Investment Disputes under NAFTA

An Annotated Guide to NAFTA Chapter 11

By

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TABLE OF CONTENTS

GENERAL SECTION

Preface . . . . . General Section 15
Abbreviations . . . . . General Section-17
Notes on Sources . . . . . General Section-19
Introduction . . . . . General Section-23

ANNOTATIONS OF ARTICLES AND ANNEXES

Section A – Investment

Article 1101 – Scope and Coverage

I. Negotiating Text 1101-1
  A. Article 1101, Paragraph 1 – "Measures" 1101-1
  B. Article 1101, Paragraph 1 – "Adopted or Maintained by a Party" 1101-1
  C. Article 1101, Paragraph 1 – "Relating to" 1101-2
  D. Article 1101, Paragraph 1 – "In the Territory" . . . 1101-2
  E. Article 1101, Paragraph 2 1101-5
  F. Article 1101, Paragraph 3 1101-6
  G. Article 1101, Paragraph 4 1101-7
II. Commentary 1101-9
  A. Introduction 1101-9
  B. Scope and Coverage: Jurisdiction and Preliminary Objections 1101-10
  C. Article 1101, Paragraph 1 – Measures Relating to Investors and Investments 1101-27
  D. Article 1101, Paragraph 2 – Exclusive Right to Perform Certain Economic Activities 1101-43
  E. Article 1101, Paragraph 3 – Relationship to Chapter 14 1101-44
  F. Article 1101, Paragraph 4 – Services for a Public Purpose 1101-47
III. Cross-References 1101-48
IV. Secondary Material 1101-49

Article 1102 – National Treatment

I. Negotiating Text 1102-1
II. Commentary 1102-10

A. Background 1102–10
B. Like Circumstances 1102–20
C. "Treatment" – *De Jure and De Facto* Discrimination 1102–35
D. "Treatment" – "No Less Favorable" 1102–44
E. State or Provincial Government Measures 1102–46
F. National Treatment Claims in Pending Cases . . . 1102–49
III. Cross-References 1102–51
IV. Secondary Material 1102–51

Article 1103 – Most-Favored-Nation Treatment
I. Negotiating Text 1103–1
II. Commentary 1103–6
A. Introduction 1103–6
B. MFN Jurisprudence in the NAFTA Context . . . 1103–9
C. MFN Jurisprudence in Non-NAFTA Investor-State Arbitrations 1103–12
D. Questions Raised by MFN Jurisprudence 1103–22
III. Cross-References 1103–24
IV. Secondary Material 1103–25

Article 1104 – Standard of Treatment
I. Negotiating Text 1104–1
II. Commentary 1104–3
III. Cross-References 1104–6
IV. Secondary Material 1104–7

Article 1105 – Minimum Standard of Treatment
I. Negotiating Text 1105–1
II. Commentary 1105–5
A. Article 1105, Paragraph 1 – The Minimum Standard of Treatment 1105–6
B. Article 1105, Paragraphs 2 and 3 – Losses Suffered Owing to Armed Conflict or Civil Strife 1105–51
III. Cross-References 1105–52
IV. Secondary Material 1105–53

Article 1106 – Performance Requirements
I. Negotiating Text 1106–2
II. Commentary 1106–5
A. Definition of Performance Requirements 1106–5
B. Prohibitions on Performance Requirements in Trade and Investment Agreements Generally . . . 1106–7
C. NAFTA Prohibition on Performance Requirements 1106–10
III. Cross-References 1106–17
IV. Secondary Material 1106–17

Article 1107 – Senior Management and Boards of Directors

I. Negotiating Text 1107–1
II. Commentary 1107–2
III. Cross-References 1107–4
IV. Secondary Material 1107–4

Article 1108 – Reservations and Exceptions

I. Negotiating Text 1108–2
II. Commentary 1108–11
A. Reservations and Exceptions Under Article 1108 1108–11
B. General Exceptions Under Chapter 21 1108–19
C. NAFTA Jurisprudence on Article 1108 1108–23
III. Cross-References 1108–26
IV. Secondary Material 1108–27

Article 1109 – Transfers

I. Negotiating Text 1109–1
II. Commentary 1109–4
A. Objectives of Transfer Provisions 1109–5
B. Treaty Provisions 1109–5
C. NAFTA Article 1109 1109–7
D. Balance of Payments Issues 1109–9
E. Provisions in Current Model Investment Treaties 1109–10
III. Cross-References 1109–12
IV. Secondary Material 1109–13

Article 1110 – Expropriation and Compensation

I. Negotiating Text 1110–2
II. Commentary 1110–8
A. Overview – History and Sources of Law 1110–9
B. Scope of Obligation 1110–12
C. Approach to Article 1110 (1)(a) to (d) 1110–30
D. Interests Subject to Expropriation 1110–36
E. Transfer of Expropriated Investment 1110–40
F. Investment in its Territory 1110–41
G. Intent 1110–42
H. Compensation: Article 1110(2)–(6) 1110–44
I. Regulation and Expropriation 1110–49
J. Taxation as Expropriation 1110–55
K. Article 1110(7) 1110–56
L. Article 1110(8) 1110–57
III. Cross-references 1110–58
IV. Secondary Material 1110–58

Article 1111 – Special Formalities and Information Requirements
I. Negotiating Text 1111–1
II. Commentary 1111–3
III. Cross-References 1111–6
IV. Secondary Material 1111–6

Article 1112 – Relation to Other Chapters
I. Negotiating Text 1112–1
II. Commentary 1112–3
A. Article 1112, Paragraph 1 – Inconsistency with Other Chapters 1112–3
B. Article 1112, Paragraph 2 – Requirements on Service Providers 1112–7
III. Cross-References 1112–7

Article 1113 – Denial of Benefits
I. Negotiating Text 1113–1
II. Commentary 1113–4
A. Criteria and Rationale for Denial of Benefits Provisions 1113–5
B. Prior Notification 1113–7
C. Denial of benefits in NAFTA Arbitrations 1113–8
D. Denial of benefits in Non-NAFTA Investor-State Arbitrations 1113–9
III. Cross-References 1113–13
IV. Secondary Material 1113–13

Article 1114 – Environmental Measures
I. Negotiating Text 1114–1
II. Commentary 1114–4
A. The Sovereign Right to Take Environmental Measures 1114–5
B. The Inappropriateness of Relaxing Health, Safety and Environmental Measures to Attract Investment 1114–9
III. Cross-References 1114–12
IV. Secondary Material 1114–13

Section B – Settlement of Disputes between a Party and an Investor of Another Party

Article 1115 – Purpose
I. Negotiating Text 1115–1
II. Commentary 1115–3
A. Investment Disputes 1115–5
B. Equality and Due Process 1115–6
III. Cross-References 1115–11

Article 1116 – Claim by an Investor of a Party on its Own Behalf
I. Negotiating Text 1116–1
II. Commentary 1116–4
A. Introduction 1116–4
B. Interplay Between Articles 1116 and 1117 1116–5
C. Standing 1116–15
D. Three-year Limitation Period 1116–33
III. Cross-References 1116–40
IV. Secondary Material 1116–40

Article 1117 – Claim by an Investor of a Party on Behalf of an Enterprise
I. Negotiating Text 1117–1
II. Commentary 1117–3
A. Consolidation 1117–3
B. "An Investment May Not Make a Claim Under this Section" 1117–5
III. Cross-References 1117–5
IV. Secondary Material 1117–6

Article 1118 – Settlement of a Claim through Consultation and Negotiation
I. Negotiating Text 1118–1
II. Commentary 1118–2
III. Secondary Material 1118–4

Article 1119 – Notice of Intent to Submit a Claim to Arbitration
I. Negotiating Text 1119–1
II. Commentary 1119–2
A. Overview 1119–2
B. Form of Notice of Intent 1119–5
C. Consideration in Awards 1119–11
III. Cross-References 1119–13

Article 1120 – Submission of a Claim to Arbitration
Annex 1120.1 – Submission of a Claim to Arbitration – Mexico
I. Negotiating Text 1120–1
II. Commentary 1120–5
A. Article 1120 – Application 1120–5
B. Procedural Issues in Chapter 11 Cases 1120–13
III. Cross-References 1120–69
IV. Secondary material 1120–70

Article 1121 – Conditions Precedent to Submission of a Claim to Arbitration
I. Negotiating Text 1121–2
II. Commentary 1121–9

A. Introduction and Overview 1121–9
B. Claimants' Waiver of the Right to Initiate or Continue Relief in Other Fora 1121–14
C. The Exhaustion of Local Remedies Rule 1121–28
D. The Exhaustion of Local Remedies Rule in NAFTA Arbitrations 1121–33
III. Cross-references 1121–37
IV. Secondary Material 1121–37

Article 1122 – Consent to Arbitration
I. Negotiating Text 1122–1
II. Commentary 1122–3
III. Cross-References 1122–8
IV. Secondary Material 1122–9

Article 1123 – Number of Arbitrators and Method of Appointment
I. Negotiating Text 1123–1
II. Commentary 1123–2
A. Overview 1123–2
B. Number and Nomination of Arbitrators 1123–3
C. Qualifications and Selection of Arbitrators 1123–4
D. List of NAFTA Chapter 11 Arbitrators 1123–7
E. Appointment 1123–13
F. Replacement of Arbitrators 1123–14
G. Fees and Expenses 1123–15
III. Cross-references 1123–17
IV. Secondary Material 1123–17

Article 1124 – Constitution of a Tribunal When a Party Fails to Appoint an Arbitrator or the Disputing Parties Are Unable to Agree on a Presiding Arbitrator
I. Negotiating Text 1124–1
II. Commentary 1124–2
III. Cross-references 1124–4
IV. Secondary Material 1124–5

Article 1125 – Agreement to Appointment of Arbitrators
I. Negotiating Text 1125–1
II. Commentary 1125–2
A. Consent to Appointment of Arbitrator 1125–2
B. Objection to Presiding Arbitrator Based On Nationality 1125–3
C. Objections Based on Grounds Other Than Nationality 1125–4
D. Applicable Arbitral Rules 1125–4
E. Challenge Procedure 1125–5

F. Impartiality and Independence 1125-7
G. NAFTA Chapter 11 Examples 1125-9
III. Cross-references 1125-13
IV. Secondary Material 1125–13

Article 1126 – Consolidation
I. Negotiating Text 1126–2
II. Commentary 1126-3
A. Overview 1126-4
B. Rationale 1126-4
C. Procedure 1126-6
D. Model Treaties 1126–16
III. Cross-references 1126–16
IV. Secondary Material 1126–17

Article 1127 – Notice
I. Negotiating Text 1127-1
II. Commentary 1127-1
III. Cross-references 1127–2

Article 1128 – Participation by a Party
I. Negotiating Text 1128–1
II. Commentary 1128-1
III. Cross-references 1128-4
IV. Secondary Material 1128–5

Article 1129 – Documents
I. Negotiating Text 1129-1
II. Commentary 1129–1
III. Cross-references 1129–2
IV. Secondary Material 1129-2

Article 1130 – Place of Arbitration
I. Negotiating Text 1130–1
II. Commentary 1130-2
A. Overview 1130-2
B. Selecting the Place of Arbitration 1130-3
C. Where Hearings Are Held 1130–17
D. Changing the Place of Arbitration 1130-18
E. Summary of Decisions 1130-18
III. Cross-references 1130–22
IV. Secondary Material 1130-22

Article 1131 – Governing Law
I. Negotiating Text 1131–1
II. Commentary 1131–2
A. Article 1131, Paragraph 1 – Governing Law 1131–3

B. Article 1131, Paragraph 2 Interpretation of the Free Trade Commission 1131–27
III. Cross-references 1131–36
IV. Secondary Material 1131–36

Article 1132 – Interpretation of Annexes
I. Negotiating Text 1132–1
II. Commentary 1132–3
III. Cross-references 1132–5

Article 1133 – Expert Reports
I. Negotiating Text 1133–1
II. Commentary 1133–2
III. Cross-references 1133–3
IV. Secondary Material 1133–4

Article 1134 – Interim Measures of Protection
I. Negotiating Text 1134–1
II. Commentary 1134–2
A. Overview 1134–2
B. Types of Interim Measures 1134–3
C. Applicable Arbitration Rules 1134–4
D. Article 1134 Interim Measures 1134–7
E. Procedural Issues 1134–11
F. Enforcement Questions 1134–14
III. Cross-references 1134–14
IV. Secondary Material 1134–15

Article 1135 – Final Award
I. Negotiating Text 1135–1
II. Commentary 1135–2
A. Introduction 1135–3
B. Types of Award 1135–4
C. Final Awards 1135–6
D. Bifurcation of Proceedings 1135–8
E. Formal Requirements for Award 1135–11
F. Principles Governing Compensation 1135–13
G. Monetary Damages 1135–17
H. Restitution 1135–25
I. Costs of Arbitration 1135–26
J. Interest 1135–38
K. No Punitive Damages 1135–42
L. Payment to Enterprise 1135–42
M. Post-Award Proceedings 1135–43
III. Cross-references 1135–47
IV. Secondary Material 1135–48

Article 1136 – Finality and Enforcement of an Award
I. Negotiating Text 1136-1
II. Commentary 1136–3
A. Introduction 1136–4
B. Precedential Value of Awards 1136–4
C. Compliance with Awards 1136–6
D. Set-Aside and Annulment of Awards 1136–7
E. Enforcement of Awards 1136–35
III. Cross-references 1136–39
IV. Secondary Material 1136–39

Article 1137 – General
Annex 1137.2 – Service of Documents on a Party Under Section B
Annex 1137.4 – Publication of an Award
I. Negotiating Text 1137–2
II. Commentary 1137–5
A. Time When a Claim is Submitted to Arbitration 1137–5
B. Service of Documents 1137–7
C. Receipts under Insurance or Guarantee Contracts 1137–7
D. Publication of an Award 1137–8
III. Cross-references 1137–9
IV. Secondary Material 1137–9

Article 1138 – Exclusions
Annex 1138.2 – Exclusions from Dispute Settlement
I. Negotiating History 1138–1
II. Commentary 1138–5
A. The Non-Applicability of Chapter 11 to Acquisition of Investments Challenged on National Security Grounds 1138–5
B. The Non-Applicability of Chapter 11 to Acquisitions of Investments Covered by Investment Review Legislation 1138–8
III. Cross-references 1138–9
IV. Secondary Material 1138–10

Section C – Definitions

Article 1139 – Definitions
I. Negotiating Text 1139–2
A. Disputing Investor, Disputing Parties, Disputing Party, Disputing Party 1139–3
B. Enterprise, Enterprise of a Party 1139–4
C. Equity or Debt Securities 1139–7

D. G7 Currency 1139–7
E. ICSID, ICSID Convention, Inter-American Convention 1139–7
F. Investment 1139–7
G. Investment of an investor of a Party 1139–17
H. Investor of a Party 1139–18
I. Investor of a non-Party 1139–21
J. New York Convention 1139–21
K. Secretary-General 1139–21
L. Transfers 1139–21
M. Tribunal 1139–22
N. UNCITRAL Arbitration Rules 1139–22

II. Commentary 1139–22
A. Investment 1139–23
B. Investor of a Party 1139–30

III. Cross-references 1139–35

IV. Secondary Material 1139–35

APPENDICES

Schedules

- Notes of Interpretation on Access to Documents and Minimum Standard of Treatment in Accordance with International Law (July 31, 2001) Appendices–1
- Statement of the Free Trade Commission on Non-disputing Party Participation (October 7, 2003) Appendices–3
- Statement of the Free Trade Commission on Notices of Intent to Submit a Claim to Arbitration (October 7, 2003) Appendices–5
- Statement of Canada on Open Hearings in NAFTA Chapter Eleven Arbitrations (October 7, 2003) Appendices–11
- Statement of United States on Open Hearings in NAFTA Chapter Eleven Arbitrations (October 7, 2003) Appendices–13
- NAFTA Free Trade Commission Joint Statement (Mexico Endorses Open Hearings) (July 16, 2004) Appendices–11

Comprehensive Bibliography Appendices–15

Table of Cases Appendices–47

Index Appendices–55

could only be made under Article 1117. Under this theory, so-called "derivative damages" – damages based on the diminution in value of the interest in the enterprise owned by the investor – would not be compensable under Article 1116.

Article 1116 does permit an investor of a Party to submit a claim alleging that it has been harmed due to injuries suffered by its investment, including an investment that is itself an enterprise.[24] What constitutes injuries suffered separately by the investor that are compensable under Article 1116, and injuries suffered by the investment that is an enterprise, compensable only under Article 1117, must be determined on a case-by-case basis.

Derivative damages raise a concern about double recovery. If an enterprise were indeed to suffer loss or damage due to a breach of Section A of Chapter 11, damages to the enterprise could be awarded under Article 1117. If an investor pursuing a claim on its own behalf could also recover for the diminution in the value of the interest it owned, the injury might be recompensed twice.

Derivative damages also raise a concern about basic corporate structure. If an enterprise is injured, but damages are paid directly to shareholders with standing to bring a claim under an investment treaty such as NAFTA Chapter 11, what is the effect on other shareholders of the corporation and on creditors? Are their rights effectively circumvented by the payment of damages directly to other shareholders?

These questions have not yet been thoroughly addressed in NAFTA jurisprudence. In particular, the questions posed above have not been adequately considered.

In *Pope & Talbot v. Canada*, Pope & Talbot had brought a claim under Article 1116 on behalf of its wholly-owned subsidiary in Canada. Canada argued that the claim should have been submitted under Article 1117, and that Pope & Talbot had suffered no direct injury, but only derivative injury due to the damage to its investment.[25] The tribunal rejected Canada's contention. It cited Article 1121(1)(b), which requires that in an Article 1116 claim which involves "loss or damage to an interest in an enterprise of another Party that is a juridical person that the investor owns or controls directly or indirectly," the enterprise must sign a waiver separate from that of the investor. Thus, concluded the tribunal, NAFTA evidently contemplates an Article 1116 claim arising from loss or damage to an investor's interest in the relevant enterprise.[26] It noted, however, that the investor would still have to prove "that the loss or damage was caused to its interest, and that it was causally connected to the breach complained of."[27]

A similar issue arose in *Mondev Ltd. v. United States*. The United States had challenged Mondev's failure to bring a claim on behalf of its enterprise, Lafayette Place Associates, under Article 1117. Mondev had brought its claim

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24. Article 1121(1)(b) requires that an "investor and, where the claim is for loss or damage to an interest in an enterprise of another Party that is a juridical person that the investor owns or controls directly or indirectly, the enterprise" waive their rights to initiate or continue proceedings with respect to the measure at issue in local courts or administrative proceedings.
25. *Pope & Talbot Inc. (U.S.) v. Canada*, (UNCITRAL) ¶¶ 75–76 (Award in Respect of Damages) (May 31, 2002).
26. *Id.* at ¶ 80.
27. *Id.*