that of the Tribunal’s. Notwithstanding this internal inconsistency, however, the Court did appear to leave open the question whether a sufficiently egregious failure by a Tribunal to address all arguments could constitute a procedural breach sufficient to set aside an award.

To sum up, the *Metalclad* decision effectively used the narrow confines of review allowed for under the *ICAA* to extend the standard of review beyond what one would deem appropriate using a plain reading of the statutory language. It did so in the following ways:

- a) by opening the door to the application of a standard of “patent unreasonableness” to the tribunal’s factual findings on the grounds that such an error would be contrary to public policy.
- b) on public policy grounds, by allowing for a thorough review of the evidentiary record to re-evaluate a tribunal’s findings when claims of deception or corruption were involved.
- c) by opening the door for the setting aside of an award when arguments put forth by a party were not addressed by the Tribunal on the grounds of a putative procedural violation.
- d) by applying a *de facto* standard of correctness to matters involving a tribunal’s interpretation of particular NAFTA Chapter 11 provisions (for example: transparency imputed in NAFTA Art. 1105) under the guise of excess of jurisdiction.

On top of this unconventional application of the standard of review, the Court also engaged in numerous internal inconsistencies that undermined the predictability of judicial review of NAFTA Chapter 11 decisions going forward, as well as the integrity of the decision itself. The primary inconsistency is that the Court explicitly rejected the application of the P & F analysis from Canadian administrative law, and proceeded instead to apply components of it. Secondly, the Court clearly articulated the deferential approach to be adopted under the *ICAA*, and then proceeded to use circuitous legal gymnastics to extend the standard of review under the guise of public policy and jurisdiction. As stated by Hector Olasalo in a commentary:

“...although legally bound by a narrow set of grounds for judicial review directed by the principle of finality of the arbitral awards, the [BC Supreme Court] *de facto* extended such grounds in order to make sure of the correctness of the arbitral award.”

From a practical perspective, therefore, the *Metalclad* decision opened the door for more lengthy, expensive and extensive litigation under NAFTA Chapter 11, as it provided incentives for losing parties to try and give it another shot at the appellate level, and essentially allowed for a re-evaluation on the merits of a Tribunal decision – albeit indirectly. The Court’s decision also provided a means by which losing parties could have the evidentiary record completely re-examined simply by raising allegations of corruption and deception. Finally, the decision undercut the desired uniformity provided for by the widespread adoption of UNCITRAL Model Law. After all, if the B.C. Supreme Court could use such legal gymnastics to obfuscate the seemingly narrow grounds for review, it is possible that other jurisdictions would feel encouraged to follow its lead, undercutting finality of outcome in NAFTA Chapter 11 arbitration. It is for these reasons that there was such fierce criticism of the partial annulment, and it was the

possibility existed that the ultimate verdict would be delivered in an appeal to the Supreme Court of Canada. In the end, however, Mexico opted to settle with Metalclad for \$16 million and ended all litigation.<sup>68</sup>

In light of this outcome, the investment community was eager to see how *Metalclad*'s legacy would play out as precedent in subsequent NAFTA Chapter 11 appeals, and four cases would come down within just a few short years to provide the answer.

#### **2.4 MEXICO v. KARPA (ONTARIO SUPERIOR COURT OF JUSTICE)**

*Mexico v. Karpa*<sup>69</sup> was the first post-*Metalclad* judicial decision to address the judicial review of a NAFTA Chapter 11 decision, and the Court did appear to apply a more deferential standard. It came down from the Ontario Superior Court of Justice on December 3, 2003, and while the standard of review applied and the interpretation of the grounds for review did little to clarify the appropriate review standard going forward, it was perceived as a step back from the *Metalclad* decision in terms of the increased deference shown to the decision of the Tribunal.

On the surface, the facts of the dispute itself are fairly straightforward. Marvin Ray Feldman Karpa ("Feldman"), a U.S. citizen, shipped cigarettes cross-border from Mexico to other countries under a corporation formed under and operating under the laws of Mexico, the Corporación de Exportaciones Mexicanas S.A. de C.V. ("CEMSA"). Feldman initiated a claim on behalf of CEMSA under NAFTA Chapter 11 as its sole

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<sup>68</sup> Todd Weiler, *NAFTA Investment Law and Arbitration: Past Issues, Current Practice, Future Prospects* (Transnational Publishers: New York, 2004), 379.

<sup>69</sup> *Mexico v. Karpa*, [2003] O.T.C. 1070 (Ont. SCJ). ["*Karpa*"]

investor, alleging that the company was entitled to a rebate on excise taxes that had been denied to CEMSA but provided to some of its Mexican-owned competitors. Feldman alleged that in denying this rebate to CEMSA, Mexico was in breach of its NAFTA obligations, specifically Art. 1102 (National Treatment), Art.1105 (Minimum Level of Treatment) and Art. 1110 (Expropriation and Indemnification), and was therefore liable for roughly \$50 million in damages. Mexico defended on the grounds that no company was entitled to these rebates, and that the Mexican competitors were under full audit in this regard. Unfortunately for Mexico, however, it was allegedly unable to divulge any information on the purported audits or on the tax situation of CEMSA's competitors as such information was subject to Mexican privacy legislation. Consequently, the tribunal drew negative inferences and held against Mexico, finding Mexico in breach of Art. 1102, and awarded CEMSA \$1.6 million in damages.<sup>70</sup>

As a result of this tribunal ruling, Mexico's appeal to the Ontario Superior Court of Justice was limited to findings with respect to Art. 1102, with specific reference to the following:<sup>71</sup>

- a) that the procedure adopted was in contradiction to the agreement of the parties.
- b) that Mexico was unable to argue its case by virtue of the fact that the tribunal had drawn impermissible inferences from the evidence (as a result of Mexico's non-disclosure).
- c) that the award was contrary to public policy, in contradiction to the UNCITRAL Model Law.

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<sup>70</sup> *Marvin Roy Feldman Karpa v. United Mexican States*, (ICSID Case No.ARB(AF)/99/1). [“*Karpa Tribunal Decision*”]

<sup>71</sup> *Karpa*, *supra* note 69, at para. 3.

As can be inferred from the third of the enumerated grounds for appeal, the relevant statute – Ontario’s *International Commercial Arbitration Act*<sup>72</sup> – borrows directly from the set aside criteria found within UNCITRAL Model Law, as was the case with the B.C. *ICAA* in the *Metalclad* decision. As with *Metalclad*, Canada stepped in as an intervener in *Karpa*, along with the government of Quebec, as they sympathized with Mexico’s privacy concerns. Specifically, the two national governments argued that Art. 2105 of the NAFTA creates an exception whereby countries can withhold information that is protected by domestic law.<sup>73</sup> The Court rejected this argument on the grounds that Mexico had failed to refer to NAFTA Art. 2105 before the Tribunal and was thus precluded from relying on such grounds upon review.<sup>74</sup> Unfortunately, in terms of the standard applied generally, the Court appeared to depart from the *Metalclad* decision and fully embraced the P & F approach from *Pushpanathan*, even outlining the steps required in such an analysis. Borrowing directly from *Pushpanathan*, the Court considered the factors to be evaluated:<sup>75</sup>

- (i) the presence or absence of a privative clause;
- (ii) the relative expertise of the Tribunal;
- (iii) the purpose of the Act or jurisdiction-conferring enactment as a whole;
- (iv) the nature of the problem on judicial review and whether it involves a question of law or fact.

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<sup>72</sup> *International Commercial Arbitration Act*, R.S.O. 1990, c. I-9.

<sup>73</sup> Specifically, NAFTA Article 2105 states: “Nothing in this Agreement shall be construed to require a Party to furnish or allow access to information the disclosure of which would impede law enforcement or would be contrary to the Party’s law protecting personal privacy or the financial affairs and accounts of individual customers of financial institutions.”

<sup>74</sup> *Karpa*, *supra* note 69, at para. 43.

<sup>75</sup> *Ibid*, at para. 82.



In applying the test, the Court treated Art. 34 of the Model Law as tantamount to a privative clause, circumscribing the grounds for review. The expertise of the tribunal was also not in question, as such expertise is a pre-requisite for sitting on a NAFTA Chapter 11 panel. While the other two factors were addressed indirectly, the preceding two factors were deemed to weigh heavily in favour of significant deference.<sup>76</sup>

This use of the P & F analysis was perhaps the biggest inconsistency when contrasted with the standard of review applied in *Metalclad*. It will be recalled that in *Metalclad*, the Court explicitly stated that NAFTA Chapter 11 arbitrations were to be treated as quite separate from traditional principles of administrative review – although the B.C. Supreme Court proceeded to ignore its own logic to a certain extent. By contrast, the Court in *Karpa* blurred this distinction and applied a test that was seemingly identical to that used in traditional administrative review. In any event, while the route used to arrive at the deference was problematic, the ultimate decision was quite deferential.

In this vein, it is particularly noteworthy that the Court in *Karpa* did not cite *Metalclad* as authority for any of the legal reasoning applied. Moreover, the *Karpa* Court did not delve into any of the legal gymnastics applied in *Metalclad*, specifically with reference to its use of jurisdictional issues to impute a standard of correctness to particular tribunal legal findings. The *Karpa* Court also refrained from using the public policy exception to second guess particular aspects of the Tribunal's findings, nor did it use such grounds to re-examine the evidentiary record. With respect to a re-evaluation of the factual record, the Court stated:<sup>77</sup>

“In my view, a high level of deference should be accorded to the Tribunal, especially in cases where the Applicant Mexico is in reality challenging a

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<sup>76</sup> *Ibid*, at para. 86.

<sup>77</sup> *Ibid*, at para. 77.

finding of fact. The panel who has heard the evidence is best able to determine issues of credibility, reliability and onus of proof.”

Along similar lines, and in direct contrast to *Metalclad*, the Court articulated an incredibly restrictive test for the application of the public policy exception. Specifically, the Court stated:<sup>78</sup>

“In my view, there has been no breach of public policy. The courts of this province have consistently held that for an arbitral award to be interfered with as being against public policy, it ‘must fundamentally offend the most basic and explicit principles of justice and fairness in Ontario, or evidence intolerable ignorance or corruption on the part of the arbitral Tribunal’. The Applicant must establish that the awards are contrary to the essential morality of Ontario.”

The Court in *Metalclad*, by contrast, used the public policy exception to allow for a factual review under the patent unreasonableness standard, stating that such an error could be contrary to B.C. public policy.

Essentially, therefore, the *Karpa* decision can be perceived as a re-affirmation of the high deference to be accorded to NAFTA Chapter 11 tribunals, and a step back from the undue extension of the grounds for review provided for under NAFTA Chapter 11. Ultimately, the decision was appealed to the Ontario Court of Appeal, and this appeal will be the focus of the following section.

## 2.5 MEXICO v. KARPA (ONTARIO COURT OF APPEAL)

As stated, Mexico immediately appealed the *Karpa* decision to the Ontario Court of Appeal, and the judgment was delivered by R.P. Armstrong J.A in 2005.<sup>79</sup> In rejecting

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<sup>78</sup> *Ibid*, at para. 87.

the appeal, the Court essentially re-affirmed the high level of deference to be accorded to arbitrations in general. More specifically, the Court rejected all three of Mexico's grounds for appeal, with the first two relating to the appropriate standard of review and the third relating to a re-evaluation of public policy considerations inherent in a review of a Chapter 11 arbitration.

With respect to the appropriate standard of review, the Court made reference to the high level of deference to be accorded to international arbitration agreements generally, and unfortunately, proceeded to apply components of the P & F approach used in the review of domestic tribunal decisions.<sup>80</sup> This served as a re-affirmation of the lower Court's application of the test, and again stands in contrast to the explicit rejection of the test in *Metalclad*. Indeed, the Court of Appeal re-applied the test in a systematic manner, treating Art. 34 of the Model Law as tantamount to a quasi-privative clause, and highlighting the expertise of the Tribunal in question.<sup>81</sup> The Court then pointed to the fact-laden nature of the dispute as further favouring a high level of deference, and found no reason to second-guess the Tribunal in this regard.<sup>82</sup> Importantly, while the Court did purport to apply components of the *Pushpanathan* test, the Court did not explicitly endorse one of three associated standards of review and simply stated: "Taking the above factors into account, I conclude that the applicable standard of review in this case is at the high end of the spectrum of judicial deference."<sup>83</sup>

In applying this standard, the Court proceeded to engage in a factual re-evaluation of Mexico's arguments, particularly with respect to some of the procedural concerns raised.

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<sup>79</sup> *United Mexican States v. Karpa*, [2005] O.J. No. 16 (ONCA). ["*Karpa appeal*"]

<sup>80</sup> *Ibid*, at para. 38.

<sup>81</sup> *Ibid*, at para. 39.

<sup>82</sup> *Ibid*, at para. 42.

<sup>83</sup> *Ibid*, at para. 43.

In this respect, the Court was consistent with the standard ostensibly applied in *Metalclad* to procedural matters. As with the lower court, however, the Court of Appeal refused to address the NAFTA Art. 2105 argument favoured by Mexico – and Canada’s Attorney General as an intervenor – on the grounds that this was not an argument put forth by Mexico to the Tribunal.<sup>84</sup> The Court did, however, ultimately make a factual determination with respect to NAFTA Art. 2105, stating: “I am unable to conclude that the majority of the Tribunal acted in breach of NAFTA Article 2105...”<sup>85</sup>

The Court then turned to public policy, and outlined the test from an earlier non-NAFTA arbitral review:<sup>86</sup>

“The concept of imposing our public policy on foreign awards is to guard against enforcement of an award which offends our local principles of justice and fairness in a fundamental way, and in a way which the parties could attribute to the fact that the award was made in another jurisdiction where the procedural or substantive rules diverge markedly from our own, or where there was ignorance or corruption on the part of the tribunal which could not be seen to be tolerated or condoned by our courts.”

Under this standard, Mexico argued that CEMSA’s filing of fictitious rebates would satisfy the test, but the Court rejected this argument despite acknowledging that it did not condone such conduct, citing deference to the tribunal.<sup>87</sup>

To sum it up, therefore, the Court of Appeal affirmed the lower Court, particularly with respect to the application of components of the P & F analysis, seeming to conflate commercial and/or investment arbitral review with traditional administrative review. Nevertheless, while the Court did re-evaluate certain factual matters relating to procedure, it reiterated a highly deferential standard of review, and applied a standard of

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<sup>84</sup> This underscores the importance for Chapter 11 litigants to raise any and all arguments, as the failure to do so would limit one’s options on appeal.

<sup>85</sup> *Karpa appeal*, *supra* note 79, at para. 61.

<sup>86</sup> *Ibid*, at para. 66: from *Schreter v. Gasmac Inc.*, (1992), 7 O.R. (3d) 608, 623 (Gen. Div.).

<sup>87</sup> *Ibid*, at para. 68.

patent unreasonableness to certain aspects of procedural review. During the period of time between the initial *Karpa* decision and the subsequent appeal, however, another major case was decided by the Federal Court of Canada which provided further guidance on the judicial posture adopted by Canadian courts towards NAFTA Chapter 11 arbitrations.

## 2.6 CANADA (ATTORNEY GENERAL) v. S.D. MYERS INC.

The *Canada (Attorney General) v. S.D. Myers*<sup>88</sup> judgment was delivered on January 13, 2004 by the Federal Court of Canada. Again, while there were some inconsistencies in terms of the standard of review applied, it is a further step back from *Metalclad* in favour of deference towards NAFTA Chapter 11 tribunals.

The dispute arose between the Canadian government and SD Myers Inc. (“SDMI”) as a result of an export control mechanism put in place by the Canadian federal government. SDMI was a U.S. corporation in the business of PCB waste disposal, and had set up a Canadian subsidiary to arrange for the export of Canadian PCB waste to its facilities in the U.S. In 1995, however, Canada placed a ban on the export of PCB waste, effectively terminating the ability of the SDMI subsidiary to send shipments of waste to the U.S. As a result, SDMI initiated a NAFTA Chapter 11 claim against Canada on the grounds of national treatment (Art. 1102), fair and equitable treatment (Art. 1105), NAFTA’s prohibition on performance requirements, and the claim that the export ban was tantamount to expropriation.<sup>89</sup>

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<sup>88</sup> *Canada (Attorney General) v. SD Myers*, [2004] F.C.J. No. 29 (Fed. Ct.). [“*SD Myers*”]

<sup>89</sup> *S.D. Myers Inc. v. Canada* (Nov. 13, 2000), 40 ILM 1408.

The tribunal ruled against Canada, holding that the export ban was initiated in such a way that it favoured Canadian waste disposal firms in a manner prejudicial to their U.S. counterparts operating in Canada, thus placing Canada in breach of its national treatment requirements under NAFTA Art. 1102. The tribunal also found Canada in breach of NAFTA Art. 1105, finding that the arbitrary and unjust way SDMI was targeted by the ban was not consistent with standards of fair and equitable treatment. With respect to SDMI's allegations of expropriation, however, the tribunal held that Canada's actions were not sufficient to rise to a level that could be considered tantamount to expropriation, seeming to recognize the public policy implications of allowing a government to regulate in the public interest free from undue interference. SDMI was ultimately awarded \$6,050,000.00 for lost profits and \$850,000.00 in costs.<sup>90</sup>

Perhaps encouraged by the outcome in *Metalclad*, Canada immediately launched an appeal of the decision in 2001 based principally on jurisdictional objections. Interestingly, the appeal was initiated after the tribunal's findings on liability, but prior to its ruling on damages and the size of the award, and was therefore launched prior to the completion of arbitral proceedings. The significance of the case, however, lies in the fact that it represented the first instance where a losing party had a case judicially reviewed by its own courts – playing directly into notions of perceived bias. In fact, Canada's arguments borrowed heavily from *Metalclad* in that Canada's counsel argued that a “patently unreasonable error” of law in the application of NAFTA Arts. 1102 and 1105 would result in an excess of jurisdiction - which is essentially a back-door approach to a re-evaluation of the tribunal's factual and legal findings under the camouflage of

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<sup>90</sup> *Ibid*: The PCB export ban was lifted by the Canadian government in 1997 and damages were therefore limited to the period of the ban.

“jurisdiction.” While the Court in *Metalclad* left this point open, the Court in *S.D. Myers* rejected this argument, stating that reviews of a tribunal’s findings with respect to fact and law are explicitly precluded under Art. 34 of the *Commercial Arbitration Code* – which applies standards from UNCITRAL Model Law to Canada’s *Commercial Arbitration Act*<sup>91</sup>.

Indeed, the review itself was undertaken using the criteria set out under UNCITRAL Model Law, consistent with both the *Metalclad* and *Karpa* decisions. As with the NAFTA Art. 2105 confidentiality argument attempted by Mexico in *Karpa*, the Court held that Canada’s failure to put forth an argument based on lack of jurisdiction to the *S.D. Myers* tribunal precluded it from using such an argument on appeal.<sup>92</sup> According to UNCITRAL arbitration rules, specifically Art. 21(3), a specific plea regarding a Tribunal’s jurisdiction must be pleaded no later than the filing of the Statement of Defense<sup>93</sup> – and the Court held that Canada had only made such objections in a broader sense. In this regard, the Court cited a desire to avoid widespread frivolous appeals to arbitration decisions.<sup>94</sup>

While the Court did entertain a P & F analysis, this was done only “in the alternative” that its primary findings were erroneous, and under the alternative analysis, the Tribunal findings were nonetheless upheld. Specifically, the Court held that with respect to matters within the scope of submission to arbitration (ie: jurisdiction), questions of law

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<sup>91</sup> *Commercial Arbitration Act*, R.S.C. 1985, c. 17 (2nd Supp.)

<sup>92</sup> *SD Myers*, *supra* note 88, at para. 45.

<sup>93</sup> UNCITRAL Model Law, *supra* note 8, Art.21(3).

<sup>94</sup> Unfortunately, this may also have the unintended consequence of encouraging frivolous arguments, as parties will have an incentive to raise every possible argument – no matter how frivolous – so that it may be brought up on appeal.

would be reviewed on a correctness standard, and questions of mixed fact and law would be reviewed on a reasonableness standard.<sup>95</sup>

In applying this standard, the Court rejected Canada's contention that SDMI's activity did not constitute an "investment" pursuant to the text of NAFTA, and was thus not within the scope of NAFTA Chapter 11 arbitration. The Court held that the tribunal was "correct" in its interpretation, and that it had applied the definition to the facts in a "reasonable" manner.<sup>96</sup> The Court also determined that the tribunal's interpretation of "like circumstances," as required for a national treatment claim under NAFTA Art. 1102, was reasonable.<sup>97</sup>

With respect to Canada's public policy argument, the Court applied a strict test similar to the other decisions, defining a breach of public policy as being tantamount to a violation of "fundamental notions and principles of justice." The Court held that the tribunal decision did not rise to such a level, as there was no "flagrant denial of justice."<sup>98</sup> It is also worth noting that the Court addressed a novel approach to the public policy exception put forth by Canada, whereby counsel argued that public policy encompasses political factors relating to the decision, such as the ability to regulate in the public interest. Naturally, this argument is an understanding of the public policy exception that is quite separate from traditional notions and principles of justice. The Court, however, closed the door on this line of argument, stating:

"While Article 34 provides that a Court may set aside an award where 'it is in conflict with the public policy of Canada', public policy does not refer to a political position, it refers to 'fundamental notions and principles of justice'. In this case the Tribunal's decision does not breach

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<sup>95</sup> *SD Myers*, *supra* note 88, at para. 58.

<sup>96</sup> *Ibid*, at para. 70.

<sup>97</sup> *Ibid*, at para. 74.

<sup>98</sup> *Ibid*, at para. 56.



fundamental notions and principles of justice so that the decision is not in conflict with the public policy of Canada.”<sup>99</sup>

The Court also made reference to the importance of having a high level of deference towards international arbitrations in general, stating:

“Courts restrain themselves from exercising judicial review with respect to international arbitration tribunals so as to be sensitive to the need of a system for predictability in the resolution of disputes and to preserve the autonomy of the arbitration forum selected by the parties.”<sup>100</sup>

In light of statements such as these, along with the outcome of the decision, *S.D. Myers* can be seen as a strong re-affirmation of deference towards NAFTA Chapter 11 tribunals – especially compared to the legal gymnastics employed by the Court in *Metalclad*. Some observers note that it is similar to *Karpa* in that it shows a commitment from the courts to deference.<sup>101</sup>

Importantly, it also pushed back on the notion that principles of administrative law could be applied in reviewing a NAFTA Chapter 11 decision, instead focusing on the *grounds* for review.

## 2.7 COUNCIL OF CANADIANS v. CANADA (ATTORNEY GENERAL)

The *Council of Canadians v. Canada (Attorney General)*<sup>102</sup> case was decided by the Ontario Superior Court of Justice on July 8, 2005, and dealt with a constitutional challenge to NAFTA Chapter 11. Specifically, the challenge was launched by the

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<sup>99</sup> *Ibid*, at para. 76.

<sup>100</sup> *Ibid*, at para. 39.

<sup>101</sup> See Angela Cousins, “Case Comment: Canada (A-G) v. SD Myers,” *14 Dalhousie Journal of Legal Studies* 191 (2005), at pg. 198.

<sup>102</sup> *Council of Canadians v. Canada (Attorney General)*, [2005] O.J. No. 3422 (Ont. SCJ). [“*Council of Canadians*”]

Council of Canadians, an environmentally minded advocacy group headed by Canadian anti-globalization activist Maude Barlow. The group is fiercely resistant to the spread of the neo-liberal model of globalization, and perceives NAFTA Chapter 11 as a means through which multi-national corporations usurp the ability of nation-state governments to legislate in the public interest. In light of this concern, the Council initiated a constitutional challenge on the grounds that NAFTA Chapter 11 and its associated dispute settlement mechanism vest authority in arbitral tribunals to deal with matters exclusively within the spheres of provincial and federal authority, contrary to Canada's *Constitution Act*.<sup>103</sup> While not an actual case involving the judicial review of a NAFTA Chapter 11 Tribunal decision, much of the decision involved an analysis of the interplay between such tribunals and domestic Courts.

In discussing the standard of review that is generally applied, the Court observed:

“Although Canada has in the past taken the position that a less deferential standard of review should be applied, courts in Canada have given a high degree of judicial deference to NAFTA tribunal decisions. See for example *Canada (Attorney General) v. S.D. Myers, United Mexican States v. Metalclad Corp. and United Mexican States v. Karpa*.”<sup>104</sup>

This underscores the fact that a high level of deference has become entrenched in the judicial mindset.

There is one more major decision, however, which had the potential to cloud the landscape of Canadian judicial review going forward – at least to the extent that Courts apply principles of administrative review.

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<sup>103</sup> *The Constitution Act, 1867 (The British North America Act, 1867)*, 30 & 31 Victoria, C. 3.

<sup>104</sup> *Council of Canadians*, *supra* note 102, at para. 12.

## 2.8 DUNSMUIR v. NEW BRUNSWICK

The *Dunsmuir v. New Brunswick*<sup>105</sup> case represents the latest incarnation of the Supreme Court of Canada's approach to administrative review, and it fundamentally altered the structure of Canadian administrative review. As such, it is important in the sense that some of the courts impute administrative review into the review of decisions rendered under NAFTA Chapter 11. Most notably, the decision collapsed the three standards adopted from the P & F analysis into two standards – correctness and reasonableness. This occurred as a result of the perceived shortcomings of the approach adopted in *Pushpanathan*, particularly with respect to the practical difficulties encountered by courts in differentiating between reasonableness *simpliciter* and patent unreasonableness. As stated by the Court:<sup>106</sup>

“Looking to either the magnitude or the immediacy of the defect in the tribunal's decision provides no meaningful way in practice of distinguishing between a patently unreasonable and an unreasonable decision.”

In this respect, the Court dismissed the notion that there can be degrees of unreasonableness and introduced a streamlined standard to reflect this. In the eyes of the Court, an administrative action is either reasonable or it is not, with no shades of grey in between, and it is therefore foolish to suggest that a party should be forced to accept an administrative decision that is deemed only “partially unreasonable.” Under the new standard, tribunals would be accorded deference to the extent that reasonable decision making can result in several different but satisfactory outcomes, and that the courts are not to interfere in such instances. Interestingly, however, the factors highlighted for

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<sup>105</sup> *Dunsmuir v. New Brunswick*, [2008] 1 S.C.R. 190 (SCC). [“*Dunsmuir*”]

<sup>106</sup> *Ibid.*, at para. 41.

consideration in calibrating the level of deference remain essentially unchanged from P & F analysis, but the Court emphasized that the analysis need not be extensive.<sup>107</sup>

On questions of jurisdiction, the Court reiterated that tribunals must still be correct, but explicitly rejected the broadening of jurisdictional analysis that occurred prior to the *CUPE* decision. In this regard, the Court stated:

“Administrative bodies must also be correct in their determinations of true questions of jurisdiction or *vires*. We mention true questions of *vires* to distance ourselves from the extended definitions adopted before *CUPE*. It is important here to take a robust view of jurisdiction. We neither wish nor intend to return to the jurisdiction/preliminary question doctrine that plagued the jurisprudence in this area for many years.”<sup>108</sup>

Similarly, the Court also made it clear that on matters of law, the correctness standard is to be applied when dealing with an issue "that is both of central importance to the legal system as a whole and outside the adjudicator's specialized area of expertise."<sup>109</sup>

While the *Dunsmuir* decision was subsequently upheld by the Supreme Court of Canada a year later in *Canada (Citizenship and Immigration) v. Khosa*,<sup>110</sup> its ultimate impact on the review of NAFTA Chapter 11 arbitrations remained indeterminate. With respect to *Metalclad*, the above quoted passage dealing with jurisdiction would appear to close the door on future attempts to broaden jurisdictional analysis and thus apply a back door correctness standard to non-jurisdictional matters. Similarly, both *Metalclad* and *S.D. Myers* applied the standard of patent unreasonableness to parts of the respective decisions. This, however, is only true to the extent that traditional administrative review is applied to the review of investment arbitration, which the courts in *Metalclad* and *S.D.*

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<sup>107</sup> *Ibid.*, at para. 55.

<sup>108</sup> *Ibid.*, at para. 59.

<sup>109</sup> *Ibid.*, at para. 60.

<sup>110</sup> *Canada (Citizenship and Immigration) v. Khosa*, [2009] S.C.J. No. 12 (SCC).

*Myers* both ostensibly rejected (although *Karpa* did incorporate components of it into its analysis).

Fortunately, in late 2011, a decision was rendered by the Ontario Court of Appeal which clarified some of the potential impact of the *Dunsmuir* decision to the review of NAFTA Chapter 11 awards.

## 2.9 MEXICO v. CARGILL

The *Mexico v. Cargill*<sup>111</sup> decision came down from the Ontario Court of Appeal in October, 2011, and clarified both the impact of *Dunsmuir* on NAFTA Chapter 11 review, and re-affirmed the deferential posture adopted by Canadian courts in reviewing NAFTA Chapter 11 awards. By way of background, Cargill, through its subsidiary CDM, sold a low-cost substitute to cane sugar, HFCS, in Mexico by importing HFCS from its American facilities to a distribution centre it set up in Mexico. As a result, the soft drink industry in Mexico began to use HFCS extensively. Mexico then enacted a number of trade barriers, resulting in the eventual closure of the CDM distribution facility in Mexico, as well as the associated U.S. production facilities.

Cargill then submitted a claim to arbitration under NAFTA Chapter 11 for violation of NAFTA Arts. 1102, 1103, 1105, 1106 and 1110, with Toronto chosen as the place of arbitration. The tribunal later ruled in favour of Cargill, and awarded damages for both “up-stream” and “down-stream” losses, with the former being the lost sales and costs incurred from the CDM distribution facility in Mexico, and the latter being the cost of lost sales to CDM of products manufactured by Cargill in the United States. Mexico had

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<sup>111</sup> *United Mexican States v. Cargill, Inc.*, [2011] O.J. No. 4320 (Ont. CA). [“*Cargill*”]

attempted to argue that the tribunal lacked jurisdiction to award damages for up-stream losses which were actually sustained by Cargill in the United States and not directly from its Mexican investment in the CdM facility. The Tribunal, however, ruled that the up-stream investments were inextricably linked to Cargill's Mexican operations, and therefore compensable under NAFTA Chapter 11, and thereby falling under the jurisdiction of the Tribunal.

Mexico then appealed to the Ontario Superior Court of Justice requesting that the damages associated with the up-stream investments be set aside for lack of jurisdiction. The application judge rejected this argument on the basis that Mexico's objection was not actually an issue of jurisdiction, but an attack on the merits of the award, and correctly held that "an attack on the merits of the decision...was beyond the scope of review for the court" under UNCITRAL Model Law, thereby demonstrating a further rejection of the jurisdictional gymnastics employed by the Court in *Metalclad*. However, in considering Mexico's alternative argument that the Tribunal's reasoning was not "reasonable" as defined in *Dunsmuir*, the Court proceeded to apply a reasonableness standard and held that the decision was reasonable and consistent with the objectives underlying NAFTA.

In light of this decision, Mexico went to the Court of Appeal, and challenged the standard of review applied with respect to jurisdiction, along with several of the lower court's findings relating to jurisdiction. Fortunately, the Court proceeded to thoroughly examine the use of *standards* of review under Canadian administrative law, and how they intersect with the *grounds* for review under Article 34(2) UNCITRAL Model Law as adopted by statute. Indeed, reflecting some of the confusion discussed earlier in this

chapter, an intervenor from ADR Chambers argued that administrative law has no place in the review of NAFTA Chapter 11 awards and creates inconsistency. On this point, the Court agreed, stating the following:<sup>112</sup>

“I agree that it is important to clearly define the standard of review to be applied by a court in reviewing an arbitral decision on the grounds set out in Article 34 of the Model Law. I also agree that importing and directly applying domestic concepts of standard of review, both from administrative law and from domestic review by appeal courts of trial decisions, may not be helpful to courts when conducting their review process of international arbitration awards under Article 34 of the Model Law.”

While the Court did proceed to apply a standard of “correctness” to the question of jurisdiction under Article 34(2)(a)(iii), it was quick to highlight the fact that this was limited strictly to the issue of jurisdiction, as a Tribunal cannot assume jurisdiction that it does not have, but that courts ought not broaden its scope to any review of the merits of the decision itself. As stated by the court:<sup>113</sup>

“Therefore, courts are to be circumspect in their approach to determining whether an error alleged under Article 34(2)(a)(iii) properly falls within that provision and is a true question of jurisdiction. They are obliged to take a narrow view of the extent of any such question. And when they do identify such an issue, they are to carefully limit the issue they address to ensure that they do not, advertently or inadvertently, stray into the merits of the question that was decided by the tribunal.

One challenge for a reviewing court is to navigate the tension between the discouragement to courts to intervene on the one hand, and on the other, the court's statutory mandate to review for jurisdictional excess, ensuring that the tribunal correctly identified the limits of its decision-making authority. Ultimately, when deciding its own jurisdiction, the tribunal has to be correct.”

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<sup>112</sup> *Ibid*, at para. 30.

<sup>113</sup> *Ibid*, at paras.47 & 48.

This is important, as it demonstrates a recognition of the fact that the statutory mandate to review questions of jurisdiction should not be conflated with a review of the substantive merits of a decision, which is a trap some of the earlier courts fell into.

On this basis, the Court held that the lower court was incorrect when it applied a “reasonableness” standard, as it would invariably lead to a review on the merits of the decision. The Court then crystallized the approach to be adopted in reviewing a NAFTA Chapter 11 award with the following passage:

“The role of the reviewing court is to identify and narrowly define any true question of jurisdiction. The onus is on the party that challenges the award. Where the court is satisfied that there is an identified true question of jurisdiction, the tribunal had to be correct in its assumption of jurisdiction to decide the particular question it accepted and it is up to the court to determine whether it was. In assessing whether the tribunal exceeded the scope of the terms of jurisdiction, the court is to avoid a review of the merits.”

In applying this standard, the Court held that the Tribunal was correct in finding that it had jurisdiction to award damages for up-stream losses, as the U.S. operations were created for and inextricably linked to the distribution of HFCS in Mexico.

This decision is significant, as it directly addresses some of the earlier confusion with respect to the intersection of the *standards* of review contained within Canadian administrative law and the *grounds* for review under UNCITRAL Model Law. Essentially, on any issue of pure jurisdiction, the court will apply a correctness standard. However, any review on the merits, or any attempt to broaden the jurisdictional question, is to be resisted, and administrative law has no role in such review. This also underscores the high degree of deference settled on by Canadian courts towards the review of NAFTA Chapter 11 decisions.



## 2.10 CONCLUSION

To conclude, while the *Metalclad* decision did put a scare into the international investment community, subsequent jurisprudence has adopted a more deferential posture. Many commentators have suggested that the judicial posture now favours strict deference.<sup>114</sup> While the routes used to arrive at some of the decisions vary, particularly with the incorporation of elements from administrative review principles, it is generally accepted that Canadian courts have settled on a deferential posture, and the *Metalclad* decision is generally regarded as an anomaly. Moreover, the *Cargill* decision has gone a long way towards removing any ambiguity with respect to the role of administrative law in reviewing NAFTA Chapter 11 decisions. Having established this, this thesis will now examine the nature of NAFTA Chapter 11 review in the United States.

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<sup>114</sup> See Todd Weiler, *International Investment Law and Arbitration: Leading Cases from the ICSID, NAFTA, Bilateral Treaties and Customary International Law* (London: Cameron May, 2005), 717-719; Angela Cousins, "Case Comment: Canada (A-G) v. SD Myers," *14 Dalhousie Journal of Legal Studies* 191 (2005), at pg. 198.

## **CHAPTER III:**

# **JUDICIAL REVIEW OF NAFTA CHAPTER 11 ARBITRATIONS IN THE UNITED STATES**

## **3.1 INTRODUCTION**

Given the uneven but largely deferential state of NAFTA Chapter 11 review in Canada, it is instructive to look south of the border and to see how the other NAFTA signatories have addressed the issue. Seeing that Mexico has yet to entertain any such review in its courts, we are left with the United States, which will be the focus of this chapter.

The situation in the United States regarding NAFTA Chapter 11 review is far less complex than that found in Canada. The reasons for this are threefold. First, the number of cases have been minimal, with only one case addressing the issue directly (or two, if the appeal in that case is counted). Second, the review of arbitral awards in the United States is not conflated with traditional administrative review, as it is in Canada, and is treated as entirely separate. This removes a layer of ambiguity, as demonstrated by the hazy and infinitely complex interplay of review standards in Canada. Finally, the U.S. courts make absolutely no distinction between the review of investment arbitrations and the awards rendered in the field of commercial arbitration in general. This is distinct from the situation found in Canada, and indeed, under ICSID, which exists solely to adjudicate investment disputes.

In light of the foregoing, it could be said that the United States could serve as a model for simple and efficient review of NAFTA Chapter 11 investment arbitration awards.

### **3.2 INTERNATIONAL THUNDERBIRD GAMING CORPORATION v. UNITED MEXICAN STATES – TRIAL DECISION AND APPEAL<sup>115</sup>**

The *Thunderbird* decision was rendered by the District Court of the District of Columbia in February, 2007. Its significance lies in the fact that it is the only U.S. case to date to deal directly with the review of a NAFTA Chapter 11 award, and is therefore the only concrete example of the application of U.S. law to such review. As will be demonstrated, however, the tendency of U.S. courts to draw no distinction whatsoever between investment and commercial arbitral review allows us to examine cases in the commercial arbitration sphere as well.

With respect to the circumstances under which the dispute arose, International Thunderbird Gaming Corp. (“Thunderbird Corp.”) is a Canadian company which set up gaming operations in Mexico. Thunderbird Corp. had opened gaming facilities featuring two versions of their patented gaming machines - essentially electronic gambling machines featuring poker and slots. Embedded within the software for these gaming machines were randomized number generators setting the payout rates – completely invisible to the player.

Prior to the establishment of the facilities, Thunderbird Corp. had sought and received permission from Mexican authorities relating to the legality of their gaming machines. The approval from the Mexican government was premised on a description put forth by

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<sup>115</sup> *International Thunderbird Gaming Corporation v. United Mexican States*, 473 F. Supp. 2d 80; 2007 U.S. Dist. LEXIS 10070 (D.C. Dist. Ct.). [*“Thunderbird”*]

Thunderbird Corp. whereby the machines were described as skill machines that would test a user's ability without any luck or betting. Approval was conditional upon the machines functioning as described, in which case they would qualify as "commercial use" rather than falling under the ambit of the Mexican gaming authority. Shortly after the establishment of the gaming facilities, however, Thunderbird's operations in Mexico were shut down by Mexican authorities. In response, Thunderbird Corp. initiated a NAFTA Chapter 11 claim against the Mexican government.

The arbitration was held in Washington, DC, and the Tribunal ultimately ruled against Thunderbird Corp., awarding the Mexican government roughly \$1,250,000.00 in costs and fees. Unsatisfied with this result, Thunderbird Corp. sought vacatur (annulment) the award in the DC District Court pursuant to the U.S. *Federal Arbitration Act*<sup>116</sup> ("FAA").

Set aside criteria found within the FAA do not directly mirror those ostensibly applied under the relevant Canadian arbitration acts. Rather, the FAA criteria for set aside are as follows:<sup>117</sup>

- a) where the award was procured by corruption, fraud, or undue means;
- b) where there was evident partiality or corruption in the arbitrators, or either of them;
- c) where the arbitrators were guilty of misconduct in refusing to postpone the hearing, upon sufficient cause shown, or in refusing to hear evidence pertinent and material to the controversy; or of any other misbehavior by which the rights of any party have been prejudiced; or
- d) where the arbitrators exceeded their powers, or so imperfectly executed them that a mutual, final, and definite award upon the subject matter submitted was not made.

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<sup>116</sup> *Federal Arbitration Act*, 9 U.S.C. §§ 1 et seq. (2006). ["FAA"]

<sup>117</sup> *Ibid*, s. 10.

On the surface, the criteria outlined immediately above would appear to provide for a narrow set of grounds for vacatur. As will be demonstrated, however, U.S. courts have imputed two additional criteria to the analysis: manifest disregard of the law, and in some instances, public policy considerations, although the latter is rarely applied.

In terms of the actual standard of review, the Court articulated a standard that is very restrictive at the outset. Specifically, the Court stated that a “Court may vacate an award only if there is a showing that one of the limited circumstances enumerated in the *Federal Arbitration Act* is present, or if the arbitrator acted in manifest disregard of the law.”<sup>118</sup> In defining this standard, the Court cited numerous commercial arbitration cases, seemingly indifferent to the distinction between investment arbitration and commercial arbitration in general. Along these lines, the Court stated that “Courts have long recognized that judicial review of an arbitration award is extremely limited,”<sup>119</sup> implicitly rejecting any distinction between commercial and investment arbitration.

Notwithstanding this deferential posture, U.S. courts do impute an additional common law ground for review: “manifest disregard of the law” - as mentioned above. Indeed, it was upon these grounds that Thunderbird Corp. rested much of its argument, essentially maintaining that the Tribunal had manifestly disregarded the applicable law by failing to apply its own stated standards for the requisite burden of proof. As a result, the Court outlined the prevailing test of manifest disregard of the law that has emerged in American jurisprudence, stating that it is more than an error or misunderstanding and that the following two steps need to be satisfied for it to be triggered:<sup>120</sup>

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<sup>118</sup> *Thunderbird*, *supra* note 115, at para. 5.

<sup>119</sup> *Ibid*, at para. 5.

<sup>120</sup> *Ibid*, at para. 6.

(1) The arbitrators knew of a governing legal principle yet refused to apply it or ignored it altogether, and

(2) the law ignored by the arbitrators was well defined, explicit, and clearly applicable to the case."

Emphasizing the deferential posture, the Court also stated that the reasons given for a decision by a tribunal in law need not be adequate – or even existent. This stands somewhat in contrast to much of the Canadian jurisprudence and even the decisions rendered under the ICSID process. In this regard, the Court stated that “even where explanation for an award is deficient or non-existent, we will confirm [the award] if a justifiable ground for the decision can be inferred from the facts of the case.”<sup>121</sup>

This high level of deference was consistently observed throughout the District Court’s decision. The Court did, however, introduce a second test that intersects with that listed above. Specifically, Thunderbird Corp’s primary argument was that the tribunal had failed to apply the elements of its own burden of proof standard as follows:<sup>122</sup>

“The Tribunal shall apply the well-established principle that the party alleging a violation of international law giving rise to international responsibility has the burden of proving its assertion. If said Party adduces evidence that *prima facie* supports its allegation, the burden of proof may be shifted to the other Party, if the circumstances so justify.”

In this regard, Thunderbird Corp. rested its argument on the idea that it had indeed satisfied the burden of proof on a *prima facie* basis, and that the Tribunal had failed to appropriately shift the burden to Mexico. Consequently, Thunderbird Corp. argued that the tribunal had “manifestly disregarded the law” and failed the associated test.

In rejecting these submissions, the Court stated that for Thunderbird Corp. to succeed, there would have to have been a determination that Thunderbird Corp. had succeeded in

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<sup>121</sup> *Ibid.*, at para. 6.

<sup>122</sup> *Ibid.*, at para. 8.

putting forth a *prima facie* case, following which the tribunal “refused to require Mexico to overcome the resulting presumption of a violation of international law.” Only in such an instance would there be a manifest disregard of the law as per the two-step test described above. Finding that there was no basis to suggest that the Thunderbird had established a *prima facie* case, the Court declined to vacate the tribunal’s decision.<sup>123</sup>

While Thunderbird’s primary argument rested on “manifest disregard of the law,” several additional arguments were put forth based on the enumerated grounds under the FAA, particularly with reference to excess of authority and evidentiary shortcomings. These secondary arguments were soundly rejected by the Court with minimal consideration.<sup>124</sup>

While the decision was appealed, the District of Columbia Court of Appeals upheld the District Court’s findings and re-affirmed that the only basis for vacatur beyond the enumerated grounds was “manifest disregard of the law” and that the tribunal had properly applied the burden of proof.<sup>125</sup>

At its core, therefore, the *Thunderbird* decision represents a strong affirmation of deference towards NAFTA Chapter 11 arbitrations by U.S. courts. As stated in Mealey’s *International Arbitration Report*:<sup>126</sup>

“The significance of this case lies in the fact that a U.S. Court was reviewing an investment treaty award, and that the D.C. Court proved itself to be neutral, and applied a deferential review standard. Indeed, assuming the ‘manifest disregard’ standard is applicable to a NAFTA Chapter XI award, this standard is deferential to arbitrators’ decisions and

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<sup>123</sup> *Ibid.*, at para. 9.

<sup>124</sup> *Ibid.*, at paras.10 & 11.

<sup>125</sup> *International Thunderbird Gaming Corporation v. United Mexican States*, 255 Fed. Appx.531; 2007 U.S. App. LEXIS 26720 (U.S. Court of Appeals for the DC Circuit).

<sup>126</sup> Marco Schnabl and Timothy Nelson, “Nothing Left to Chance: Thunderbird v. Mexico and the Power of a Domestic U.S. Court to review a NAFTA Investment Arbitration Award,” *Mealey’s International Arbitration Report*, Vol. 22, #3, March 2007, at pg. 7.

would be triggered only in cases where it could be shown that arbitrators behaved irrationally or wholly disregarded controlling law.”

Two commentators have proceeded to suggest that the *Thunderbird* decision has positioned Washington, D.C. as the pre-eminent NAFTA Chapter 11 forum due to the high deference shown and quality of the judicial approach:<sup>127</sup>

[E]ven a hint of local hostility to arbitration might deter parties or tribunals from selecting the forum in question. The *Thunderbird* case, the first in which a D.C. court adjudicated a motion to vacate a NAFTA merits award, was therefore a vital test for the suitability of Washington, D.C. as an arbitral locale the NAFTA claims and any other investment treaty claims arbitrable under the ICSID Additional Facility or UNCTRAIL rule. If *Thunderbird* is to be read as a harbinger of things to come, U.S. courts have acquitted themselves well.

While the *Thunderbird* decision and its appeal do indeed constitute the entire body of U.S. law directly dealing with the review of NAFTA Chapter 11 awards to date, there is one other decision worth mentioning which addressed the review of NAFTA Chapter 11 arbitrations from a different angle.

### 3.3 LOEWEN v. UNITED STATES OF AMERICA<sup>128</sup>

While the *Loewen* decision did involve a judicial review of a NAFTA Chapter 11 award, the decision itself did not address the full review process. Rather, the U.S. District Court’s analysis was limited to the timing requirements for initiating judicial review, and having found that the applicant was in breach of these requirements, no actual review process on the merits of the tribunal decision was undertaken. The decision, however, is instructive to the extent that it demonstrates the rigid approach

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<sup>127</sup> *Ibid*, at pg. 7.

<sup>128</sup> *Loewen v. United States of America*, 2005 U.S. Dist. LEXIS 44999 (DC Dist. Ct.). [“*Loewen*”]



taken by U.S. courts in applying the relevant arbitral law, along with a tendency to avoid the legal gymnastics employed in other jurisdictions and - as will be demonstrated later - in ICSID itself.

The original claim was arbitrated in the U.S. using the ICSID Additional Facility Rules. In the facts of the case, a Canadian petitioner, Raymond Loewen, along with his Canadian corporation, the Loewen Group Inc., initiated a NAFTA Chapter 11 claim against the U.S. government as a result an adverse jury award of \$500 million from a Mississippi court relating to its U.S. operations. Citing a lack of jurisdiction, the tribunal denied the petitioner's claim, as there were issues involving U.S. ownership of the Canadian corporation.

While the decision was rendered on June 26, 2003, the U.S. requested a supplementary decision relating to a component of the petitioner's claim involving NAFTA Art. 1116 that had not been expressly disposed of by the tribunal. The petitioner, for his part, submitted that this represented a failure by the tribunal to consider his NAFTA Art. 1116 claim. Nevertheless, the tribunal declined to issue a supplementary decision, stating in its August 17, 2004 decision as follows:<sup>129</sup>

“[T]he dismissal of all the claims 'in their entirety' following the examination of the merits was necessarily a resolution of the article 1116 claim. That dismissal was a consequence of the reasoning expressed.... We therefore reject the argument that the Award did not deal with the article 1116 claim.”

Loewen proceeded to initiate his appeal for vacatur of the tribunal decision on December 13, 2004, on the basis that the tribunal had engaged in “disturbing misconduct” and had

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<sup>129</sup> *The Loewen Group, Inc. and Raymond L. Loewen v. United States of America*, ICSID Case No.ARB(AF)/98/3, Aug. 17, 2004, at 6.

acted in “manifest disregard of the law” by not considering all of the relevant evidence.<sup>130</sup> Irrespective of any legal merits the appeal may have had, however, the primary consideration was whether Loewen was in breach of the 3-month limitation period provided for under the FAA for launching a judicial appeal of a final arbitral award. Seeing that there is no exception to the 3-month limitation, under either statute or at common law, Loewen was in *prima facie* breach, as the tribunal decision was rendered on June 26, 2003 and the appeal was not initiated until December 13, 2004. Acknowledging this, Loewen submitted that the June 26, 2003 decision was not final for purposes of a vacatur application due to the U.S. request for a supplementary decision. In rejecting this argument and finding Loewen in breach of the limitation period, the Court held that the language under both the FAA and the ICSID Additional Facility were such that an award is final for purposes of limitation periods irrespective of any request for a supplementary decision. The Court opined that to rule otherwise would allow any party to render an award incomplete by simply submitting a request for a supplementary decision on a minor aspect of the award.<sup>131</sup>

In effect, therefore, the *Loewen* decision suggests that U.S courts will generally adopt a very restrictive approach in interpreting both the FAA and the relevant procedural arbitral rules as it pertains to NAFTA Chapter 11 judicial review – even if it results in a potential unfairness to a party involved.

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<sup>130</sup> *Ibid*, at para. 4.

<sup>131</sup> *Ibid*, at para. 10.

### 3.4 COMMERCIAL ARBITRATION DECISIONS

In light of the foregoing, the procedural steps to be followed in the review of NAFTA Chapter 11 awards by U.S. courts are rather straightforward and narrow in contrast to that observed in other jurisdictions, at least in the very limited body of jurisprudence made available. Essentially, the limited grounds for review under the FAA are narrow and strictly adhered to, and although the “manifest disregard of the law” test is also applied, the case law suggests that it is applied only in egregious cases. The fact remains, however, that “manifest disregard” is a non-statutory ground for review that could potentially be broadened. Accordingly, there is value looking at its application in the commercial arbitration context upon which the U.S. NAFTA Chapter 11 cases base their analysis. Indeed, the fact that U.S. courts treat the review of commercial and investment arbitration as one and the same allows us to more fully delineate the scope of the “manifest disregard” ground for review.

The leading case cited in the *Thunderbird* decision in applying the “manifest disregard” test was *Abdullah Al-Harbi v. Citibank*<sup>132</sup>, in which the U.S. Court of Appeals for the D.C. Circuit upheld the District Court’s decision to deny vacatur of a commercial arbitration award. In the facts of the case, the plaintiff alleged that the defendant bank had defrauded him and/or breached its fiduciary duty in a transaction in which he paid nearly \$6 million for a 50% stake in Czech real estate. The losses on the transaction amounted to \$7.5 million. After going to binding arbitration, Al-Harbi was awarded \$1.1

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<sup>132</sup> *Abdullah Al-Harbi v. Citibank*, 85 F.3d 680; 318 U.S. App. D.C. 114; 1996 U.S. App. LEXIS 13814 (U.S. Court of Appeals for the DC Circuit). [“*Al-Harbi*”]

million. Unsatisfied with the award, he sought vacatur, which was denied by the District Court and subsequently appealed to the Court of Appeals.

The Plaintiff's argument for vacatur was based first on "evident partiality" of the arbitrator due to an undisclosed relationship with Citibank, one of the enumerated grounds for set aside under the FAA. The Plaintiff also argued for vacatur on the basis of "manifest disregard of the law" by only considering procedural factors and not substantive factors despite the fact that the submission agreement upon which the arbitrator was to make his decision was to be based on "the procedural *and* substantive laws of the Southern District of New York."<sup>133</sup> In discussing the latter, the Court acknowledged that courts "recognize a limited non-statutory ground for vacating an arbitration award where the arbitrator has acted in manifest disregard of the law."<sup>134</sup> However, in delineating this standard, the Court emphasized its extremely limited nature, citing the seminal U.S. Supreme Court decision, *Wilco v. Swan*<sup>135</sup>, for the proposition that "interpretations of the law by the arbitrators in contrast to manifest disregard are not subject, in the federal courts, to judicial review for error in interpretation." In other words, mere errors in interpretation are not sufficient for vacatur. Rather, the error must be egregious and manifest to trigger a vacatur award. As stated by the Court:<sup>136</sup>

"[T]his non-statutory theory of vacatur cannot empower a District Court to conduct the same de novo review of questions of law that an appellate court exercises over lower court decisions. Indeed, we have in the past held that "it is clear that [manifest disregard] means more than error or misunderstanding with respect to the law."

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<sup>133</sup> *Ibid*, at para. 12.

<sup>134</sup> *Ibid*, at para. 4.

<sup>135</sup> *Wilco v. Swan*, 346 U.S. (U.S. Sup. Ct.), at 436-437.

<sup>136</sup> *Al-Harbi*, *supra* note 132, at para. 11.

On this basis, the Court denied the plaintiff's appeal for failing to satisfy the onerous threshold.

While not cited in the *Thunderbird* decision, a more thorough analysis of the "manifest disregard" standard was also undertaken by the United States Court of Appeals for the Second Circuit in *Duferco International Steel Trading v. T. Klavenes Shipping*.<sup>137</sup> While the facts of the case are complex, the dispute involved damage to a chartered shipping vessel. In seeking vacatur of the arbitrator's award, the plaintiff corporation argued "manifest disregard of the law," which was denied by the District Court. On appeal, the Court undertook a thorough analysis of "manifest disregard."

Citing the origins of "manifest disregard" from the aforementioned obiter passage in *Wilco v. Swan*, the Court underscored the notion that such a review is "severely limited," that it is "highly deferential," and that successful instances of its application are extremely rare.<sup>138</sup> In this respect, the Court stated as follows:<sup>139</sup>

"Our reluctance over the years to find manifest disregard is a reflection of the fact that it is a doctrine of last resort -- its use is limited only to those exceedingly rare instances where some egregious impropriety on the part of the arbitrators is apparent, but where none of the provisions of the FAA apply. It should be remembered that arbitrators are hired by parties to reach a result that conforms to industry norms and to the arbitrator's notions of fairness. To interfere with this process would frustrate the intent of the parties, and thwart the usefulness of arbitration, making it "the commencement, not the end, of litigation."

In application, this means that mere errors of interpretation are not sufficient to trigger vacatur. Indeed, the high threshold is such that the Court opined as to the lack of precedent available outlining successful instances of the standard being applied, and the

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<sup>137</sup> *Duferco International Steel Trading v. T. Klavenes Shipping*, 333 F.3d 383; 2003 U.S. App. LEXIS 12734; 2003 AMC 1521 (U.S. Court of Appeals for the Second Circuit). [*"Duferco"*]

<sup>138</sup> *Ibid*, at para. 19.

<sup>139</sup> *Ibid*, at para. 21.

resulting ill-defined parameters of its application. Accordingly, the Court proceeded to outline a refined, 3-step inquiry to be undertaken when considering whether there has been a “manifest disregard of the law”:<sup>140</sup>

1. whether the law that was allegedly ignored was clear, and in fact explicitly applicable to the matter before the arbitrators.
2. whether the law was in fact improperly applied, leading to an erroneous outcome.
3. subjective knowledge on the part of the arbitrator with respect to the law that was ignored.

In articulating this test, the Court emphasized that if the law was misapplied but the outcome was nevertheless correct, the award will not be set aside. Likewise, if the outcome achieved was one of several which could reasonably be arrived at, the award will not be set aside. As such, even a “barely colorable” justification for a particular outcome could save an arbitral award.<sup>141</sup> On this basis, although there were significant shortcomings in the arbitral decision, the award was not set aside. Clearly, the “manifest disregard” standard is very strict and rigidly applied in the commercial arbitration context.

Despite this standard, there have been calls from some academic commentators to have the standard done away with altogether. In a 2005 article published in the *American Review of International Arbitration*, for instance, Hans Smit argued that the U.S. Supreme Court ought to clarify the standard or do away with it entirely. His argument is premised on the contention that the standard as originally conceived is to only be applied

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<sup>140</sup> *Ibid.*, at para. 23.

<sup>141</sup> *Ibid.*, at para. 28.

if there has been a manifest disregard of “mandatory law” and that courts have broadened their analysis beyond this level in considering vacatur of arbitral awards.<sup>142</sup> Likewise, in a 2007 article published in the *University of Louisville Law Review*, Nicholas Weiskopf echoed Smit’s contention that the manifest disregard standard is ill-defined and leads to uncertainty in arbitral outcomes, and that clarification from the Supreme Court is needed. In this vein, Weiskopf observed:<sup>143</sup>

“In discussing the confusion in the ‘manifest disregard’ case law, certain points should be taken into account when, and if, any effort is made to return to the drawing board. It would be best if that occurred. Unless and until there is a defined expectation as to whether arbitrators must actually adhere strictly to established legal rules in the different types of cases, statutory and nonstatutory, one cannot define a viable standard of review or determine if any review on the merits is really necessary... ‘Manifest disregard’ has not worked well in practice, and the cases which embrace it send a largely false signal. This requires fixing, and means to effectuate repairs are available. Hopefully, particularly if Congress remains silent, the United States Supreme Court will have more to say on this subject in the near future because the current state of the case law is shockingly inadequate.”

Essentially, there is an emerging view among legal scholars that the manifest disregard standard is flawed and needs clarification. Unfortunately, when the U.S. Supreme Court was given a golden opportunity to provide such a clarification, it failed to do so.

In 2008, the Supreme Court addressed the issue of arbitral review in the *Hall Street Associates v. Mattel, Inc.* decision.<sup>144</sup> The dispute centered around a commercial lease involving Hall Street Associates as lessors and Mattel as lessees. Hall Street initiated a claim against Mattel alleging that Mattel had improperly terminated the lease and had failed to comply with the applicable environmental laws during the term of the lease.

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<sup>142</sup> Hans Smit, “Note & Comment: The Time is Ripe for the U.S. Supreme Court to Bury the Misconceived Doctrine of Manifest Disregard of the Law,” *16 Am. Rev. Int’l Arb.* 211(2005), at pg. 212.

<sup>143</sup> Nicholas Weiskopf, “Arbitral Injustice: Rethinking the Manifest Disregard Standard for Judicial Review of Awards,” *46 U. Louisville L. Rev.* 283 (2007), at pp. 311 & 312.

<sup>144</sup> *Hall St. Assocs. v. Mattel, Inc.*, 128 S. Ct. 1396 (2008). (“*Hall St.*”)

This second issue - pertaining to environmental laws - was submitted to arbitration with an arbitral clause allowing for judicial review of the arbitral award for plain legal errors. In other words, the parties were attempting to lower the standard of review. At issue, therefore, was whether "the [FAA] precludes a federal court from enforcing the parties' clearly expressed agreement providing for more expansive judicial review of an arbitration award than the narrow standard of review otherwise provided for in the FAA."<sup>145</sup>

In granting Hall Street Associates' petition for *certiorari*, the Supreme Court answered the question in the affirmative, holding that the FAA prohibits expanded judicial review through private ordering and that the grounds for vacatur under the FAA are "exclusive."<sup>146</sup>

Unfortunately, the Court did not indicate how its declaration that grounds for vacatur under the FAA are "exclusive" impacts the non-statutory "manifest disregard" standard, which would presumably not fit within such a framework. As a result, the confusion surrounding the application of the standard has only been augmented since the holding in *Hall St.*, with some courts finding that the standard can no longer be used, and others continuing to apply it. This confusion is highlighted in a recent article published in the *Georgia Law Review* in which the author argues that while the U.S. Supreme Court took some steps towards abrogating the manifest disregard standard, it failed to go all the way. Consequently, he argues that Congressional action is required:<sup>147</sup>

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<sup>145</sup> Petition for Writ of Certiorari at i, *Hall Street Assocs. v. Mattel, Inc.*, 128 S. Ct. 1396 (2008) (Jan. 12, 2007) (No. 06-989).

<sup>146</sup> *Hall St.*, *supra* note 144, at pp. 1396, 1400, 1401, 1403, 1404, and 1406.

<sup>147</sup> Kevin Patrick Murphy, "Alive But Not Well: Manifest Disregard After Hall St.," *44 Ga. L. Rev.* 285 (2009), at pp. 314-315.



“The confusion surrounding manifest disregard requires decisive and clear action at the federal level to eliminate the doctrine. Given the low number of successful manifest disregard claims, few parties would suffer from such action. Due to the frequent litigation over the issue, the beneficiaries would be many...Removing manifest disregard as a ground for vacatur makes judicial enforcement more predictable and, thus, less necessary. Losing parties will feel more inclined to abide by arbitration awards without judicial enforcement. Manifest disregard is still alive after *Hall Street*, but not well. Its disfavored position and the uncertainty surrounding its future jeopardize the arbitration process. Congress should step in and eliminate it sooner, rather than later.”

In light of this, the *Hall Street*. decision has potentially added an additional layer of confusion in the application of the manifest disregard standard - over and above the pre-existing blurry boundaries of its application – by bringing into question its very legitimacy with an ambiguous ruling. As a consequence, there is now a split in the circuit courts as to whether the standard can even be applied.<sup>148</sup> Nevertheless, this has simply resulted in increased deference, in that some courts will no longer allow for its application in any event, whereas other courts continue to apply it just as they always have. As such, the already strict grounds for judicial review in the U.S. have only been strengthened.

On a final note, however, there remains the possibility that an additional non-statutory ground for annulment could emerge in the U.S.: public policy. While not discussed in the *Thunderbird* case, this newer and rarely used ground for annulment has crept into a small number of arbitration cases involving collective bargaining arbitration. The line of authority begins with the D.C. Circuit Court of Appeals decision, *Cole v. Burns*

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<sup>148</sup> See Hiro N. Aragaki, “The Mess of Manifest Disregard,” *119 Yale L.J. Online 1* (2009); and John Steffens, “Consistent With Inconsistency: The Sixth Circuit Keeps Manifest Disregard After Hall St.,” *2009 J. Disp. Resol 531*.

*International Security Services*.<sup>149</sup> This decision did not involve arbitration *per se*, but rather considered an appeal from a lower court decision compelling arbitration arising from an employment contract. In obiter, the Court opined on the nature of the “public policy” standard.<sup>150</sup>

“The grounds listed in the FAA, however, are not exclusive. Indeed, even in the context of arbitration in collective bargaining--where judicial review of arbitral awards is extremely limited--awards may be set aside if they are contrary to ‘some explicit public policy’ that is ‘well defined and dominant’ and ascertained ‘by reference to the laws and legal precedents.’ There is no doubt that in the scope of review of arbitration in cases involving mandatory arbitration of statutory claims is at least as great as the judicial review available in the context of collective bargaining. ”

The example cited by the Court was behavior enabling sexual harassment in the workplace, which would run against public policy and constitute grounds for vacatur.

While the “public policy” exception would appear to be confined to the employment realm, some more recent cases speak of the exception applying to the review of arbitration in general, as illustrated by the following passage from a 2001 D.C. District Court of Appeals decision:<sup>151</sup>

“It is well settled that a court's review of an arbitration award is limited. In addition to the limited statutory grounds on which an arbitration award may be vacated, arbitration awards can be vacated only if they are in manifest disregard of the law, or if they are contrary to some explicit public policy that is well defined and dominant and ascertained by reference to the laws or legal precedents.”

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<sup>149</sup> *Cole v. Burns International Security Services*, 323 U.S. App. D.C. 133, 105 F.3d 1465 (D.C. Cir. 1997). [“*Cole*”]

<sup>150</sup> *Ibid.*, at para. 90.

<sup>151</sup> *Laprade v. Kidder, Peabody and Co. Inc.*, 246 F.3d 702; 345 U.S. App. D.C. 358; 2001 U.S. App. LEXIS 7381 (U.S. Court of Appeals for the D.C. Circuit), at para. 6.

While this could have the potential to result in increased judicial assertiveness down the road, it has yet to creep into the realm of investment or commercial arbitration review, and the review standard remains strict.

### 3.5 CONCLUSION

At its core, the “manifest disregard” test can be broadly analogized to the “patent unreasonableness” standard previously used in Canadian jurisprudence. From this perspective, the simplicity and high threshold inherent in the American approach is preferable even to the situation in Canada, which seems to have settled on a very deferential judicial posture to the review of investment arbitrations. Indeed, the review of NAFTA Chapter 11 cases in the United States is limited to the narrow set of criteria stipulated under the FAA, and the single common law standard of “manifest disregard,” which is highly deferential, consistently applied, and well defined due the broader set of case law available as precedent – notwithstanding the lingering confusion brought about by the *Hall Street* decision. While there remains the potential that an additional non-statutory ground for review could be recognized in American case law, at this juncture “the “public policy” exception has remained confined to employment arbitration, and has not carried over into the review of general commercial arbitration, and by extension, investment arbitration.

In conclusion, while there are some differences between the review standards applied in Canada and the U.S., both jurisdictions have adopted a very deferential approach to the review of NAFTA Chapter 11 awards that is conducive to finality of outcome and the advantages inherent in using arbitration. As such, foreign investors investing in either country can be reasonably confident that any disputes with the host government will be

resolved expeditiously and fairly with minimal potential for judicial intervention or forum shopping. Importantly, this favourable investment climate and finality of outcome is achieved without resorting to the review infrastructure set up under ICSID, which ironically, appears to operate under greater uncertainty than that observed under traditional arbitration and judicial review processes in Canada and the U.S. This will be the focus of the following chapter.

## **CHAPTER IV:**

### **ICSID AS AN ALTERNATIVE TO JUDICIAL REVIEW UNDER NAFTA CHAPTER 11**

#### **4.1 INTRODUCTION**

In light of the inconsistent – albeit largely deferential - application of review criteria to NAFTA Chapter 11 arbitrations by courts in Canada and the United States, many observers have searched for a viable means through which consistent and deferential review could be applied. The most obvious mechanism is to simply utilize the arbitration infrastructure set up under the International Centre for the Settlement of Investment Disputes (“ICSID”), as it completely precludes judicial review of any kind. Instead, the ICSID employs its own internal review process should a party decide to challenge an arbitral decision rendered under its auspices. At this stage, however, such application is merely theoretical under the NAFTA, as the use of the ICSID requires both parties to have ratified the 1965 Washington Convention, mentioned previously in Chapter I. Canada only recently ratified the ICSID Convention, and Mexico remains a non-signatory. As a result, the invocation of ICSID jurisdiction in the settlement of NAFTA Chapter 11 disputes has not yet occurred, even though it is explicitly foreseen in the text of the NAFTA itself.

This chapter will explore the background and function of ICSID, as well as examine the major review cases rendered under its annulment procedure. The consistency of these decisions will be explored along with the efficiency of the process itself. This record will

then be contrasted with decisions rendered by courts, as seen in the last three chapters. After having undertaken this analysis, a determination will be made as to whether the recent ratification of the ICSID Convention by Canada will help or hurt the deference applied to NAFTA Chapter 11 decisions.

## 4.2 BACKGROUND TO ICSID

While the minimization of the role of national court systems has long been a goal in international commercial arbitration, it is in the realm of investment arbitration, as administered by the ICSID, that this objective has largely been achieved. Interestingly, the initial impetus for the ICSID came from the International Bank for Reconstruction and Development (also referred to generically as the World Bank). A component of the World Bank's mandate is the promotion of economic development and macro-economic growth in less developed countries.<sup>152</sup> In the 1960s, a perceived hindrance to this development was the sense that foreign investors were reticent to invest in such countries out of fear that their investments were vulnerable to expropriation and undue interference. As such, the World Bank sought to create an arbitral system not bound to any particular nation-state that would mediate disputes arising between a foreign investor and a nation-state government relating to interference with the investment – regulatory or otherwise.<sup>153</sup> The drafting of the Convention to create the ICSID was concluded by 1965. After coming into force in 1966, it became apparent that the Washington Convention's members were primarily from poor African countries, underscoring its initial emphasis

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<sup>152</sup> Reisman, *supra* note 10, at pg. 46.

<sup>153</sup> *Ibid.*, at pg. 47.

on economic development.<sup>154</sup> In subsequent years, however, membership grew, to the point that most major industrialized countries (and even least developed countries) have ratified the Washington Convention, with the notable exception of Mexico. In this respect, although the Convention retains its principles of investor protection, perceived emphasis as to the real benefits of the Convention have shifted from the promotion of economic development in poor countries to the promotion of FDI flows in general. Indeed, the first case under the ICSID's dispute settlement mechanism was not decided until 1974, but starting in the 1990's, there was a marked increase in the number of arbitrations.<sup>155</sup> By the early 2000's new case registrations averaged one per month.<sup>156</sup> Most important to this analysis, however, is that the ICSID is largely autonomous and self-contained, and any arbitration conducted under its auspices is completely free from judicial review – thus rendering the arbitral *situs* irrelevant. Instead, any review of an ICSID award is conducted internally within the ICSID by means of a specialized review mechanism. In this respect, the ICSID provides an arbitral infrastructure completely separate from the traditional channels of ad hoc arbitration under UNCITRAL rules and its associated use of national court systems for the review of awards.<sup>157</sup> In effect, it is an alternative system.

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<sup>154</sup> C. Schreuer, "Course on Dispute Settlement: International Centre for Settlement of Investment Disputes, 2.1," *United Nations Conference on Trade and Development (UNCTAD)*, 10. <available from: <http://r0.unctad.org/disputesettlement/course.htm>>

<sup>155</sup> *Ibid.*, at pg. 11.

<sup>156</sup> *Ibid.*, at pg. 11.

<sup>157</sup> Richard B. Lilich and Charles N. Brower, *International Arbitration in the 21<sup>st</sup> Century: Towards "Judicialization" and Uniformity?* (New York: Transnational Publishers, 1994), 200: Andre Giardina describes how sitting on two ICSID ad hoc committees reinforced his belief "that ICSID arbitration, and more specifically its award review mechanism, is entirely self contained and especially autonomous from national legal orders."

The review of awards under the ICSID falls under the general rubric of annulment. The annulment mechanism itself is provided for in Washington Convention Art. 52 and takes place before a separate ad hoc committee appointed by the Secretary General for each case.<sup>158</sup> The committee is made up of three individuals, none of whom can have served as arbitrators in the original decision or be nationals of either party in dispute.<sup>159</sup> As with traditional judicial review, either party may make a request for annulment.<sup>160</sup> Generally, the request must be made within 120 days of the decision being rendered. The committee can choose to annul all or part of the award given the facts of the case, and it is therefore possible to have parts of a decision upheld while setting aside another part, similar to what occurred in *Metalclad*.<sup>161</sup> In terms of procedure, the ad hoc committee essentially operates as a new tribunal in its own right, subject to the same procedural directives as the original tribunal, but functions under a more limited mandate.<sup>162</sup> In this regard, the specific allowable grounds for annulment under the Washington Convention are as follows:<sup>163</sup>

1. The tribunal was not properly constituted.
2. The tribunal exceeded its powers.
3. There was corruption on the part of a member of the tribunal.

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<sup>158</sup> ICSID Convention, *supra*, Art. 52.

<sup>159</sup> Reisman, *supra* note 10, at pg. 50.

<sup>160</sup> D. Wang, "Course on Dispute Settlement: International Centre for the Settlement of Investment Disputes, 2.8," *United Nations Conference on Trade and Development* (UNCTAD), 17. <available from: <http://r0.unctad.org/disputesettlement/course.htm>>

<sup>161</sup> *Mexico v. Metalclad Corp.*, [2001] B.C.J. No. 950. [*"Metalclad"*]

<sup>162</sup> Reisman, *supra* note 10, at pg. 50.

<sup>163</sup> ICSID Convention, *supra* note 16, Art. 52.



4. There was a serious departure from a fundamental rule of procedure.
5. The award failed to state the reasons upon which it is based.

As is evident, such grounds for annulment are strictly limited to defects of a procedural nature and appear to preclude any re-evaluation of the factual or legal merits of a decision. As will be discussed, however, the grounds for annulment under ICSID can be interpreted just as flexibly as the set-aside criteria found under UNCITRAL Model Law, thereby limiting its utility as a real alternative to judicial review. The following section will explore the relevant jurisprudence in this regard.

### 4.3 KLOCKNER v. GOVERNMENT OF CAMEROON

The *Klockner* award represented the first instance of the use of the annulment mechanism under ICSID. The decision was rendered in 1984.<sup>164</sup> Prior to that time, the use of Art. 52 as an appellate mechanism existed as a mere theoretical possibility despite the fact that ICSID had entertained, but ultimately dismissed, annulment proceedings regarding fourteen prior awards.<sup>165</sup> As a result, *Klockner* was closely watched by the investment community as a test of how Art. 52 could be used going forward.

In terms of the dispute itself, the original case was centered around a multi-national West German corporation, Klockner, which had contracted in 1973 to begin supplying Cameroon, a West African country, with fertilizer products and the associated know-how to use them effectively. To help achieve this aim, a factory was to be constructed in

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<sup>164</sup> *Klöckner v. Cameroon*, Decision on Annulment, 3 May 1985, 2 ICSID Reports 95. [“*Klockner*”]

<sup>165</sup> Reisman, *supra* note 10, at pg. 51.

Cameroon through a joint venture involving Klockner and the Government of Cameroon, with Klockner holding a 51% stake in the joint venture and the government holding the remainder. As part of a contract for construction, payment was guaranteed to Klockner through the joint venture. In subsequent years, however, it became apparent to Klockner that the project was not going to be profitable, and that there were serious deficiencies at all stages, although this information was not revealed to the Cameroon government. In 1978, after the factory output fell below projections, the government sought another capital infusion to upgrade the plant, inviting Klockner to participate. In refusing, Klockner relinquished majority control of the joint venture. Ultimately, the project failed completely, and Klockner did not end up getting paid. As a result, Klockner initiated an arbitration claim against the government of Cameroon under ICSID, as had been foreseen as a possibility under the primary contract. In deciding against Klockner, the tribunal concluded that Klockner had not been forthright in its dealings with the Cameroonian government. Citing the French contract law that served as a basis for contract law in Cameroon, the tribunal held that Cameroon was relieved from the obligation to pay due to Klockner's failure to perform. The tribunal also dismissed Cameroon's counter-claims, but given that damages were not awarded, the decision constituted a victory for Cameroon.<sup>166</sup>

Klockner, for its part, proceeded to seek annulment proceedings under Art. 52, and used arguments largely mirroring the dissent of one of the arbitrators in the initial decision. One of Klockner's primary arguments rested on excess of jurisdiction. Specifically, a sub-contract to the initial agreement with the Cameroonian government dealing with

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<sup>166</sup> *Ibid*, at pg. 51-57.

management issues provided for the use of the International Chamber of Commerce in adjudicating any related disputes, rather than ICSID. As such, Klockner submitted that the ICSID tribunal was wrong to have assumed jurisdiction in this area. While finding some flaws in the Tribunal's jurisdictional findings on this point, the annulment committee opted to not substitute its own judgment, yielding to a presumption of validity with respect to the tribunal's findings.<sup>167</sup>

The Committee's deference, however, ended at this. Essentially, the committee found that the tribunal had manufactured a supposed principle of French law dealing honesty/openness requirements, treated it as authoritative, extrapolated it to the international business arena, and applied it to Klockner's activities. Without undertaking its own analysis in this regard, the committee held that the tribunal's error was sufficient to have the award set aside. As stated by the committee:

“In the absence of any information, evidence or citation in the Award, it would seem difficult to accept, and impossible to presume, that there is a general duty, under French civil law, or for that matter other systems of civil law, for a contracting party to make a ‘full disclosure’ to its partner.”<sup>168</sup>

The committee added:

“In its reasoning, limited to postulating and not demonstrating the existence of a principle or exploring the rules by which it can only take concrete form, the Tribunal has not applied “the law of the Contracting State.”<sup>169</sup>

So, while the Committee concluded that there was a misapplication of law, it couched its determination in the language of inadequate reasons, which fell under the fifth ground of annulment under Art. 52. Technically, such a determination would require the award to

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<sup>167</sup> *Klockner*, *supra* note 164, at pg. 109.

<sup>168</sup> *Ibid*, at pg. 114.

<sup>169</sup> *Ibid*, at pg. 114.

be set-aside, as a re-evaluation of the legal merits of a tribunal decision is not allowed for. In effect, the committee was engaging in similar legal gymnastics to that used in *Metalclad*, as it simply undertook a re-evaluation of the soundness of a tribunal decision and fit it into an enumerated ground for annulment.<sup>170</sup>

In light of the *Klockner* decision, many commentators thought that the outcome would provide an incentive for losing parties under ICSID arbitration to seek annulment and have awards subject to detailed scrutiny. Such a scenario would run counter to one of the very benefits that ICSID purported to provide, namely finality and efficiency. These fears were largely confirmed when the losing party in the ICSID tribunal decision immediately subsequent to *Klockner*, *AMCO v. Republic of Indonesia*,<sup>171</sup> sought annulment under Art. 52.

#### 4.4 AMCO v. REPUBLIC OF INDONESIA

The core facts in the *AMCO* case are straightforward. Indonesia had a program for attracting FDI whereby foreign investors would receive tax breaks and various other inducements for capital investments in the country. Under such an arrangement, a U.S. company named AMCO agreed to invest in the construction and management of a hotel in Jakarta in a joint venture with an Indonesian company which had strong ties with the Indonesian military. AMCO's total investment was to be \$3 million. When construction

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<sup>170</sup> *Klockner* also initiated a second ICSID arbitration which remains unpublished, although it was decided in favour of the company on January 1988. A subsequent annulment challenge was partially successful.

<sup>171</sup> *Amco v. Indonesia*, Decision on Annulment, 16 May 1986, 1 ICSID Reports 509. [“*AMCO*”]

was completed, however, the relationship with the joint venturer deteriorated and many complaints were submitted against AMCO. Further, the Indonesian government itself had complained to AMCO that the capital investment promised had not materialized. All of these complaints were ignored by AMCO, and on March 30, 1980, army and police personnel seized the hotel and expelled management, alleging that AMCO had failed to honour the terms of its license. After unsuccessful attempts to have the situation rectified in Indonesian court, AMCO filed an ICSID claim for \$9 million pursuant to the ICSID arbitration clause in the contract.<sup>172</sup>

In its decision, the tribunal held that AMCO had indeed violated the terms of the license through non-payment of capital and that this violation was a breach of the investment agreement, but not necessarily a material one. Interestingly, however, the tribunal ultimately ruled in favour of AMCO, stating that the means employed by the Indonesian government in seizing the property were unlawful and were not in accordance with basic tenets of due process at international law, among other possible grounds of review. In effect, therefore, the Indonesian government's decision to terminate the arrangement was substantively justified, but procedurally unjustified, in execution. As such, AMCO was awarded \$3.2 million plus interest and Indonesia immediately sought annulment under Art. 52.<sup>173</sup>

The committee differed with the tribunal by finding that AMCO's breach was in fact material, and on the view that the Indonesian government was justified at law in severing

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<sup>172</sup> Reisman, *supra* note 10, at pgs. 66-69.

<sup>173</sup> *Ibid*, at pg. 68.

the relationship. The committee also found that the Tribunal had failed to adequately explain its accounting of AMCO's payments to the Indonesian government, stating:<sup>174</sup>

“The ad hoc committee feels obliged to consider that the Tribunal manifestly exceeded its powers in failing to apply fundamental provisions of Indonesian law and failed to state reasons for its calculation of P.T. Amco's investment.”

As a result, the committee annulled the portions of the award dealing with these transgressions, resulting in a partial nullification of the award.

The matter, however, was far from settled. Under ICSID Rules, a losing party can apply for a new arbitration following an annulled award. The potential for circuitous, lengthy litigation arising from this procedural rule is obvious, and indeed, AMCO availed itself of this option. At issue was just how much of the matter was to be re-litigated, as well as the limits of *res judicata*, since the portions of the award that were not annulled could in theory still stand. Ultimately, the committee opted to apply *res judicata* narrowly, opening the door for extensive re-litigation.<sup>175</sup> In doing so, the *AMCO II* tribunal cited a desire to avoid treating the ad hoc committee as a court of appeal with binding authority over subsequent tribunals. Unfortunately, however, such reasoning had the ancillary effect of encouraging litigation and undercutting the finality of ICSID decisions. Regardless, the new Tribunal found in favour of AMCO, awarding \$2,567,966.20 plus interest, close to the original award – although it can be assumed that litigation costs would have consumed some of this amount.<sup>176</sup> Essentially, the new Tribunal held that because both the first Tribunal and the committee found AMCO in breach of its license, it was not appropriate to have awarded it \$2.5 million for procedural

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<sup>174</sup> *AMCO*, *supra* note 171, at para. 98.

<sup>175</sup> Reisman, *supra* note 10, at pg. 76.

<sup>176</sup> *Ibid.*, at pg. 78.

violations on the part of the Indonesian government. Instead, the tribunal manufactured a new legal principle, termed the “tainted doctrine,”<sup>177</sup> which essentially allows for full compensation to the investor in the presence of non-defined tainting factors even if a party were ostensibly operating within the parameters of the law.<sup>178</sup>

Simply put, after years of litigation, two tribunal decisions, and two attempts at annulment under Art. 52, AMCO ended up with an award nearly identical to that awarded at the outset. At this juncture, it did not appear that ICSID was proving itself to be a viable alternative to traditional commercial arbitration with the associated review function held by domestic courts. In fact, the reasons for judgment appeared to be equally incoherent as that arrived at in decisions such as *Metalclad*, if not moreso. Likewise, the potential for extensive litigation under ICSID was just as prevalent as the appellate process in domestic courts. It is with this background that the following annulment claim under Art. 52 of ICSID had great significance.

#### 4.5 MINE v. GUINEA

The *MINE v. Guinea*<sup>179</sup> decision is considered by many to be somewhat of a repudiation of *Klockner* and a step towards confirming the finality of ICSID awards – at least at the time. In terms of the facts of the dispute, the government of Guinea had set up a public/private joint venture in 1963 for the purpose of mining bauxite. In 1971, the

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<sup>177</sup> *Ibid*, at pg. 78.

<sup>178</sup> After this decision, AMCO and Indonesia again sought annulment of the award. In an unpublished decision, the award was upheld.

<sup>179</sup> *MINE v. Guinea*, Decision on Annulment, 22 December 1989, 4 ICSID Reports 79. [“*MINE*”]

Guinean government contracted with the Maritime International Nominees Establishment (MINE), a company based in Liechtenstein, for the transport of bauxite exports, and created another joint venture with MINE to facilitate this. As part of the second joint venture, MINE was obligated to provide the personnel and ships necessary for transport, as well as to guarantee the ships financially. MINE, however, was unable to deliver on its commitments in terms of having ships available for transporting the bauxite by 1973 as agreed, and subsequently, disagreements arose between MINE and the Guinean government with respect to the apportionment of fault. To resolve this issue, MINE attempted to have the matter discussed at a meeting of the Administrative Council, the administrative arm of the joint venture. In turn, Guinea unilaterally severed the relationship without notifying MINE, and made alternate arrangements for transport with a different company in 1974. Under this arrangement, a new joint venture was to be established. MINE subsequently made a request for arbitration pursuant to the ICSID clause in the contract, and the arbitral panel was constituted in 1985.<sup>180</sup>

Among MINE's claims was that Guinea had breached the transport contract by failing to adequately contribute to the joint venture's viability, by unilaterally severing the relationship, and by contracting with a new company. Ultimately, the tribunal agreed, and awarded MINE \$12,249,483. In coming to this decision, the tribunal concluded that Guinea had directly contravened its contract with MINE by contracting with a new company for the transport of bauxite, and by doing so secretly and in bad faith contrary to the French *Civil Code* – the operative local law.<sup>181</sup>

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<sup>180</sup> Reisman, *supra* note 10, at pg. 80.

<sup>181</sup> *Ibid.*, at pg. 80.



Subsequent to the decision, Guinea filed a request for annulment in March, 1988 under Art. 52., and an annulment committee was formed in 1989. Unique to this case, as compared with *Klockner* and *AMCO*, is that part of MINE's submissions rested on an argument that the outcomes of the prior annulment decisions undercut the effectiveness of ICSID arbitration. This prompted the annulment committee to address the policy angle head on, and in the process, to repudiate much of *Klockner*. In line with this view, the committee explicitly rejected the notion that an award can be annulled for any violation of the one of the enumerated grounds for annulment, re-iterating that a violation must be manifest, serious or fundamental to rise to a level sufficient to annul an award.<sup>182</sup> In this regard, the committee made specific reference to the idea of excess of powers referred to in Art. 52(I)(b) of the Washington Convention and to departures from rules of procedure under Art. 52(I)(d). The committee also deviated from *Klockner* on the significance of establishing a single ground for annulment. It will be recalled that in *Klockner*, the committee put forth the proposition that a violation on *any* single ground for annulment constitutes a breach sufficient to nullify the entire award. By contrast, the committee in *MINE* stated:<sup>183</sup>

“The Convention does not require automatic exercise of that authority to annul an award whenever a timely application for its annulment has been made and the applicant has established one of the grounds for annulment.”

In this respect, the committee retains its discretion on whether or not to annul a particular award even in the presence of a finding that a single ground for annulment has been established. The committee also appeared to relax the reasons for decision criteria used by the committees in *Klockner* and *AMCO* as favouring annulment – partial or otherwise.

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<sup>182</sup> *MINE*, *supra* note 179, at pg. 103.

<sup>183</sup> Reisman, *supra* note 10, at pg. 103.

Instead, the *MINE* committee posited that tribunals must simply state the fact and law which lead to a particular finding, and that this is limited to arguments actually dealt with by the committee. Further, the committee stated that “the adequacy of the reasoning is not an appropriate standard of review.”<sup>184</sup> In an apparent contradiction, however, the committee went on to state that “the minimum requirement is in particular not satisfied by either contradictory or frivolous reasons.”<sup>185</sup> This statement is itself contradictory in that an evaluation as to whether the reasoning applied is contradictory or frivolous itself entails a value judgment as to whether the reasoning is adequate.

In terms of the main decision, the committee showed deference to a minor tribunal error with respect to the application of the appropriate law, as the tribunal cited Art. 1134 of the French *Civil Code* instead of the identical provision under Art. 1134 of the *Code Civil de l’Union Française* (the actual operative body of law).<sup>186</sup> In the committee’s view, this did not rise to a material breach. Further, the committee rejected Guinea’s argument that the tribunal had failed to provide adequate reasons for its finding that the 1973 Middle East War did not create conditions of commercial impossibility for completion of the contract. In doing so, the committee held that notwithstanding the alleged lack of reasons, neither party had brought forth a legal argument resting on commercial impossibility, and that the argument was therefore essentially moot. In this regard, the committee stated “there was no necessity for the Tribunal to give reasons for stating an obvious truth from which it drew no conclusions.”<sup>187</sup> This, however, is again somewhat contradictory, as the statement is categorizing a particular truth as “obvious,”

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<sup>184</sup> *Ibid.*, at pg.105.

<sup>185</sup> *Ibid.*, at pg. 105.

<sup>186</sup> *Ibid.*, at pg. 113.

<sup>187</sup> *Ibid.*, at pg. 114.

and thereby applying its own standard. Regardless, the committee proceeded to grant even more leeway with respect to the adequacy of reasons by finding that it was not a material violation for the tribunal to have not addressed all arguments put forth by Guinea. From the perspective of the committee, the tribunal's central finding that MINE had not violated the agreement through lack of will or incompetence precluded the necessity of addressing any of Guinea's secondary arguments premised on such a violation.<sup>188</sup> In this respect, only core arguments needed to be addressed, the *MINE* committee suggested, and secondary arguments flowing from the disposition of the core arguments could be disregarded if the primary finding rendered them irrelevant.

The committee did, however, adopt a less deferential posture in terms of the tribunal's reasoning as applied to the quantification of damages. Specifically, the committee held that the Tribunal had ignored a term of the contract which limited damages flowing from a breach to one year and that it failed to provide adequate reasoning when it allowed damages for two years. As a result, this portion of the award was annulled. The committee further found that to the extent that any reasoning was applied to the allocation of damages, it was inconsistent and contradictory.<sup>189</sup>

In effect, therefore, the *MINE* annulment decision was superficially deferential, and largely upheld the tribunal's findings. Requirements with respect to the adequacy of reasons were relaxed significantly when contrasted with the earlier decisions, and the threshold was raised with respect to what constitutes a tribunal error sufficient to have an award nullified. Despite this, the committee did examine substantive aspects of the

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<sup>188</sup> *Ibid.*, at pg. 115.

<sup>189</sup> *Ibid.*, at pg. 125.

tribunal's reasoning, and applied a value judgment thereto. In this respect, it was just as willing to re-evaluate tribunal findings, but simply tended to defer. As a result, the committee did little to narrow the parameters of review that had been broadened in earlier annulment decisions.

In light of the foregoing, the propensity to re-evaluate factual and legal findings places ICSID annulment proceedings closer to an actual appeal than to a review. Moreover, the length of time required from the initiation of arbitral decisions to their final resolution under ICSID can actually take much longer than their non-ICSID counterparts. Both *AMCO* and *Klockner* went through what is essentially an extensive appellate process, with both decisions being referred to a new tribunal following successful annulment proceedings, which were subject in turn to a second annulment request. Although the second attempts failed, the end result was such that the decisions took nine and 12 years, respectively, for final resolution of the disputes.

Two subsequent decisions, however, *WENA v. Egypt*<sup>190</sup> and *Vivendi v. Argentina*,<sup>191</sup> briefly provided some hope that ICSID ad hoc committees would adopt a more deferential posture to tribunal decisions.

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<sup>190</sup> *Wena Hotels Limited v. Arab Republic of Egypt*, Decision on application for annulment, Feb. 5, 2002, 41 I.L.M. 933 (2002). [“Wena”]

<sup>191</sup> *Vivendi Universal v. Argentine Republic*, Decision on application for annulment, July 3, 2002, 41 I.L.M. 1135. [“Vivendi”]

#### 4.6 THE “THIRD GENERATION”: WENA v. EGYPT & VIVENDI v. UNIVERSAL

Both *Wena* and *Vivendi* were decided in 2002, fully 10 years subsequent to the *MINE* annulment decision. They are often touted as the “third generation” of ICSID review decisions, and at the time, were perceived as an affirmation of the deferential posture to be adopted towards ICSID tribunal decisions.<sup>192</sup>

More specifically, the committees in each decision rejected the hair trigger approach adopted in *Klockner* whereby a violation of any single ground for annulment would automatically trigger an annulment of a tribunal decision. In this regard, the material violation approach put forth by the committee in *MINE* was endorsed, in which a violation of one of the grounds for annulment would have to rise to a certain level of materiality before satisfying one of the grounds for annulment. Moreover, even if such a threshold were to be satisfied, this would not be sufficient – in and of itself – to have a successful annulment of the award. As stated by the committee in *Vivendi*, the committee retains “a certain measure of discretion as to whether to annul an award, even if an annulable error is found.”<sup>193</sup> Such discretion is to be exercised in the context of a presumption of deference, and in this regard, the committee stated that it “must guard against the annulment of awards for trivial cause.”<sup>194</sup>

In effect, therefore, the twin 2002 decisions suggested that ICSID annulment committees had taken a step back from the *Klockner* and *AMCO* decisions. Initially, this produced optimism in the investment community that ICSID annulment committees had

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<sup>192</sup> Schreuer, *supra* note 154, at pg. 42.

<sup>193</sup> *Vivendi*, *supra* note 191, at para. 66.

<sup>194</sup> *Ibid*, at para. 62.

settled on a more deferential posture. Scholars at the time noted that this third wave of decisions had demonstrated “that the ICSID annulment process had found its proper balance and that the annulment committees had come to peace with their limited mandate under Art. 52, which precluded the review of substantive elements of the decisions. Indeed, certain investment scholars at the time seemed sure that this new deferential posture would remain. In Christopher Schreuer’s 2004 paper, “Three Generations of ICSID Annulment Proceedings,” for instance, the author appeared convinced that the new deferential posture would continue to be the new standard, stating unequivocally that the third generation decisions show “that ad hoc committees will only intervene in serious and important cases.” Schreuer proceeded to conclude as follows:<sup>195</sup>

“The two decisions in *Wena* and *Vivendi* rendered in 2002 demonstrate that ICSID’s review mechanism has found its proper place. It has abandoned the early activism of the *Klockner* case and now presents itself as what it was designed for: an unusual remedy for unusual situations. The recent cases have helped to dispel fears about frequent attacks on awards for trivial reasons leading to protracted and expensive litigations.”

As such, there was early optimism that the annulment committees had learned from their mistakes, and would henceforth avoid the propensity of experts to second guess substantive arbitral findings. Unfortunately, subsequent decisions would prove that this optimism was entirely unfounded, and that the flaws inherent in the ICSID structure may be impossible to overcome. In this vein, some more recent ICSID decisions demonstrate that the twin 2002 decisions are not indicative of a trend towards greater deference, leaving ICSID arbitral review in a state of flux.

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<sup>195</sup> Schreuer, *supra* note 154, at pg. 42.

#### 4.7 THE “FOURTH GENERATION”

As stated, the early enthusiasm in the investment community with respect to the “third generation” decisions has been largely supplanted by pessimism that the annulment committees will ever overcome their propensity to substantively re-evaluate arbitral findings. The beginning of the so-called “4<sup>th</sup> generation” of ICSID decisions began in September 2009, after which there was a proliferation of annulment committee decisions. In fact, between September, 2009 and September 2010, there were a total of 8 annulment decisions, prior to which there had only been sixteen.<sup>196</sup> Unfortunately, this proliferation of review cases coincided with an assertiveness on the part of the annulment committees which harkened back to the early years of ICSID review exemplified by cases like *Klockner*. Moreover, even in cases which did not result in annulment, the committees nonetheless demonstrated their propensity to operate in an appellate capacity, rather than the narrow review capacity contemplated by Art. 52. In *Helnan v. Egypt*, for instance, the annulment committee upheld the Tribunal’s decision not to annul, but effectively annulled some of the core reasoning behind the decision and substituted its own reasoning.<sup>197</sup> Likewise, in *Vivendi v. Argentina II*, the annulment was rejected and the committee paid lip service to the importance of protecting “the integrity of the system” and the narrow scope of Art. 52, but then proceeded to suggest that the ad hoc committee exercises a narrow appellate function. Specifically, the committee stated that

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<sup>196</sup> Lise Johnson, “Annulment of ICSID Awards: Recent Developments,” *Annual Forum for Developing Country Investment Negotiators*, New Delhi, October 27-29, 2010, pg. 1.

<sup>197</sup> *Helnan International Hotels A/S v. Arab Republic of Egypt*, Decision on Annulment, June 14, 2010, ICSID Case No. ARB/05/19. (“*Helnan*”)

Article 52(1)(e) – being failure to state reasons – “is cast more in terms of an ordinary appeal.”<sup>198</sup>

The paper will now proceed to review some of the major decisions which did result in annulment.

#### 4.8 *SEMPRA v. ARGENTINA*

The *Sempra v. Argentina*<sup>199</sup> decision arose from the Argentinian economic crisis, and hung on the definition of “necessity” under international law, as Argentina had attempted to invoke the “necessity” defence against a foreign investor, and the defence was invoked under both the Argentina – U.S. BIT and under customary international law. In its decision, the Tribunal held that the lack of a definition of “necessity” under the BIT allowed for the application of the definition under customary international law to be applied in interpreting the BIT. Applying this interpretation, the Tribunal held that the economic crisis did not meet the applicable standard. As part of its decision, the Tribunal also concluded that it did not need to undertake any further analysis of the relevant provisions contained within the BIT as there were no specific conditions set out within which deviated from customary international law.

The ad hoc committee, however, disagreed with the Tribunal’s application of customary international law, and annulled the award. Specifically, the “necessity” defence under the

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<sup>198</sup> *Vivendi Universal v. Argentine Republic*, Decision on Annulment, August 10, 2010, ICSID Case N. ARB/97/3. (“*Vivendi II*”)

<sup>199</sup> *Sempra Energy International v. Argentine Republic*, Decision on Annulment, June 29, 2010, ICSID CASE No. Arb/02/16. (“*Sempra*”)



BIT was deemed to be materially different than the law on “necessity” found under customary international law, and that the latter could not therefore guide in the interpretation of the former. Essentially, the committee disputed that customary international law could be applied in this instance, and substituted its decision for that of the Tribunal. Clearly, this is a substantive re-evaluation of the Tribunal’s findings, but the Committee couched its decision under the guise of “manifest excess of powers,” similar to some of the earlier committee decisions which applied this ground for annulment broadly in a manner tantamount to a full appeal. Indeed, the committee stated that it “did not wish totally to rule out the possibility that a manifest error of law may, in an exceptional situation, be of such egregious nature as to amount to a manifest excess of powers.” This stands in stark contrast to the commonly held principle that an erroneous interpretation or misapplication of the law will not support annulment.

#### 4.9 ENRON v. ARGENTINA

*Enron v. Argentina*<sup>200</sup> is another case involving Argentina’s attempts to invoke the “necessity” defence against a foreign investor in response to the Argentinian economic crisis. Unfortunately, it also serves as another example of the ad hoc committee reviewing the merits of an award and then annulling it under the guise of “manifest excess of powers.” Specifically, the Tribunal in this case had essentially made the same finding as the Tribunal in *Sempra* with respect to the necessity defence and its interpretation under the relevant BIT. The ad hoc committee, however, annulled the

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<sup>200</sup> *Enron Creditors Recovery Corp & Ponderosa Assets, L.P. v. Argentine Republic*, Decision on Annulment, August 10, 2010, ICSID Case No. ARB/97/3. (“*Enron*”)

award on the basis that the Tribunal had failed to adequately consider the economic expert reports, and for failing to adequately consider the defences available to Argentina under the BIT and under customary international law. On this basis, the ad hoc committee concluded that the Tribunal had manifestly exceeded its powers by failing to apply the applicable law. Importantly, this conclusion was arrived at notwithstanding the fact that the Tribunal itself had previously concluded that the parties had not argued the legal elements of the necessity defence and that the Tribunal was not therefore required to consider them. Nevertheless, the ad hoc committee again exercised an appellate function and annulled the award on grounds that are tantamount to a legal review of the merits.

#### **4.10 FRAPORT v. PHILIPPINES**

In this case, the Tribunal considered a claim brought by a foreign investor against the Philippines government, and the decision hung on the application of Philippine law which required Philippine control of public utilities, along with a 60 percent Philippine equity stake in public utilities. Finding that the investor had an “illegitimate managerial control,” the Tribunal dismissed the claim on the basis of lack of jurisdiction due to a violation of Philippine law.

However, prior to the issuing of the award but after the close of proceedings, there was a prosecutor’s decision relating to the aforementioned equity stake component of the Philippine law dealing with ownership and control of public utilities. Notwithstanding the fact that the Tribunal did not base its decision on the equity stake component, the ad hoc committee held that there had been a serious departure from a fundamental rule of

procedure because the parties had not had the opportunity to comment on the prosecutor's decision.<sup>201</sup>

In an apparent internal inconsistency, the committee had acknowledged that the decision was not binding on its decisions applying international law. Moreover, both parties to the arbitration argued that there was no relevance to the prosecutor's decision. On this basis, the decision appears at odds with previous committee decisions which held that an award need not be annulled if the annulable error was not material to the outcome. As such, while this decision did not involve a review of the legal merits, as occurred in *Sempra* and *Enron*, it did represent an assertive posture on the part of the ad hoc committee which adopted a looser standard for annulment than that which had been applied previously.

#### 4.11 CONSEQUENCES ARISING FROM "FOURTH GENERATION"

Clearly, the newly assertive posture on the part of the annulment committees evident during the so-called "4<sup>th</sup> generation" is at odds with the supposedly deferential posture and early optimism brought about by the 2<sup>nd</sup> and 3<sup>rd</sup> generation decisions. As a result, just as posited by this thesis, there have been adverse consequences with respect to the perceived legitimacy of ICSID arbitration. For instance, Dohyun Kim, writing in the *New York University Law Review*, stated in response to the 4<sup>th</sup> generation decisions that the annulment committees were behaving more as appellate bodies, and that.<sup>202</sup>

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<sup>201</sup> *Fraport AG Frankfurt Airport Services Worldwide v. Republic of the Philippines*, Decision on Annulment, December 23, 2010, ICSID Case No. ARB/03/25. ("*Fraport*")

<sup>202</sup> Dohyun Kim, "The Annulment Committee's Role is Multiplying Inconsistency in ICSID Arbitration: The Need to Move Away From an Annulment-Based System," *NYUL Rev.* 86, 242-638, pg. 279.

“The ICSID annulment mechanism has proven, both historically and recently, that it is a hazard both to fostering coherence in arbitral decisions and to improving the legitimacy of ICSID arbitral rulings.”

Likewise, in a paper prepared by Lise Johnson of the International Institute for Sustainable Development, several of the 4<sup>th</sup> generation decisions were analyzed with an eye to coherence and the relative assertiveness of the ad hoc committees in annulling awards. While acknowledging that the total number of annulled awards remained relatively minor, the *Sempra* and *Enron* decisions were criticized:<sup>203</sup>

“Overall, the decisions evidence that applicants for annulment face low chances of success...Nevertheless, in several cases, the annulment committees did accept parts of the applicants’ arguments; and in *Enron* and *Sempra*, these decisions had significant practical ramifications, collectively releasing Argentina from the obligation to pay more than US \$200 million in damages.”

Indeed, as alluded to in the foregoing passage, there are tangible consequences to the re-emergence of ad hoc committee assertiveness that extends beyond mere academic or think tank criticism, and has produced tangible results reflective of a perceived lack of legitimacy.

In a commentary provided by Carolyn Lamm, a partner at White & Case LLP who has represented various parties in front of both ICSID tribunals and ad hoc committees, Lamm stated the following in a commentary on the 4<sup>th</sup> generation cases:<sup>204</sup>

“If left unchecked, this trend will cause parties to consider very seriously whether to choose ICSID with its ad hoc committees which annul freely – or to select other forums for arbitration of their investment disputes.”

This demonstrates a serious concern amongst those who actually engage in ICSID arbitration as to its long-term viability.

<sup>203</sup> Johnson, *supra* note 196, at pg. 12.

<sup>204</sup> American Society of International Law, “Proceedings of the Annual Meeting (American Society of International Law): Remarks by Carolyn B. Lamm,” *Vol. 105, March 23-26, 2011*, pp. 335-338. [“ASIL”]

This concern is also reflected in the posture adopted by several nation-state governments towards ICSID, particularly in Latin America. In 2007, the ICSID Convention was denounced by Bolivia, followed by Ecuador in 2010, and Venezuela in 2012.<sup>205</sup> While this may be partially attributable to internal political issues, it nevertheless demonstrates that the structural underpinnings of ICSID are weak enough that countries do not fear pulling out.

This is further re-inforced by the fact that Argentina has simply ignored ICSID rulings and refused to pay some of the awards.<sup>206</sup> In one case, *CMS Gas Transmission Co. v. Argentina*,<sup>207</sup> its behaviour can be directly attributable to the ad hoc committee ignoring its role and operating in an appellate manner. Interestingly, the ad hoc committee in *CMS* did refuse to annul the award against Argentina even in the presence of supposedly flawed legal reasoning on the part of the tribunal, which is ostensibly the appropriate role of the committee. However, having exercised its proper role in not annulling the award on substantive legal grounds, it nevertheless criticized the award on substantive legal grounds, which is somewhat contradictory. Specifically, the committee stated that the Tribunal had “cryptically and defectively” applied the law. Essentially, therefore, the committee engaged in superfluous substantive review despite upholding the award which had the result of undermining the award itself. As might be expected, Argentina then

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<sup>205</sup> Carolyn Lamm, “Prominent Issues in Latin-American Arbitration: Annulment, Multi-Party Arbitrations, Corruption and Fraud,” *White & Case LLP* (April 12, 2012), pg. 7. <available from: [http://www.law.yale.edu/documents/pdf/sela/Lamm\\_ppt.pdf](http://www.law.yale.edu/documents/pdf/sela/Lamm_ppt.pdf) >

<sup>206</sup> *Ibid.*, at pg. 7.

<sup>207</sup> *CMS Gas Transmission Co. v. Argentine Republic*, Decision on Annulment, September 25, 2007, ICSID Case No. ARB/01/8.

refused to pay the award, which speaks directly to the effect of ad hoc committees undermining ICSID's legitimacy.

Cognizant of these concerns, and further demonstrative of a perceived lack of legitimacy, ICSID has been forced to address them head-on in a recent "Background Paper on Annulment for the Administrative Council of ICSID," dated August 10, 2012.<sup>208</sup> The paper came about as a direct result of criticism brought about by the 4<sup>th</sup> generation decisions and concerns about ad hoc committees exceeding their narrow grounds for review. The specific complaint was brought by the Philippines in response to the *Fraport* decision, which viewed the decision as "further evidence of a systemic problem of ICSID ad hoc committees failing to adhere to the mandate established in Article 52 of the ICSID Convention" and exceeding its powers. To remedy this, the Philippines urged that the following guidelines be adhered to:<sup>209</sup>

- a) Reaffirm the extraordinary and limited scope of Article 52 annulment.
- b) Reaffirm that an ad hoc committee's authority is limited to the application of the Article 52 standards.
- c) Reaffirm that as such, annulment is limited to the most serious and egregious cases, providing a specific definition of Article 52 standards.
- d) Confirm that it is not within the mandate of an ad hoc committee to offer critical or corrective commentary on decisions of the tribunal for which there is no basis to annul.
- e) In view of the importance of consent to the role of ICSID in the resolution of disputes, confirm that the mandate of an ad hoc committee under Article 52 of the Convention is limited to addressing the application for annulment presented.

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<sup>208</sup> ICSID Secretariat, "Background Paper on Annulment For the Administrative Council of ICSID," *International Centre for Settlement of Investment Disputes* (August 12, 2012).

<sup>209</sup> *Ibid.*, at pg. 2.

f) Confirm that ad hoc committees must accord the parties the same right to present their case as the parties enjoy in the arbitration and thus must be permitted to present observations on the issues to be decided by the ad hoc committee.

g) Ad hoc committees should be composed of members with substantial experience with ICSID arbitrations either as an advocate or tribunal member. In addition, where one of the parties is from a developing country, at least one committee member should represent the developing country perspective either by virtue of nationality or experience.

Clearly, this represents a full frontal assault on ICSID legitimacy, with some concrete recommendations put forth to address the problem of annulment. However, instead of seriously considering these recommendations, the background paper simply denied the problem, and concluded that “it is clear that the annulment mechanism is a limited and exceptional recourse, available only on the basis of the grounds enumerated in Article 52 of the ICSID Convention.” This conclusion, in turn, was partially premised on a misleading set of statistics:<sup>210</sup>

“The task of an ad hoc Committee should also be assessed in the overall context of the ICSID case load. In its 47 year history, ICSID registered 344 cases and issued 150 awards. Of these, 6 awards have been annulled in full and another 6 awards have been partially annulled. In other words, only 4 percent of all ICSID awards have led to full annulment and 4 percent have led to partial annulment.”

This, however, is misleading from several perspectives. First, the metric against which the annulments are contrasted is the total number of awards, rather than the total number of annulment proceedings, which would be a far more useful contrast when discussing the propensity of ad hoc committees to annul awards. Secondly, this statistic ignores the cases in which the ad hoc committee opted to uphold the award while criticizing the substantive legal underpinnings of the award, such as the *CMS* decision. While it is factually true that such decisions are not actual annulments, the end result is similar, in

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<sup>210</sup> *Ibid.*, at pg. 50.

that the losing party can use the criticism as a basis to avoid paying the award, as occurred with Argentina.

ICSID's conclusions in the background paper are also undermined by several statistics which they failed to cite. For instance, the appeal rate has actually doubled in recent years. In the 1990s, the appeal rate was 17 percent. However, by the end of 2010 – after the spate of 4<sup>th</sup> generation decisions – the appeal rate had increased to 35 percent.<sup>211</sup> This suggests that the propensity on the part of the ad hoc committees to engage in substantive legal review and annul awards has resulted in an increased willingness on the part of losing parties to seek annulment, which stands in contrast to the purported benefits of finality trumpeted by ICSID in its background paper as one of ICSID's inherent advantages.

Indeed, between September, 2009 and September, 2010, there were eight ad hoc committee decisions, which is significant when one considers that there had only been sixteen prior to this dating back to 1965. Moreover, in 2010, five of the eight decisions rendered exceeded the scope of review under Art. 52, and four of them resulted in annulment.<sup>212</sup> Combined, this represents both a proliferation of annulment proceedings, and a marked increase in the rate of annulment which stands in stark contrast to the picture presented by the statistics in the ICSID background paper.

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<sup>211</sup> *ASIL*, *supra* note 204, at pg. 335.

<sup>212</sup> *ASIL*, *supra* note 204, at pg. 336.



## 4.12 CONCLUSION

It is readily apparent that the ICSID is not necessarily preferable to traditional ad hoc arbitrations in terms of finality of awards and deference. In fact, ICSID arbitral review appears less deferential than the judicial review cases under NAFTA Chapter 11, and there have been tangible consequences flowing from this, including non-payment of awards and repudiation of ICSID by several nation-states, culminating in a report from the ICSID itself directly addressing these concerns. Indeed, early optimism arising from the “3<sup>rd</sup> generation” decisions has given way to a “4<sup>th</sup> generation” of decisions which have brought back early concerns that ad hoc committees are exceeding their roles and undermining finality of outcome. This suggests that absent serious reforms, ad hoc committees and the experts rendering the decisions may never be able to resist using their expertise to engage in substantive legal review of Tribunal decisions. This, however, is compounded by the fact that ICSID is burdened with a flawed structure that cannot be remedied, as will be demonstrated. With this in mind, the following chapter will explore the pros and cons of the two systems, and suggest some alternative reforms.

## CHAPTER V:

### REFLECTION AND CONCLUSION

#### 5.1 INTRODUCTION

Having considered the nature of investment arbitration review, and its application in national court systems under NAFTA Chapter 11, and having conducted a comparison of set-aside procedures under ICSID, it is necessary to now provide a final analysis as to the relative advantages of each system. The thesis will then conclude by providing several policy alternatives given what has been canvassed thus far.

#### 5.2 ICSID VS. JUDICIAL REVIEW THUS FAR UNDER NAFTA CHAPTER 11

ICSID's finality is often cited as its primary advantage versus national systems of judicial review. Choosing ICSID also has the benefit of rendering the arbitral *situs* irrelevant, along with any attempts at jurisdiction shopping.<sup>213</sup> Indeed, as stated by Jack J. Coe:

“(Upon) ratification of the ICSID Convention by Mexico and Canada, a number of problems associated with domestic court review of Chapter 11

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<sup>213</sup> Todd Weiler, *International Investment Law and Arbitration: Leading Cases from the ICSID, NAFTA, Bilateral Treaties and Customary International Law* (London: Cameron May Ltd., 2005), 164-167: Todd Weiler demonstrates how the self-contained nature of ICSID can diminish lengthy disputes over the arbitral *situs*.

awards would evaporate, at least in cases in which ICSID arbitration is chosen.”<sup>214</sup>

As demonstrated in the preceding analysis, however, ICSID’s preclusion of judicial review is not necessarily an inherent advantage over traditional ad hoc arbitration, at least when considered in execution as opposed to theory. Litigation has gone on over a decade in one case, and the appellate process can extend indefinitely based on the circuitous appellate route demonstrated in *AMCO*. First and foremost, ICSID offers a procedural framework for the settlement of investment disputes. While no substantive rules are put forth, the Washington Convention does provide a framework for ways in which the applicable law will be chosen.<sup>215</sup>

David Sedlak has written of ICSID’s supposed advantages. He highlights the expertise, neutrality, irrevocability, widespread recognition of awards and investor confidence in facilitating FDI flows through the use of ICSID. Specifically, Sedlak states:

“The overall effect of the ICSID Convention is more far reaching than a simple enunciation of the rights of investors in foreign countries, or the particular methodologies of any resulting arbitrations. The ICSID Convention gives investors the confidence and re-assurances necessary to invest in a foreign State.”<sup>216</sup>

This statement, however, is the typical argument put forth in support of investment arbitration generally and says little of ICSID’s inherent advantages over ad hoc arbitration – especially under NAFTA Chapter 11. While ICSID may provide a stable

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<sup>214</sup> Jack J. Coe, “Taking Stock of NAFTA Chapter 11 in Its Tenth Year: An Interim Sketch of Selected Themes, Issues, and Methods,” 36 *Vand. J. Transnat’l L.*, 1381, 1389 (2003), at 1450.

<sup>215</sup> D. Wang, “Course on Dispute Settlement: International Centre for the Settlement of Investment Disputes, 2.8,” *United Nations Conference on Trade and Development (UNCTAD)*, at pg. 14. <available from: <http://r0.unctad.org/disputesettlement/course.htm>>

<sup>216</sup> David Sedlak, “ICSID’s Resurgence in International Investment Arbitration: Can the Momentum Hold,” 23 *Penn St. Int’l L. Rev.* 147 2004-2005, pg. 155.

and irrevocable system of dispute resolution under a traditional investor-state conflict, this option is rendered moot under the NAFTA framework. The investor protections offered under NAFTA and Chapter 11 ensure that disputes will be promptly adjudicated and enforced, whether the arbitral mechanism is ICSID or ad hoc. From this perspective, ICSID's traditional advantages over ad hoc arbitration are minimized when NAFTA Chapter 11 is invoked, and are essentially limited to neutrality, the provision of arbitral infrastructure, and finality of awards, the latter of which has not borne itself out. Moreover, the procedural advantages offered by ICSID must be weighed against some of the procedural disadvantages which can often prove useful in an investment dispute.<sup>217</sup>

ICSID's secrecy and lack of transparency can also be somewhat of a problem – at least in earlier decisions. As was discussed earlier, both the *Klocker* and *AMCO* secondary annulment decisions remain unpublished.<sup>218</sup> As such, scholars are forced to rely on unconfirmed reports – essentially hearsay – as to how the decisions were decided. With an absence of transparency requirements, therefore, an annulment committee could choose to keep secret certain controversial aspects of a decision, undercutting both transparency principles as well as the establishment of a well developed body of precedent. Naturally, this runs counter to the strong emphasis on transparency within NAFTA. As stated by Jeffrey Atik the secret nature of ICSID proceedings do not fit well within the intended structure of NAFTA Chapter 11. In this regard he states:

“These practices might be appropriate in some investment contexts – one can imagine a host country ICSID party preferring that its dirty laundry hang out of view. Yet the NAFTA was intended to promote and increase

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<sup>217</sup> Todd Weiler, *NAFTA Investment Law and Arbitration: Past Issues, Current Practice, Future Prospects* (New York: Transnational, 2004), 361: Professor Weiler highlights ICSID's lack of interim measures as a disadvantage.

<sup>218</sup> *Schreuer, supra* note 154, at pg. 18.

transparency in Mexico – and in the United States and Canada. The closed door ethos of private arbitration does not fit a culture of legal transparency.”<sup>219</sup>

Under NAFTA, by contrast, the significant NAFTA Chapter 11 decisions are largely recorded thanks to the efforts of investment law scholar/lawyer Todd Weiler. Indeed, this was alluded to by Atik later on in his paper when he states:<sup>220</sup>

“...there has been a surprising amount of real documentary transparency about early Chapter 11 decisions – at least after the fact. This is in large extent due to the efforts of Todd Weiler, a resourceful and energetic lawyer/scholar who has developed a comprehensive website dedicated to Chapter 11. Weiler’s website collects both decisions and associated pleadings of the major Chapter 11 cases...in the absence of formal reporting, these documents constitute the accepted jurisprudence of Chapter 11.”

Indeed, some of the Chapter 11 arbitrations, such as *Methanex*, *UPS* and *Thunderbird*, have all been held out in the open as opposed to in camera.<sup>221</sup> Moreover, it is at the review stage that the transparency requirements become strongest – not by virtue of anything inherent in ad hoc arbitration itself, but due to the fact that North American courts are generally subject to strict reporting requirements and are fully accessible to the public.

Speaking in broader terms, it is also worth considering whether appeals can actually be beneficial to the arbitral process in that they can provide assurance that fundamentally flawed decisions not be able to stand. As stated by Sedlak in his paper: “[w]ithout any annulment process, fundamentally defective awards such as *MINE* could not be

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<sup>219</sup> Jeffrey Atik, “Repenser NAFTA Chapter 11: A Catalogue of Legitimacy Critiques,” 3 *Asper Review Int’l Bus. & Trade Law* 215 (2003), 224.

<sup>220</sup> *Ibid.*, at pg. 32.

<sup>221</sup> *Methanex Corp. v. United States*, (NAFTA/UNCITRAL Trib., Aug. 7, 2002) (award on jurisdiction & admissibility); *United Parcel Service of America, Inc. v. Canada*, (NAFTA/UNCITRAL Tribunal, Oct. 17, 2001) (Decision on place of arbitration); *International Thunderbird Gaming Corporation v. The United Mexican States*, (NAFTA/UNCITRAL Trib., Jan. 26, 2006), (Final Decision).

remedied.”<sup>222</sup> ICSID’s review system, however, is not intended to be truly appellate in nature, but rather more akin to a procedural review that precludes factual and legal re-evaluations of the award. To the extent that ICSID review has evolved to encompass broader review criteria, therefore, it begs the question: why not use the real thing? A system conceived as a mere annulment proceeding is not equipped to handle full fledged appeals, and in the context of NAFTA Chapter 11, the North American common law courts may be better equipped to handle such proceedings.

In her 2010 paper, “The Annulment Committee’s Role in Multiplying Inconsistency in ICSID Arbitration: The Need to Move Away From an Annulment Based System,” Dohnyun Kim argues, “that the ad hoc committees have become increasingly judicialized, without the underlying structural support to allow for judicialization. As a result, and particularly evident after the 4<sup>th</sup> generation decisions, the committees have produced inconsistent and incoherent decisions. In light of this, and in light of the repeated failures of the ad hoc committees to operate within their ostensible parameters, Kim argues that the ad hoc committees should undergo formal judicialization to help foster coherence and consistency.”<sup>223</sup>

“Although the drafters of the ICSID Convention did not intend to allow an annulment committee...to review the substantive merits of the Tribunal’s award, annulment committees have previously based their decisions on more expansive substantive review than that found under the Convention...[I]n a recent series of decisions, annulment committees appear to be engaging in greater substantive review of tribunal’s awards once again, a fact that triggers a renewed sense that annulment committees are still confused over the proper role of annulment in the ICSID arbitration system. Such confusion has serious implications in that it leads to the production of inconsistent decisions at the annulment level...thus

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<sup>222</sup> Sedlak, *supra* note 216, at pg. 154.

<sup>223</sup> Kim, *supra* note 202, at pg. 1.

adding to the layer of inconsistent decisions produced at the Tribunal level. These incoherent decisions may ultimately imperil the legitimacy of the ICSID arbitration system as a judicialized body for shaping prospective state and individual behaviour. To strengthen the legitimacy of ICSID arbitral decisions and promote further development of coherent international investment law...it is critical for ICSID to establish a mechanism with official powers of substantive review.”

Essentially, therefore, Kim proposes adopting a formal appellate mechanism into the body of ICSID, as has been proposed by other observers.<sup>224</sup> Unfortunately, however, the Washington Convention suffers from another structural flaw that would make this very difficult, namely, its amendment process.

Put simply, amendments under ICSID are incredibly difficult, much like amending a national constitution. Essentially, any amendment to the Washington Convention must be approved by all parties to the agreement. This is stipulated under Art. 65 and 66 of the Washington Convention, in which it is stated that “each amendment shall enter into force 30 days after...all Contracting States have ratified, accepted or approved the amendment.”<sup>225</sup> In a Convention containing well over 150 signatory members, however, this is a significant logistical hurdle, to the point that amendments are not feasible. In fact, any change to this amending procedure would require an amendment of its own, creating somewhat of a paradox that locks the Convention in its present state. Indeed, no amendment has ever even been attempted under Art. 56.<sup>226</sup> In discussing proposed improvements to ICSID’s review system through the formation of a permanent review board that could streamline appeals, Sedlak observes:

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<sup>224</sup> Alan Redfern, “ICSID: Losing its Appeal?” 8 *Arbitration International* 98 (1987), 102.

<sup>225</sup> ICSID Convention, *supra* note 16, Arts.55 & 56.

<sup>226</sup> Ibrahim F.I. Shihata, *Forward to Christopher Schreuer, The ICSID Convention: A Commentary* (London: Cambridge University Press, 2001), xv.

“This would alleviate the worry over multiple appeals and the lack of finality of an award. However, the Convention itself must be amended through Articles 65 and 66 for such a review board to exist, an amendment that is unlikely to occur. Because of the strict amendment process of the ICSID Convention, the worry over an unfettered annulment may never be formally alleviated.”<sup>227</sup>

Sedlak goes on to suggest that because an endless appeal has not yet occurred, and that because arbitrators are aware of the problem, investor concerns may be moot in this regard. Still, the fact that this is the only means through which investors could be assuaged speaks volumes about the shortcomings of ICSID in terms of adapting to structural problems that emerge.

Indeed, the 4<sup>th</sup> generation decisions undercut Sedlak’s contention that mere awareness of the problem is sufficient to alleviate investor concerns. These shortcomings are highlighted quite effectively in Dohyun Kim’s more recent paper:<sup>228</sup>

“A systematic attempt to promote greater coherence in investor-state arbitral decisions cannot be implemented through the current annulment mechanism... The analysis of the evolution of annulment decisions reveals that, thus far, the annulment committees have not been able to serve as this check because they simply do not have the formal authority to do so under the ICSID Convention..

More importantly, when the committees attempt to provide this check by overstepping their power boundaries, they only infuse greater confusion into the body of law because they are inherently unable to modify substantively incorrect or inconsistent decisions. Annulment committees are thus unfit to serve as a check on coherence and, at worst, may only delegitimize tribunal decisions by attempting to provide substantive review that is outside of their legal authority, even if they do not end up annulling on this basis.”

All of this highlights the fact that while judicial review under NAFTA Chapter 11 thus far has been partially inconsistent, this must be weighed against the problems inherent in

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<sup>227</sup> Sedlak, *supra* note 216, at pg. 165.

<sup>228</sup> Kim, *supra* note 202, at pg. 34.



ICSID – structural and otherwise. Essentially, they are alternative systems, and any evaluation of Chapter 11 review thus far must be undertaken in the context of the alternatives available. In fact, this thesis has demonstrated that the Chapter 11 review cases outside of ICSID have been more deferential than their ICSID counter-parts, notwithstanding some mild lingering inconsistencies. Indeed, if the early ICSID Tribunal decisions can be analogized to *Metalclad* in terms of the first tests of a new arbitral review system, a strong argument can be made that the *Metalclad* court performed better in reviewing its award. Specifically, the ad hoc committees in the earlier ICSID decisions would annul portions of the award in the presence of a single error, demonstrating minimal deference. By contrast, the B.C. Supreme Court in *Metalclad* upheld a portion of the award even in the presence of an error, as it considered the award in its totality. In fact, even though it found that Mexico was correct in its Art. 1105 submissions, the Court essentially refused to set aside the entire award for a single violation.<sup>229</sup> The Court in *Metalclad* also refrained from setting aside the award despite its failure to address all the arguments put forth by a party. Interestingly, counsel for *Metalclad* had attempted to apply *Klockner* and *MINE* as precedent in this regard, but the Court refused to do so.<sup>230</sup> In light of the foregoing, early NAFTA Chapter 11 judicial review seems more deferential than the early ICSID annulment decisions. This argument was echoed by David Williams, who states:

“Overall there is an argument for concluding that the British Columbian Court, exercising jurisdiction under the grounds contained in the New York Convention and UNCITRAL Model Law, performed rather better

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<sup>229</sup> *Metalclad*, *supra* note 36, at paras. 136-137.

<sup>230</sup> *Metalclad*, *supra* note 36, at para. 130.

than the first ad hoc annulment committees in ICSID international arbitration.”<sup>231</sup>

Similarly, looking at the most recent decisions under the “alternative systems,” it appears that the courts have settled on a an even more deferential posture, while ICSID ad hoc committees have refused to resist the temptation of the experts on the committee to second guess the tribunals and have taken a step backwards – even in the face of overwhelming criticism and a widespread awareness of the problem. For instance, in the recent *Cargill* decisions from the Ontario Court of Appeal, it was expressly stated by the Court that any review is strictly limited to questions of jurisdiction, and that the actual merits of the decision are not to be reviewed beyond the narrowly construed grounds for review under UNCITRAL Model Law.<sup>232</sup> In *Sempra*, by contrast, the ad hoc committee explicitly stated that certain errors of law – and not jurisdiction – could constitute grounds for annulment.<sup>233</sup>

Outside of NAFTA Chapter 11, another recent key case which illustrates this contrast is *Argentina v. BG Group*<sup>234</sup> which was recently decided by the U.S. District Court for the District of Columbia. It is notable because it deals with Argentina’s attempts to invoke the “necessity defence” against foreign investors in response to the Argentinian economic crisis, and therefore can be directly contrasted with the ad hoc committee decisions discussed in the preceding chapter under ICSID. It will be recalled that in *Sempra* and *Enron*, the ad hoc committees annulled Tribunal decisions which denied the application of the necessity defence and held that the Tribunals had not applied

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<sup>231</sup> David Williams, “Challenging Investment Treaty Arbitration Awards: Issues Concerning the Forum Arising From the Metalclad case,” *2003 Business Law Int’l 156* (2003), 167.

<sup>232</sup> *Cargill*, *supra* note 111, at paras. 47 & 48.

<sup>233</sup> *Sempra*, *supra* note 199.

<sup>234</sup> *Republic of Argentina v. BG Group PLC*, 715 F. Supp. 2d 108 (2010) (U.S. Dist. Ct. – D.C.) [“BG Group”]

customary international law as they should, thereby ruling in favour of Argentina. In *BG Group*, by contrast, the Court upheld the Tribunal's decision to reject the necessity defence based on its plain reading of the Argentina-UK BIT, and made it very clear that it was deferring to the Tribunal's reading of the BIT. While the facts were somewhat different, the contrast is striking.

This contrast is further bolstered by the fact that in remarks from Carolyn Lamm, the investment law practitioner from White & Case LLP discussed in the preceding chapter, Lamm contrasted the merits review undertaken by the ad hoc committee in *Fraport* – a case which she unsuccessfully argued – with the deferential posture adopted by the Superior Court in *Mexico v. Feldman*. Specifically, Lamm referenced the following passage from the decision:

“[A] high level of deference should be accorded to the Tribunal especially in cases where the Applicant Mexico is in reality challenging a finding of fact. The panel which has heard the evidence is best able to determine issues of credibility, reliability and onus of proof.”<sup>235</sup>

The disputes at issue here were obviously quite different, but the fact that the contrasts in deference were highlighted by an investment law practitioner is demonstrative of the fading legitimacy of ICSID vis-à-vis perceptions of deference with respect to judicial review under the North American court system.

To conclude, therefore, it is evident that ICSID is not markedly superior as an arbitral mechanism when contrasted with traditional ad hoc arbitration and judicial review thereof, especially in the context of NAFTA Chapter 11. The most recent ICSID decisions on annulment have reverted to the less deferential posture adopted in early

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<sup>235</sup> *ASIL*, *supra* note 204, at pg. 338.

ICSID decisions, in contrast to the North American courts which have largely settled on a deferential posture towards the review of decisions rendered under NAFTA Chapter 11. There is no evidence at this juncture to say that ICSID offers any greater finality of awards, and the ICSID decisions have the potential of being reviewed in perpetuity. Add to this the lack of transparency, the procedural shortcomings (in the lack of interim measures), and the inability to rectify these defects through amendment, and it is apparent that Canada's ratification of the ICSID may have adverse impacts on finality of outcome to Chapter 11 arbitration, and by extension, the attractiveness of Canada to foreign investors. Even more troubling is the lack of recognition of a problem by the ICSID itself, as demonstrated in the 2012 Secretariat report. To the extent that there are some problems with traditional review under the North American common law courts, it is clear that ICSID has not shown itself to be a viable alternative.

### **5.3 ALTERNATIVES AND FURTHER REFORMS**

Given the difficulties in amending the Washington Convention, one possible avenue of pursuit is to think on a smaller scale and to amend NAFTA itself so as to create a NAFTA appellate body. This would de-localize arbitral proceedings and remove the incentives of jurisdiction shopping, allowing parties to select an arbitral *situs* best suited to their actual purposes. In fact, the NAFTA appellate body could be structured in a manner that recognizes the shortcomings of both ICSID review and judicial review, given the lessons offered by hindsight. Such measures would include the removal of the review loop found under ICSID, and instead have the NAFTA appellate body serve as the final

word on a given dispute. The appellate body could also mimic many of the procedural advantages offered by ICSID, such as the provision of arbitral infrastructure, while addressing procedural shortcomings, such as the inability to provide interim measures. Transparency requirements would also be strengthened, so that an established body of law and precedent could emerge, allowing for predictability of review. This would mitigate against the inconsistency of review criteria applied by both the common law courts and ICSID annulment committees. Indeed, it may be desirable to insert language into the text of the amendment mandating that in the normal course precedent be applied by the appellate body to decisions, as this would preclude appellate panels from disregarding prior decisions and thus increase predictability of review. It will be recalled that in *AMCO*, the ad hoc committee stated that precedent was not to be applied to annulment decisions under ICSID, making each new case essentially a decision taken in a vacuum. In most legal systems in North America, by contrast, the reviewing courts are at least expected to apply the relevant precedent, notwithstanding the fact that the different courts reviewing NAFTA Chapter 11 arbitrations have occasionally neglected to do so. A permanent NAFTA appellate body operating with a doctrine of precedent, therefore, would remove both these shortcomings.<sup>236</sup>

Indeed, the political will to create such an appellate body may very well exist, particularly in the United States. The U.S. Draft Model Bilateral Investment Treaty, for instance, provides for the establishment of review body, and has been incorporated into many proposed free trade agreements to handle the review of investment decisions

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<sup>236</sup> Ari Afilalo, "Towards a Common Law of International Investment: How NAFTA Chapter 11 Panels Should Solve Their Legitimacy Crisis," *17 Geo. Int'l. Envtl. L. Rev.* 51 (2004-2005): The author argues for the incorporation of common law principles into the adjudication of NAFTA decisions. His conception of common law principles, however, is broader than what is being discussed here.

arising thereunder.<sup>237</sup> Some investment scholars also argue that a dispute settlement mechanism should be set up under NAFTA for the adjudication of *all* NAFTA disputes, beyond merely the establishment of an appellate body.

While such an appellate body could go a long way in bringing predictability and consistency to Chapter 11 arbitral review, some investment scholars propose an even broader undertaking. From this perspective, the inconsistency of arbitral review under NAFTA is symptomatic of a broader problem relating to the review of investment arbitration more generally, as evidenced by ICSID. In light of this, a proposed solution is to set up an international appellate body, much like the aforementioned NAFTA appellate body, but much broader in scope. The new entity would oversee the review of all investment arbitration worldwide, essentially creating a supra-national mega-structure like that found under the WTO's dispute settlement mechanism.<sup>239</sup> Such a body was proposed by Susan Franck. She states:

“An Investment Arbitration Appellate Court must be concerned with the legitimacy of the system as a whole. Its mandate should permit it to review awards promulgated under more than one investment treaty and focus upon the overall network of investment treaties. Thus far, the broader need for coherence has been ignored in favour of a treaty-by-treaty approach. This is overly simplistic and stands to have a deleterious effect on the long-term legitimacy of investment arbitration.”<sup>240</sup>

In this respect, such an appellate body would operate on a pan-treaty basis, serving as an appeal court of last instance under all the relevant BITs and MITs such as NAFTA. Having such a large mandate would ensure that a significant amount of case law would emerge in fairly short order, allowing for the rapid development of a consistent body of

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<sup>237</sup>Weiler, *supra* note 217, at pg. 164.

<sup>239</sup>See: Coe, *supra* note 214, at pg. 1449; Williams, *supra* note 231, at pg. 175; Franck, *supra* note 11, at pg. 1617.

<sup>240</sup>Franck, *supra* note 11, at pg. 1618.

law. Along these lines, Franck states that given “the overwhelming similarity of the rights promulgated in investment treaties, it is vital to make a comprehensive effort to harmonize and clarify the development of these standards.”<sup>241</sup> Indeed, the basic tenets of investment law are fairly uniform worldwide, particularly with respect to MFN, national treatment and expropriation. As such, it makes sense to have an overarching appellate body that would clarify the application of these principles, instead of the patchwork that currently exists.

It is plain, however, that the establishment of such an international appellate body would be a mammoth undertaking. Most likely, it would require the adoption and ratification of a new convention, much like occurred with the conclusion of the Washington Convention. An international appellate body is therefore a long-term goal that need not operate in opposition to any attempt at establishing a NAFTA appellate body, which is much more achievable in the immediate future. In fact, the two appellate bodies could even operate in tandem, essentially establishing an appellate hierarchy. Of course, measures would have to be implemented that would prevent the abuse or frivolous use of the appellate process, but having a NAFTA appellate body would ensure that the international appellate body not become overburdened. Along similar lines, Franck suggests that an international appellate body could even accommodate ICSID.<sup>242</sup> In this respect, it would complement and augment the current investment arbitration regime rather than turn it upside down.

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<sup>241</sup> *Ibid.*, at pg. 1619.

<sup>242</sup> *Ibid.*, at pg. 1625.

A similar international appellate body was also proposed by Stephen Schwebel who urged that a new investment arbitration convention be drafted by UNCITRAL. Schwebel's proposal, however, is more limited in scope than that discussed above. Rather, he envisaged that reviews under the new appellate body would be limited to procedural matters in order to ensure the "integrity" of the arbitral process, similar to the function ostensibly held by the ICSID annulment proceedings. In this regard, Schwebel stated:

"...the new court would not be entitled to consider the merits of disputes which had been referred to arbitration, or the merits of resultant arbitral awards except insofar as examination of the validity of an arbitral award might require, as typically it would not."<sup>243</sup>

As stated, however, this simply serves to duplicate the function of ICSID's ad hoc committees, and seems rather redundant given the scale of the undertaking. Further, the bulk of the complaints regarding the consistency of investment arbitration review do not rest on procedural concerns. Such a review mechanism, therefore, would do little to address the primary concerns.

## 5.4 CONCLUSION

To conclude, the recent ratification of ICSID will not serve to increase deference and finality of outcome with respect to NAFTA Chapter 11 decisions. ICSID awards have been inconsistent, are often unpublished, and amendments are nearly impossible. More

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<sup>243</sup> Stephen Schwebel, "The Creation and Operation of an International Court of Arbitral Awards," in Hunter Marriott, and Veeder (eds), *The Internationalisation of International Arbitration* (1995), pp. 115-123; also see: Howard Holtzmann, "Task for the 21<sup>st</sup> Century: Creating a New International Court for Resolving Disputes on the Enforceability of Arbitral Awards," in Hunter Marriott, and Veeder (eds), *The Internationalisation of International Arbitration* (1995), pp. 109-114.



importantly, the finality offered by ICSID has shown itself to be inferior to that found under ad hoc arbitration and judicial review by North American courts reviewing NAFTA Chapter 11 awards. In light of this, Canada should not ratify ICSID if it hopes to promote finality of outcome under NAFTA Chapter 11. To the extent that alternatives are sought to the deferential, but somewhat flawed, system of judicial review, the most immediate recommendation would be the establishment of an internalized, NAFTA appellate body that would combine the best aspects of both systems while allowing for the stable and consistent application of review criteria lacking in both. The appellate body would be permanent, so as to avoid the tendency of ad hoc committees to apply different criteria and ignore prior holdings. This would also avoid the application of different review criteria by different levels of courts. Such a structure would be much more conducive to the emergence of a predictable body of case law upon which parties could rely in the review of their awards. In any event, it is clear that the status quo with respect to the review of NAFTA Chapter 11 awards is vastly preferable to the state of flux involved with ICSID review, and on this basis, the ratification of the ICSID Convention will not be helpful in advancing deference and finality of outcome.

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