Investment Disputes under NAFTA

An Annotated Guide to NAFTA Chapter 11

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TABLE OF CONTENTS

APPENDICES

– Save for minor conforming changes (Section A became a subchapter for a time), the provision did not change again until October 2, 1992. At that time, the title was amended to read "Claim by an Investor of a Party on Its Own Behalf." The language of paragraph one was changed slightly. The word "obligation" was inserted into the first sentence, so that it read "An investor of a Party may submit to arbitration under this Section a claim that another Party has breached an obligation under. . . ." Subparagraph (a) was amended to exclude the word "provision" (which was effectively replaced by the word "obligation" in the chapeau), and to include a specific reference to Article 1503(2) (State Enterprises), which had previously been in subparagraph (b). Subparagraph (b) was amended slightly to read "Article 1502(3)(a) (Monopolies and State Enterprises) where the monopoly has acted in a manner inconsistent with the Party's obligations under Section A."[14] The gist of the provision did not change, but with those amendments it reached its final form.

II. COMMENTARY

CONTENTS

A. INTRODUCTION

Articles 1116 is entitled "Claim by an Investor of a Party on Its Own Behalf," while Article 1117 is entitled "Claim by an Investor of a Party on Behalf of an Enterprise." Both, then, have to do with claims submitted by investors, and both serve two primary purposes. First, they are effectively standing provisions,

14. INVEST.002 (Oct. 2, 1992) 11-11, Art. 1116.

describing who is entitled to bring a claim under Chapter 11. Article 1116(1) gives an investor the right to bring a claim on its own behalf, while Article 1117(1) gives an investor that owns or controls an investment that is an enterprise the ability to bring a claim on behalf of that investment. Second, they contain a limitation provision: a claimant must make a claim within three years of having acquired knowledge of the alleged breach, or within three years of the date they *should* have acquired knowledge of the alleged breach, and accompanying loss or damage. Article 1116(1) parallels Article 1117(1), while Article 1116(2) parallels Article 1117(2). It is difficult to separate the commentary on some aspects of these parallel provisions. For that reason, much of the commentary under Article 1116 is applicable to Article 1117 as well, and *vice versa*. For the sake of clarity and parsimony, we will not repeat the commentary under both Articles, but discuss those common issues relating to paragraphs (1) and (2) of each article in this commentary.

B. INTERPLAY BETWEEN ARTICLES 1116 AND 1117

Articles 1116 and 1117 were designed to be broad standing provisions that addressed certain aspects of the customary international law of State responsibility for injuries to aliens. Article 1116 permits an investor to bring a claim on its own behalf for loss or damage incurred by reason of a breach of Section A of Chapter 11. The focus in Article 1116 is on the loss or damage suffered by the investor. An award made under Article 1116 is payable to the investor. Article 1117 permits an investor to bring a claim on behalf of an enterprise of another Party provided that enterprise is both a juridical person that the investor owns or controls, directly or indirectly, and has incurred loss or damage as a result of a breach of Section A of Chapter 11. The focus is on the enterprise, and the damage it suffers. An award under Article 1117 is payable to the enterprise.[15] The U.S. Statement of Administrative Action puts the matter as follows:

> "Articles 1116 and 1117 set forth the kinds of claims that may be submitted to arbitration: respectively, allegations of direct injury to an investor, and allegations of indirect injury to an investor caused by injury to a firm in the host country that is owned or controlled by an investor."[16]

This seemingly simple dichotomy can be, in practice, rather complicated.

1. The Principle of Non-responsibility

Traditionally, international law governs inter-State relationships. "State Responsibility implicates the entirety of a nation's duty to respect the international law rights of other countries. . . ."[17] Under the law of State responsibility for injuries

15. NAFTA Art. 1135(2). The Canadian Model FIPA contains a virtually identical provision, as does the U.S. Model BIT. 2003 Canadian Model FIPA Art. 44; 2004 U.S. Model BIT Art. 34.
16. *See* U.S. Statement of Administrative Action, at 145.

to aliens, a State has certain responsibilities to the nationals of foreign states. Those responsibilities generally do not extend to nationals of the State itself.[18] Thus, an international law claim may not be made against a State by a national of that State, but only by another State on behalf of its national. This is the principle of non-responsibility of States for injuries to its own nationals.[19]

The result of applying this customary international law principle in the realm of investor-State arbitration would be to limit the kinds of claims that could be presented against a host State. First, an investor would have to convince its State to espouse its claim. Second, a U.S. company, even if owned by a foreign investor from another NAFTA Party, could not bring a claim against the United States for a breach of an international obligation owed to itself, such as one found in Section A of Chapter 11. The home State foreign investor could bring such a claim, but only for injury to the foreign investor.

Article 1117 derogates from this rule to a degree by permitting an investor of a Party to submit a claim to arbitration, and by permitting an investor of a Party to bring a claim against another Party on behalf of a juridical person that is an enterprise of that other Party. Because any award made under Article 1117 is payable to the investment by virtue of Article 1135(2), one could view the investment as the beneficiary of any award. Yet the enterprise may not itself assert the claim; its foreign owner is the only entity able to bring the NAFTA claim.[20] Thus, the domestic enterprise may in fact receive some protection from violations of Section A of Chapter 11, but a remedy may only be sought by an investor of another NAFTA Party.

2. The *Barcelona Traction* Problem

In *Barcelona Traction*, the International Court of Justice set forth as a matter of customary international law the principle that shareholders had no standing to bring a claim on behalf of a corporation; only the corporation could act in its own interests.[21] Correlatively, in the law of diplomatic protection, only the State of the corporation, rather than the State of its controlling shareholders, could espouse an international claim on the part of the corporation.

In *Barcelona Traction*, the ICJ dismissed the claim that Belgium asserted on behalf of Belgian shareholders in a Canadian company incorporated under Canadian law and with its principal place of business in Canada. The Canadian company was operating in Spain and had been effectively expropriated by the Spanish government. The ICJ reasoned that municipal law placed great weight on the distinction between the shareholders of a company and the company

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17. DAVID J. BEDERMAN, INTERNATIONAL LAW FRAMEWORKS 80 (2001).
18. The area of international human rights law is an exception to this norm.
19. *See*, e.g., IAN BROWNLIE, PRINCIPLES OF PUBLIC INTERNATIONAL LAW 459–461 (6th ed. 2003); JAMES CRAWFORD, THE INTERNATIONAL LAW COMMISSION'S ARTICLES ON STATE RESPONSIBILITY: INTRODUCTION, TEXTS, AND COMMENTARIES 264–265 (2002).
20. *See* the commentary under Article 1117 for discussion of the ICSID Convention's approach to non-responsibility.
21. *The Barcelona Traction, Light & Power Co. (Belg. v. Spain)*, 1970 I.C.J. 3 [hereinafter *Barcelona Traction*].

itself, and determined that only Canada could espouse the claim on behalf of the Canadian company.[22]

Articles 1116 and 1117 avoid any potential *Barcelona Traction* problem.[23] Article 1117 specifies that an investor of a Party that owns or controls, either directly or indirectly, an enterprise in the territory of another NAFTA Party may advance a claim on behalf of that enterprise. The "directly or indirectly" language solves the problem raised by *Barcelona Traction* and permits a controlling shareholder that is a national of a NAFTA Party to bring a claim on behalf of an enterprise in another NAFTA Party, even if the shareholder owns the controlling interest through intermediaries.

The *Barcelona Traction* distinction between a corporation and its shareholders could also limit claims by shareholders if not for Article 1116. For example, if a Mexican shareholder owned a Mexican corporation, which in turn owned property in Canada, the principle in *Barcelona Traction* would permit only the Mexican corporation to bring a claim for any breach of Section A of Chapter 11. However, an investor of a Party may submit an Article 1116 claim on behalf of an investment that is "owned or controlled directly or indirectly by an investor of a Party." Thus, in the hypothetical described above, the Mexican shareholder could itself bring the claim on behalf of the investment.

3. Derivative Damages

The NAFTA Parties have argued that tribunals should treat seriously the differences between claims under Articles 1116 and 1117. In particular, they have argued that Article 1116 permits a claim only for damage suffered by the investor. If the investment is an enterprise, any claim for damages to the enterprise itself

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22. *Id.* at ¶¶ 41-47.
23. *Barcelona Traction* was decided in the context of diplomatic protection, in which a State was espousing a claim on behalf of its nationals. Its relevance to claims brought under investment treaties that permit claims to be made directly by investors is therefore debatable. Furthermore, in *Elettronica Sicula*, a case brought under the auspices of the Italy–United States Treaty of Friendship, Commerce & Navigation, a Chamber of the International Court of Justice recognized that shareholders could be protected even though the corporation itself had the nationality of the host State. *Elettronica Sicula S.p.A. (U.S. v. Italy)* [1989] I.C.J. 15, 23, 48–82. The International Court of Justice recently had occasion to revisit its holding in *Barcelona Traction*. In the *Case Concerning Ahmadou Sadio Diallo* (Guinea v. Republic of the Congo), the question was whether Guinea could exercise diplomatic protection on behalf of Guinean shareholders in a Congolese company. (Decision on Preliminary Objections) (May 24, 2007). The claims themselves were to be submitted against the Republic of the Congo. Guinea invoked the principle of "protection by substitution," under which foreign shareholders in a company could claim the protection of their home State to assert claims that would otherwise be unavailable because the company itself had the same nationality as the State against which the claims were sought. The ICJ held that, at the present time, there is no principle in customary international law of protection by substitution such as was relied on by Guinea. *Id.* at ¶ 89. The Court did not rule out the possibility of a more limited rule of protection by substitution that could be invoked in circumstances in which a company's incorporation in the State whose conduct was challenged was required as a precondition for doing business in that State, but such was not the case here. *Id.* at ¶¶ 91-93.