

# UNITED STATES-CHILE FTA CHAPTER 10: LESSONS FROM NAFTA CHAPTER 11 JURISPRUDENCE

*Andrew P. Tuck\**

## I. INTRODUCTION

ON June 6, 2003, the United States, a decade after negotiating the North American Free Trade Agreement (NAFTA), signed a free trade agreement with Chile, based upon NAFTA.<sup>1</sup> Not surprisingly, therefore, like NAFTA, the United States-Chile Free Trade Agreement (“Chile FTA”) also provides robust protections for foreign investors and foreign investments. Specifically, both Chapter 11 of NAFTA<sup>2</sup>, and Chapter 10 of the Chile FTA<sup>3</sup> deal extensively with disputes between investors and the state and provide for appropriate remedies, such as consultation, negotiation, and even arbitration. However, NAFTA Chapter 11 presented many thorny legal issues that Chapter 10 of the Chile FTA attempts to resolve.

This article presents a comparative analysis of the Chile FTA Chapter 10 and NAFTA Chapter 11 dispute resolution processes, by examining the efficacy of Chapter 10 of the Chile FTA in the context of the “minimum standard of treatment”<sup>4</sup> and “expropriation” issues raised by Chapter 11 of NAFTA.<sup>5</sup> Since NAFTA came into effect, Chapter 11 has produced a significant volume of litigation brought by foreign investors against NAFTA host governments, resulting in at least twelve final deci-

---

\* LL.M. International Trade Law, University of Arizona, James E. Rogers College of Law (2007); J.D., University of Miami School of Law (2005); B.A. History, University of Utah (2002); B.A. Spanish, University of Utah (2002). *Admitted* Florida, 2005. Special thanks to my wife Amy for her love and support.

1. Free Trade Agreement, U.S.-Chile, June 6, 2003, Office of the U.S. Trade Representative, [http://www.ustr.gov/Trade\\_Agreements/Bilateral/Chile\\_FTA/Final\\_Texts/Section\\_Index.html](http://www.ustr.gov/Trade_Agreements/Bilateral/Chile_FTA/Final_Texts/Section_Index.html) (last visited Oct. 15, 2006) [hereinafter Chile FTA]; see also DIRECON, General Directorate for International Economic Affairs, [http://www.direcon.cl/index.php?accion=tlc\\_eeuu](http://www.direcon.cl/index.php?accion=tlc_eeuu).

2. See North American Free Trade Agreement, U.S.-Can.-Mex., Dec. 17, 1992, 32 I.L.M. 639, ch. 11 [hereinafter NAFTA]; see also North American Free Trade Agreement, 19 U.S.C.A. §§ 3301-3473 (West 2008).

3. See Chapter 10 Chile FTA, *supra* note 1.

4. See discussion *infra* art. 1105 of NAFTA.

5. *Id.* at art. 1110.

sions.<sup>6</sup> Among them, *Metalclad v. United Mexican States*,<sup>7</sup> *S.D. Myers v. Canada*,<sup>8</sup> *Pope & Talbot v. Canada*,<sup>9</sup> *Loewen v. United States*,<sup>10</sup> and *Methanex v. United States*,<sup>11</sup> have generated considerable criticism from NAFTA member governments and non-governmental organizations concerned with national sovereignty, the erosion of democratic governance, and environmental and labor protections.<sup>12</sup>

Consequently, the NAFTA parties reacted, both to public pressure and anticipated NAFTA litigation, by attempting to narrow the scope of state liability. The states issued an “interpretation” of NAFTA Article 1105 that applies international customary law to limit the scope of “fair and equitable treatment”<sup>13</sup> under international law.<sup>14</sup> This is contrary to Article 38 of the Statute of the International Court of Justice, which states that custom is only one of four sources of international law; therefore, the scope of “fair and equitable treatment” should be broader than the states’ interpretation.

In addition, the state parties have argued that NAFTA Chapter 11’s nationalization and expropriation provisions should not afford coverage for indirect or “creeping” expropriation—namely, when reasonable government regulation, including environmental regulation reduces the value of a foreign investor’s property interest. Still, the NAFTA governments have struggled to find a balance between foreign investment protections and valid governmental or administrative regulations.

Although Chile FTA Chapter 10 is modeled after NAFTA Chapter 11, Chapter 10 investor-state dispute resolution attempts to address the major concerns voiced about NAFTA Chapter 11 dispute resolution by providing more “transparency, public input into the dispute settlement, mechanisms to improve the investor-state process by eliminating frivolous claims,” and the possibility of establishing a future appellate mechanism to review arbitral awards under the agreement.<sup>15</sup>

---

6. NAFTA Claims, The Disputes: Pleadings, Orders & Awards, <http://www.naftaclaims.com/disputes.htm>.

7. *Metalclad Corp. v. United Mexican States (U.S. v. Mex.)*, ICSID (W. Bank) Case No. ARB(AF)/97/1, 40 I.L.M. 36 (2001), <http://naftaclaims.com/Disputes/Mexico/Metalclad/MetalcladFinalAward.pdf>.

8. See generally *S.D. Meyers, Inc. v. Canada*, 40 I.L.M. 1408 (2001).

9. *Pope & Talbot, Inc. v. Canada*, 41 I.L.M. 1347 (2002).

10. *Loewen Group, Inc. v. United States*, 42 I.L.M. 811 (2003).

11. *Methanex v. United States*, (NAFTA Arb. Trib. (Aug. 7, 2002)) [http://naftaclaims.com/Disputes/USA/Methanex/Methanex\\_Final\\_Award.pdf](http://naftaclaims.com/Disputes/USA/Methanex/Methanex_Final_Award.pdf).

12. See David A. Gantz, *The Evolution of FTA Investment Provisions: From NAFTA to the United States-Chile Free Trade Agreement*, 19 AM. U. INT’L L. REV. 679, 686 (2004).

13. See discussion of “fair and equitable treatment” *infra*. Foreign investors should not lack the protection and security afforded to nationals, and should not, in comparison with nationals, be put at a competitive disadvantage in obtaining permits or authorizations necessary to conduct business operations in the state concerned.

14. See NAFTA, *supra* note 2, at art. 1105(1).

15. See United States-Chile Free Trade Agreement Implementation Act, H.R. Rep. No. 108-224, pt. I, at 3 (2003) [hereinafter Chile FTA Implementation Act].

Whether Chapter 10 dispute resolution will generate similar criticisms as NAFTA Chapter 11, of course, remains to be seen. For now, one must consider how and to what extent the Chapter 10 text differs from or expands upon investor-state arbitration under NAFTA Chapter 11. Part I of this article will review the origin of NAFTA Chapter 11. Although NAFTA was the first major free trade agreement between developing and developed countries, most of the key language regarding the definition of investment and investors, national treatment, fair and equitable treatment, expropriation, and the requirement for binding international arbitration of investment disputes generally derives from over forty U.S. bilateral investment treaties (BITs) concluded since the early 1980s.<sup>16</sup>

Part II discusses NAFTA Chapter 11 with emphasis on Article 1105, the “minimum standard of treatment,” and Article 1110, “expropriation.” These provisions have generally been the most difficult for NAFTA arbitrators to apply and interpret.<sup>17</sup>

Part III will analyze Chile FTA Chapter 10’s “fair and equitable treatment,” and “expropriation” standards, commenting on the rationale behind the open investment provisions and the reasons for some exceptions to the open regime.

Part IV will then examine select articles of the Chapter 10 investor-state dispute resolution process in detail and compare it to NAFTA Chapter 11. Free Trade Agreements (“FTAs”) between developed and developing countries are now more common, so it is logical to look to NAFTA for lessons as the United States pursues FTAs with several developing (and developed) countries. Indeed, the Chile FTA was intended to be a bellwether for future FTAs in Latin America and simultaneously provide an incentive for countries in the hemisphere to continue Free Trade Area of the Americas (“FTAA”) negotiations.<sup>18</sup> Finally, Part V speculates on the extent to which the changes in Chapter 10 of the Chile FTA might affect the results of future foreign investment disputes. Chapter 10 solidifies the applicability of international law to foreign investment disputes, providing greater transparency to the international arbitration process between private individuals and sovereign entities. Chapter 10 of the Chile FTA is evidence that investment dispute resolution based on principles of international law belong in FTAs in the

---

16. For additional information on BITs, see K. Scott Gudgeon, *United States Bilateral Investment Treaties: Comments on Their Origin, Purposes, and General Treatment Standards*, 4 INT’L TAX & BUS. L. 105, 112-129 (1986).

17. See Gantz, *supra* note 12, at 692.

18. In December of 1994, thirty-four democratic countries met in Miami, Florida at the Summit of the Americas, with the goal of fashioning the FTAA. See FTAA, [http://www.ftaa-alca.org/View\\_e.asp](http://www.ftaa-alca.org/View_e.asp) and Summit of the Americas, <http://www.summit-americas.org>. See also Sidney Weintraub, *Lessons from the Chile and Singapore Free Trade Agreements*, in *Free Trade Agreements: U.S. Strategies and Priorities* 79 (Jeffrey J. Schott ed., 2004) [hereinafter Weintraub, *Free Trade Agreements*].

Americas.<sup>19</sup>

## II. THE ORIGINS OF NAFTA CHAPTER 11

NAFTA broke new ground with Chapter 11, the investor-dispute resolution mechanism. Indeed, the NAFTA state parties waived sovereign immunity for private party claims to a degree far greater than before, such as in jurisdictional issues involving the International Court of Justice.<sup>20</sup> The investment provisions of NAFTA Chapter 11, however, are not completely innovative. Actually, NAFTA Chapter 11 was based in large part on the U.S. Model Bilateral Investment Treaty (“BIT”)<sup>21</sup> and earlier treaties that provided prompt, adequate, and effective compensation for expropriation as a response to economic nationalists’ assertions that expropriated investors were entitled to no more than the same treatment that states afford its nationals.<sup>22</sup> Indeed, the U.S. Model BIT obligates a host state, at the request of the investor, to submit investment disputes to binding third-party arbitration. In light of this, NAFTA’s establishment of similar arbitral panels, therefore, is not revolutionary.

Specific aspects of NAFTA investor–state arbitration are, nonetheless, dissimilar to the American Model BIT. For example, the BIT program typically paired the United States, a developed exporter of capital, with a developing state that imports capital but exports very little of it. In fact, prior to the Canada FTA and NAFTA, all of the BITs the United States entered into were with developing countries, and the Canada FTA incorporated neither the “fair and equitable” treatment language nor binding international arbitration.

Conversely, NAFTA combines comprehensive investment protections and provision for direct claims as between two States with substantial capital exchange. Indeed, the bilateral investment relationship between Canada and the United States is one of the most extensive in the world, with more than \$1.4 billion of trade per day between the two nations.<sup>23</sup> The United States is Canada’s largest investor at \$175 billion, while Canada’s \$134 billion trade with the United States ranks seventh.<sup>24</sup> Their well-developed legal systems, with independent judiciaries, provide a

19. See Scott R. Jablonski, *¡Sí Po! Foreign Investment Dispute Resolution Does Have a Place in Trade Agreements in the Americas: A Comparative Look at Chapter 10 of the United States-Chile Free Trade Agreement*, 35 U. MIAMI INTER-AM. L. REV. 627, 631 (2004). Recently, the United States has negotiated bilateral FTA’s with the five Central American countries and the Dominican Republic (CAFTA-DR), Peru (PTPA) and Colombia (CTPA). In addition, the US Trade Representative opened talks with Bolivia, Ecuador, and Panama in 2004. Uruguay, moreover, signed a BIT with the United States.

20. See Gantz, *supra* note 12, at 685.

21. 2004 U.S. Model Bilateral Investment Treaty, [http://ustr.gov/assets/Trade\\_Sectors/Investment/Model\\_BIT/asset\\_upload\\_file847\\_6897.pdf](http://ustr.gov/assets/Trade_Sectors/Investment/Model_BIT/asset_upload_file847_6897.pdf).

22. Barton Legum, *The Innovation of Investor-State Arbitration Under NAFTA*, 43 HARV. INT’L L. J. 531, 534 (2002) [hereinafter Legum, *Investor-State Arbitration*].

23. See Gantz, *supra* note 12, at 697.

24. *Id.*

R

R

high level of protection for both foreign and domestic investors against arbitrary actions by the governments.

Direct claims against a member State, therefore, create substantial litigation risks for each treaty partner.<sup>25</sup> Not surprisingly, actions by U.S. investors against Canada or Canadian investors against the United States account for roughly sixty percent of NAFTA Chapter 11 disputes.<sup>26</sup> Hence, NAFTA is also a departure from the typical BIT scenario.<sup>27</sup> The distinction between NAFTA Chapter 11 and the Model BIT is important. Even though the Model BIT provisions are reciprocal,<sup>28</sup> the litigation risk is not: the developed State will not likely face a claim by an investor of a developing State.

Recently, the United States came close to adopting BIT-type language for all disputes among major developed countries through the Multilateral Agreement on Investment (MAI).<sup>29</sup> Yet the MAI negotiations failed because U.S. and Canadian government officials were concerned that BIT investment protection rules provided excessively broad protection to foreign investors.<sup>30</sup> Had the MAI been adopted, the United States and Canada would have likely faced several billions worth of North American, European, and Japanese investments claims.<sup>31</sup>

### III. NAFTA'S FOREIGN INVESTMENT PROVISIONS

NAFTA Chapter 11, entitled "Investment," serves two purposes. First, it provides a set of mandatory substantive provisions, which include, *inter alia*, most-favored-nation treatment, performance requirements, nationality of senior management, and financial transfers.

Second, NAFTA Chapter 11 provides for binding dispute arbitration between foreign investors and their host governments under the United Nations Commission on International Trade Law (UNCITRAL) arbitration rules, the World Bank's International Centre for the Settlement of Investment Disputes (ICSID) Convention, or the ICSID's "Additional Facility Rules."<sup>32</sup>

If a NAFTA arbitral tribunal concludes that a host government has violated any of its Chapter 11 obligations, the tribunal may require that government to pay compensation to the foreign-investor complainant.<sup>33</sup> An investor, moreover, may seek enforcement of an arbitration award under the ICSID, New York, or InterAmerican Conventions.<sup>34</sup> Although

25. *Id.* at 685.

26. *Id.* at 697-98.

27. *See Legum, Investor-State Arbitration, supra* note 22, at 537.

28. *See* Chapter 11 of NAFTA, *supra* note 2 (illustrating that all investment provisions apply equally to the other party or parties). R

29. *See* Multilateral Agreement on Investment, Organization for Economic Co-operation and Development, <http://www.oecd.org/daf/mai/intro.htm>.

30. *Id.*

31. *See* Gantz, *supra* note 12, at 696. R

32. *See* NAFTA, *supra* note 2, at art. 1120.

33. *Id.* at art. 1135.

34. *Id.* at art. 1136(6).

NAFTA Chapter 11 contains a comprehensive set of mandatory substantive provisions, Chapter 11's most important and controversial provisions relate to "fair and equitable treatment" and "expropriation."

#### A. FAIR AND EQUITABLE TREATMENT

Article 1105 states that "each Party shall accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security."<sup>35</sup> Because the drafters connected the "fair and equitable treatment" and "full protection and security" standards with "international law," foreign investors asserting that the state had denied them fair and equitable treatment must demonstrate that the denial was a violation of international law.<sup>36</sup>

Unfortunately, there was little guidance regarding the definition of "fair and equitable treatment." NAFTA itself never defines the precise meaning of "fair and equitable treatment," and the U.S. Statement of Administrative Action, which accompanied NAFTA to Congress in 1993, never mentions Article 1105.<sup>37</sup> However, the Canadian Statement on Implementation of NAFTA explained that Article 1105(1) "provides for a minimum absolute standard of treatment, based on long-standing principles of customary international law."<sup>38</sup>

The difference between "international law" and "customary international law" has been a primary source of contention in investor-state arbitration proceedings. Under Article 1105, the term "international law" suggests a broader scope than "customary international law." For instance, Article 38 of the Statute of the International Court of Justice defines international law to include: "(a) international conventions, (b) international custom, (c) the general principles of law recognized by civilized nations, and (d) judicial decisions and the teachings of the most highly qualified publicists of the various nations."<sup>39</sup> In other words, customary international law is merely a subset of international law.<sup>40</sup> Customary international law is "created and sustained by the constant and uniform practice of States," and indicates "the mutual conviction that the recurrence is the result of a compulsory rule."<sup>41</sup> It is one possible interpretation of the "fair and equitable treatment" language, not the only definition.

---

35. *Id.* at art. 1105(1).

36. See Daniel M. Price & P. Bryan Christy, *An Overview of the NAFTA Investment Chapter: Substantive Rules and Investor-State Dispute Settlement*, 27 *Int'l Law* 727, 729 (1993).

37. *Id.*

38. North American Free Trade Agreement: Canadian Statement on Implementation, *C. Gaz.* (Jan. 1, 1994), at 149.

39. See Statute of the International Court of Justice, June 26, 1945, art. 38.

40. *Id.*

41. See Barry E. Carter, Phillip R. Trimble, & Curtis A. Bradley, *INTERNATIONAL LAW* (4th ed. 2003) (1991).

## B. EXPROPRIATION

NAFTA Chapter 11's nationalization and expropriation provisions afford protection for foreign investors against effective expropriation, or "creeping" expropriation. Chapter 11 states:

No Party may directly or indirectly nationalize or expropriate an investment of an investor of another Party in its territory or take a measure tantamount to nationalization or expropriation of such an investment ("expropriation"), except: (a) for a public purpose; (b) on a non-discriminatory basis; (c) in accordance with due process of law and article 1105(1); and (d) on payment of compensation in accordance with paragraphs 2 through 6.<sup>42</sup>

Still, even under these relatively well-established customary international law principles, it is difficult to determine when a government action that interferes with broadly defined property rights constitutes an illegal, compensable taking.

## C. NAFTA CASE LAW PRIOR TO THE FTC INTERPRETATION

Since NAFTA became effective on January 1, 1994, several Chapter 11 tribunals have considered the scope of Article 1105 "minimum standard of treatment" and Article 1110 "expropriation." Although "[a]n award made by a Tribunal shall have no binding force except between the disputing parties and in respect of a particular case," prior decisions may have persuasive authority.<sup>43</sup> Consequently, it is important to examine NAFTA case law. In particular, decisions in cases such as *Metalclad, S.D. Myers, Pope & Talbot, Loewen* and *Methanex* have influenced the revised language concerning investors rights provided under Chapter 10 of the Chile FTA.

In *Metalclad v. United Mexican States*,<sup>44</sup> Metalclad, a Delaware company, claimed that a Mexican municipality's denial of a construction license based on environmental grounds violated NAFTA Articles 1105 "fair and equitable treatment standard" and 1110 "expropriation."<sup>45</sup> COTERIN, Metalclad's wholly owned subsidiary, received authorization from the Mexican federal government to construct a hazardous waste landfill located in Guadalucazar, San Luis Potosí.<sup>46</sup> Soon thereafter, the Governor of San Luis Potosí began a public campaign to oppose the landfill. The municipality of Guadalucazar ordered Metalclad to stop construction, citing Metalclad's lack of a municipal permit.<sup>47</sup> Metalclad applied for a permit and reaffirmed its belief that federal officials had already

42. See NAFTA, *supra* note 2, at art. 1110.

43. *Id.* at art. 1136(1).

44. *Metalclad Corp. v. United Mexican States (U.S. v. Mex.)*, ICSID (W. Bank) Case No. ARB(AF)/97/1, 40 I.L.M. 36 (2001), <http://naftaclaims.com/Disputes/Mexico/Metalclad/MetalcladFinalAward.pdf>.

45. *Id.* at 37.

46. *Id.* at 41.

47. *Id.* at 42.

authorized the landfill's construction.<sup>48</sup> Metalclad relied on the federal government's assurances that no state or municipal permits were required. Immediately upon the landfill's completion, however, demonstrators and state troopers blocked traffic to and from the site, effectively preventing operation of the landfill.<sup>49</sup>

Subsequently, Guadalcázar denied Metalclad's application for a municipal permit on environmental grounds.<sup>50</sup> After Metalclad initiated Chapter 11 proceedings against Mexico, the governor of San Luis Potosí issued an ecological decree to protect rare cactus and declared the landfill a "natural area."<sup>51</sup>

The arbitral tribunal held that Mexico's failure to provide a transparent regulatory system denied Metalclad fair and equitable treatment in accordance with international law, as required by Article 1105.<sup>52</sup> The tribunal stated that NAFTA's "fair and equitable treatment" language, combined with its underlying objectives to promote and increase cross-border investment opportunities and ensure the successful implementation of investment initiatives,<sup>53</sup> required all relevant legal requirements for initiating, completing, and successfully operating investments made, or intended to be made under the Agreement, to be transparent.<sup>54</sup>

In this case, Metalclad had relied on the Mexican federal government's assurances that it had followed all necessary requirements and procedures to construct and operate the landfill. Mexico, however, failed to notify Metalclad of the requisite municipal permit. Consequently, Mexico failed to ensure a transparent and predictable framework in order for Metalclad to properly plan its business and investment, amounting to a violation of Article 1105.<sup>55</sup>

Additionally, the tribunal found that Mexico violated Article 1110 because the municipality's action "effectively and unlawfully prevented [Metalclad's] operation of the landfill."<sup>56</sup> The Governor, in his final effort to block the hazardous waste landfill, declared the concession area part of an "ecological preserve." This official action effectively barred the landfill's operation permanently, thus rendering Metalclad's investment worthless.

In holding that the expropriation was indirect, the tribunal may have added an unnecessary level of complexity to the determination of expropriation. Instead of simply characterizing the Governor's actions as direct interference that resulted in expropriation, the tribunal characterized

---

48. *Id.*

49. *Id.* at 43.

50. *Id.*

51. *Id.* at 44.

52. *Id.* at 50.

53. *See* NAFTA, *supra* note 2, at art. 102(1).

54. Metalclad Corp. v. United Mexican States (U.S. v. Mex.), ICSID (W. Bank) Case No. ARB(AF)/97/1, 40 I.L.M. 36 (2001), <http://naftaclaims.com/Disputes/Mexico/Metalclad/MetalcladFinalAward.pdf>.

55. *Id.* at 50.

56. *Id.*

the rezoning as an indirect act that effectively expropriated the investor's property by rendering it worthless. In other words, the tribunal broadly defined Article 1110 to protect against both actual and effective forms of expropriation.<sup>57</sup>

The *Metalclad* tribunal's broad interpretation of Article 1105's "fair and equitable treatment" distressed the NAFTA parties. Indeed, the *Metalclad* tribunal had expanded the scope of Article 1105's investment protections and potentially exposed the member governments to excessive amounts of investment claims. There is no explicit obligation to provide transparency to investors under Article 1105(A). General NAFTA obligations with respect to transparency are only found in Chapter 18.<sup>58</sup>

In *S.D. Myers, Inc. v. Canada*,<sup>59</sup> S.D. Myers, an Ohio company engaged in remediation of hazardous waste, alleged that Canada's export ban of polychlorinated biphenyl (PCB) waste denied it fair and equitable treatment under Article 1105 and was enacted to benefit Chem-Securities, Canada's only PCB treatment facility located in Alberta, Canada.<sup>60</sup> S.D. Myers entered the Canadian market to obtain PCB waste for treatment in Ohio. S.D. Myers enjoyed a significant cost advantage over Chem-Securities: it was cheaper for Ontario PCB producers to ship their waste a few hundred miles to Ohio rather than 1,500 miles to Alberta. In 1995, however, the Canadian Minister of the Environment issued interim and final orders that temporarily banned PCB exports from Canada. Canadian companies had to treat their PCB wastes at Chem-Securities.

S.D. Myers also charged that the export ban of hazardous waste to the firm's treatment facilities in the United States was "tantamount to expropriation."<sup>61</sup> Indeed, as demonstrated in *Metalclad* under international law, expropriation can be actual or effective. As such, Canada's ban on PCB waste exports effectively excluded S.D. Myers from the Canadian PCB waste treatment market.<sup>62</sup>

Canada argued, however, that the ban was enacted in order to comply with the Basel Convention, an international environmental agreement

---

57. *Gantz*, *supra* note 12, at 736. Shortly thereafter, the British Columbia Supreme Court (a trial court) reviewed and reversed parts of the *Metalclad* award. The International Commercial Arbitration Act (ICAA), a British Columbia statute, granted the BCSC jurisdiction to review the arbitral tribunal's award because Vancouver, British Columbia had served as the seat of the arbitration. The BCSC held that NAFTA Article 102(1)'s transparency principle was not an actionable obligation under Chapter 11: the tribunal exceeded the scope of investor-State arbitration by combining "transparency" and "fair and equitable treatment." Accordingly, it reversed the fair and equitable treatment and indirect expropriation violations based on denial of transparency. See *United Mexican States v. Metalclad Corp.*, [2001] 89 B.C.L.R. 3d 359 (Can.). Note, however, that the BCSC did not hold that Mexico provided *Metalclad* with "fair and equitable treatment;" only that transparency requirement is not an element to be considered in an Article 1105 analysis.

58. See NAFTA, *supra* note 2, at arts. 1801-04.

59. *S.D. Meyers, Inc. v. Canada*, 40 I.L.M. 1408 (2001).

60. *Id.* at 1422.

61. *Id.*

62. *Id.*

developed under the auspices of the United Nations Environment Programme.<sup>63</sup>

The tribunal held that because the “[m]inimum [s]tandard of [t]reatment” encompasses the international law requirements of due process, economic rights, and obligations of good faith and natural justice,<sup>64</sup> Canada had violated Article 1105 through blatant discrimination with its hazardous waste processing facility in Alberta and in S.D. Myers’s similar facility in Ohio.<sup>65</sup> The tribunal asserted that Article 1105(1)’s “fair and equitable treatment,” and “full protection and security” language must be read in conjunction with the introductory phrase “treatment in accordance with international law.”<sup>66</sup> Consequently, an Article 1105 breach occurs only “when. . . an investor has been treated in such an unjust or arbitrary manner that the treatment rises to the level that is unacceptable from the international perspective.”<sup>67</sup> Discriminatory and unfair treatment is also a denial of good faith under Article 1105 as foreign investors should not lack the protection and security afforded to nationals.<sup>68</sup>

Thus, it is clear that the *S.D. Myers* tribunal broadly interpreted the “fair and equitable treatment” standards under Article 1105 in favor of foreign investors.<sup>69</sup> At the same time, the arbitral tribunal rejected S.D. Myers’ expropriation claim.<sup>70</sup> The tribunal stated that “expropriation” is considered a permanent interference with ownership and economic rights rather than the “lesser interference” of government regulation.<sup>71</sup> Canada’s interference in S.D. Myers’ business was temporary and therefore did not violate Article 1110.<sup>72</sup>

In *Pope & Talbot*,<sup>73</sup> a U.S. corporation alleged that Canada’s enactment of an export quota system under the 1996 Softwood Lumber Agreement with the United States discriminated against its Canadian subsidiary in violation of Article 1105’s “minimum standard of treatment” clause.<sup>74</sup>

Additionally, *Pope & Talbot* argued that the Article 1110 standard of protection was according to international law, not merely “customary”

---

63. The Basel Convention prohibits the export and import of hazardous wastes to and from states that are not party to the Agreement. At the time the United States had signed but not ratified the Convention.

64. See *S.D. Myers*, 40 I.L.M. at 1481.

65. See *Id.* at 1448-50.

66. *Id.* at 1438.

67. *Id.*

68. See *id.*

69. See *id.* Fair and equitable treatment is subsumed in the international law standard; since international law includes rules designed to protect investors, a denial of national treatment under Article 1102 can also be violation of Article 1105, as it was in this case. *Id.*

70. *Id.* at 1440.

71. *Id.* (“An expropriation usually amounts to a lasting removal of the ability of an owner to make use of its economic rights. . . .”).

72. *Id.*

73. See *Pope & Talbot*, Award on the Merits of Phase 2 (Apr. 10, 2001), <http://www.naftaclaims.com/Disputes/Canada/Pope/PopeFinalMeritsAward.pdf>.

74. See *Id.* ¶ 106.

international law.<sup>75</sup> Accordingly, “tantamount to expropriation” means indirect expropriation, including all “non-discriminatory measures of general application”<sup>76</sup> which substantially interfere with foreign investments.<sup>77</sup>

Canada asserted, however, that according to international law, an Article 1105 minimum treatment standard violation required “egregious” state conduct.<sup>78</sup> Canada’s enactment of a lumber export control regime merely reallocated quotas among Alberta, British Columbia, Ontario, and Quebec and reduced Pope & Talbot’s exports to the United States.<sup>79</sup> Canada argued, therefore, that its actions did not rise to the level of “egregious” conduct under international law.<sup>80</sup>

Additionally, Canada argued that “mere interference is not expropriation; rather, a significant degree of deprivation of fundamental rights of ownership is required.”<sup>81</sup> Indeed, the term “tantamount” simply meant “equivalent,” and, therefore, did not expand Article 1110’s scope to cover governmental regulatory action.<sup>82</sup>

The arbitral tribunal held that Canada’s Softwood Lumber Division of the Department of Foreign Affairs and International Trade (SLD) failed to provide Pope & Talbot’s investment fair and equitable treatment.<sup>83</sup> The tribunal also held that the NAFTA right to “fair and equitable treatment” was independent of, rather than limited by, the phrase “treatment in accordance with international law.”<sup>84</sup>

The tribunal also rejected Canada’s more narrow interpretation of Article 1110 and partially accepted Pope & Talbot’s broader interpretation that indirect expropriation includes all non-discriminatory measures that substantially interfere with investments of investors of NAFTA parties.<sup>85</sup> The tribunal, nonetheless, ultimately found that Canada did not violate Article 1110.<sup>86</sup> Canada’s export quota system did not “substantial[ly]” deprive Pope & Talbot of its investment.<sup>87</sup>

---

75. *See id.* ¶¶ 107, 112, 113.

76. Article 1110 states: “No party may directly or indirectly nationalize or expropriate an investment of an investor of another Party. . . or take a measure tantamount to nationalization or expropriation of such an investment (“expropriation”) except. . . (b) on a non-discriminatory basis. . . .” NAFTA, *supra* note 2, at art. 1110.

77. *See Pope & Talbot*, Award on the Merits of Phase 1 at ¶ 104 (June 26, 2000), <http://www.naftaclaims.com/Disputes/Canada/Pope/PopeInterimMeritsAward.pdf>. For further discussion on the merits of the Article 1110 claim, *See id.* ¶¶ 96-104.

78. *Pope & Talbot*, Award on the Merits of Phase 2, *supra* note 73, ¶ 108. The “threshold” of the government conduct at issue requires “gross misconduct, manifest injustice or. . . an outrage, bad faith, or the willful neglect of duty.” *Id.* ¶ 108 n.93 (internal citation omitted).

79. *Id.* ¶¶ 20-21, 92-94, 121.

80. *See Id.* ¶¶ 108-09.

81. *Pope & Talbot*, Award on the Merits of Phase 1, *supra* note 77, ¶¶ 87-88.

82. *Id.* at ¶ 89.

83. *Pope & Talbot*, Award on the Merits of Phase 2, *supra* note 73, at ¶ 181.

84. *Id.* at ¶ 111.

85. *Pope & Talbot*, Award on the Merits of Phase 1, *supra* note 77, at ¶ 96.

86. *Id.* at ¶¶ 96, 105.

87. *Id.* at ¶ 96.

D. THE FTC INTERPRETATION AND ITS IMPACT ON FUTURE  
CHAPTER 11 TRIBUNALS

NAFTA Article 1131(2) permits the trade ministers from each party, acting as the Free Trade Commission (FTC), to issue interpretations of NAFTA, which is binding on Chapter 11 tribunals.<sup>88</sup> After the *Pope & Talbot* tribunal held that Canada breached Article 1105, the NAFTA governments issued their first, and, to date, only NAFTA Chapter 11 “Interpretation” to narrow the scope of “fair and equitable treatment” to what customary international law provides.<sup>89</sup> This Interpretation of Article 1105(1) states the following:

## B. Minimum Standard of Treatment in Accordance with International Law

1. Article 1105(1) prescribes the *customary* international law minimum standard of treatment to be afforded to investments of investors of another Party.
2. The concepts of “fair and equitable treatment” and “full protection and security” do not require treatment in addition to or beyond that which is required by the *customary* international law minimum standard of treatment of aliens.
3. A determination that there has been a breach of another provision of the NAFTA, or of a separate international agreement, does not establish that there has been a breach of Article 1105(1).<sup>90</sup>

The “customary international law” standard under Section B(1), as opposed to Article 1105’s “international law” language, substantially limits Chapter 11 investment protection provisions.<sup>91</sup> Simply put, the Interpretation does not require that the concepts of “fair and equitable treatment” and “full protection and security” be ignored, but rather that they be subsumed in the minimum standard of treatment of aliens.

Section B(2) effectively overrules the then pending *Pope & Talbot* award, clarifying that “fair and equitable treatment” and “full protection and security” are afforded only to the extent required by customary international law.<sup>92</sup> Finally, in response to the *S.D. Myers* holding that Canada had violated the minimum standard of treatment provisions of Article 1105 through blatant discrimination between its hazardous waste processing facility in Alberta and *S.D. Myers*’ similar facility in Ohio,<sup>93</sup> paragraph 3 prohibited a claimant from basing an Article 1105 violation largely on a finding of an Article 1102 national treatment violation.

---

88. NAFTA, *supra* note 2, at art. 1131(2).

89. NAFTA Free Trade Commission, Notes of Interpretation of Certain Chapter 11 Provisions § B (July 31, 2001), [http://www.naftaclaims.com/files/NAFTA\\_Comm\\_1105\\_Transparency.pdf](http://www.naftaclaims.com/files/NAFTA_Comm_1105_Transparency.pdf).

90. *Id.* (emphasis added).

91. *See Id.*

92. *See Id.*

93. *S.D. Myers*, 40 I.L.M. 1408, 1438-39, ¶¶ 263-69.

The FTC Interpretation, however, immediately sparked controversy. The *Pope & Talbot* tribunal suggested that the parties' interpretation was actually a back-door effort to amend NAFTA without the approval of each party's constitutional processes.<sup>94</sup> Indeed, the FTC had effectively amended Article 1105(1) by inserting the word "customary" before "international law," thus limiting the scope of Article 1105 protections. The United States defended the Interpretation and criticized the *Pope & Talbot* tribunal by arguing that treaty law and arbitral decisions were not relevant in determining "customary international law" unless there was evidence of a general practice and agreement in the literature or prior court cases. As noted previously, Canada urged the *Pope & Talbot* tribunal to award damages pursuant to a violation of customary international law only if the tribunal found Canada acted egregiously or otherwise failed to meet internationally required standards.<sup>95</sup>

In the end, the *Pope & Talbot* tribunal held that the Interpretation was binding, but it refused to accept the static version of customary law advanced by Canada and the other parties.<sup>96</sup> Instead, the tribunal believed that the range of actions subject to international concern included the concept of fair and equitable treatment,<sup>97</sup> which was recognized by the Organization for Economic Co-operation and Development (OECD),<sup>98</sup> and was central to the 1,800 BITs negotiated to protect foreign-owned property.<sup>99</sup> This clearly evidenced state practice towards the formation of customary international law.<sup>100</sup> The tribunal, nevertheless, did not decide the applicable customary international law standard because Canada's Softwood Lumber division violated Article 1105 by treating Pope & Talbot in an egregious manner.<sup>101</sup>

Several subsequent Chapter 11 tribunals have struggled with these same issues. In fact, many have backed away from the idea that the Interpretation was an attempt not to interpret, but to amend indirectly, NAFTA. Consequently, *Loewen*,<sup>102</sup> and *Methanex*,<sup>103</sup> both post-Interpretation cases, have great importance in terms of shaping government and public policy with regard to Chapter 11 and the application of the FTC Interpretation.

The facts leading up to *Loewen* are as follows. O'Keefe, an owner of several funeral homes and Gulf National Funeral Insurance Company, sued Loewen, a Canadian funeral home conglomerate, in Mississippi state court for breach of contract and related claims.<sup>104</sup> O'Keefe's attor-

---

94. *Pope & Talbot*, 41 I.L.M. 1347 at ¶ 47 (2002).

95. *Id.* at ¶ 108.

96. *Id.* at ¶ 110.

97. *Id.* at ¶ 109.

98. *Id.* at ¶ 112.

99. *Id.* at ¶ 111.

100. *Id.* at ¶ 111.

101. *Id.* at ¶ 181.

102. *Loewen*, 42 I.L.M. 811 (2003).

103. *Methanex*, *supra* note 11.

104. *Loewen*, *supra* note 102, at 812.

ney, Willie Gary, however, spent little time addressing the intricacies of tort or contract law during the trial. Instead, Gary targeted three main issues: (1) Ray Loewen's nationality; (2) his purported racism and deceitfulness; and (3) his wealth.<sup>105</sup> The Gary team also compared the dispute to the Japanese attack on Pearl Harbor<sup>106</sup> and to alleged unfair trade practices by Canadian farmers.<sup>107</sup> Judge Graves, moreover, "repeatedly allowed Gary to make irrelevant and highly prejudicial comments. . . [that] inflamed the passion of the jury and ultimately produced a grossly excessive verdict."<sup>108</sup>

The jury returned a verdict of \$500 million, of which \$400 million represented punitive damages, even though the disputed contracts were worth less than ten million dollars.<sup>109</sup> Following the proceedings, the jury foreman publicly stated that Ray Loewen "was a rich, dumb Canadian politician who thought he could come down and pull the wool over the eyes of a good ole Mississippi boy. It didn't work."<sup>110</sup>

Loewen subsequently brought a NAFTA Chapter 11 claim against the United States. He argued that Article 1105(1) and the Interpretation prescribe the customary international law standard of treatment of aliens as the minimum standard of treatment to be afforded to the investment property of nationals of the other party. The introduction of anti-Canadian testimony and counsel comments during the trial was prejudicial and violated the "fair and equitable treatment" standard.<sup>111</sup> Loewen argued, "under international law, an alien is entitled to an impartial trial untainted by invidious discrimination."<sup>112</sup> In addition, the excessive verdict allegedly violated Article 1110.<sup>113</sup>

The *Loewen* tribunal, however, stated that there could only be an expropriation violation if Loewen demonstrated a denial of justice under Article 1105.<sup>114</sup> However, the *Loewen* tribunal agreed that the Mississippi court decision was "clearly improper and discreditable and cannot be squared with minimum standards of international law and fair and equitable treatment."<sup>115</sup> Yet, the tribunal added: "no instance has been drawn to our attention in which an international tribunal has held a State responsible for a breach of international law constituted by a lower court decision when there was available an effective and adequate appeal

---

105. See generally Notice of Claim, *Loewen Group, Inc. v. United States* (Oct. 30, 1998), <http://www.state.gov/documents/organization/3922.pdf>.

106. *Id.* at ¶ 103.

107. *Id.* at ¶ 100.

108. *Id.* at ¶ 40.

109. *Id.* ¶ 117.

110. *Id.* ¶ 143.

111. *Id.* ¶ 144.

112. *Id.* ¶ 141.

113. *Id.* ¶ 167.

114. *Id.* ¶ 145.

115. *Proc. between Loewen Group, Inc. & Raymond L. Lowen & U.S., ICSID Case No. ARB (AF)98/3, ¶ 142 (2003).*

within the State's legal system."<sup>116</sup> In other words, a NAFTA Chapter 11 tribunal cannot find a violation of international law unless local legal remedies have been exhausted (the finality requirement via exhaustion of domestic judicial remedies).<sup>117</sup>

Notwithstanding the fact that NAFTA has an election, not an exhaustion requirement,<sup>118</sup> the NAFTA parties must have been relieved by the *Loewen* tribunal's holding because NAFTA negotiators probably never intended for domestic courts to be subject to NAFTA actionable claims,<sup>119</sup> which would effectively subject domestic judicial decisions to review by international tribunals. Indeed, many Americans would likely find this troubling. Allowing foreign investors to challenge judicial decisions under Chapter 11 would give foreign investors greater rights than domestic investors, whose only recourse is the domestic legal system.<sup>120</sup>

In *Methanex v. United States*,<sup>121</sup> Methanex, a Canadian producer and marketer of methanol, alleged that California's ban of the gasoline additive, methyl tertiary butyl ether (MTBE), constituted "unfair and inequitable treatment" and was "tantamount to expropriation."<sup>122</sup> In 1997, the California legislature passed the MTBE Public Health and Environmental Protection Act, which authorized a study of MTBE's effects. The University of California at Davis conducted the study and determined that, although MTBE was not conclusively a human carcinogen, "it did cause significant risks and costs to water contamination."<sup>123</sup> Based on this study and growing public concern, Governor Davis issued an executive order for the phase-out of MTBE. The ban, therefore, effectively excluded Methanex from the California market.

Methanex asserted that the FTC Interpretation binds the parties if and only if it is not an amendment of Article 1105(1).<sup>124</sup> Methanex recognized the FTC's ability to issue binding interpretations of NAFTA provisions<sup>125</sup> but asserted that it lacks the power to amend NAFTA.

---

116. ELIHU LAUTERPACHT & CHRISTOPHER J. GREENWOOD, INTERNATIONAL LAW REPORTS, 397 (2007).

117. The tribunal incorrectly held that under the exhaustion requirement, Loewen was required to appeal to the United States Supreme Court before the NAFTA arbitral panel had jurisdiction. A foreign investor must only waive his right to "initiate or continue" domestic court proceedings prior to initiating NAFTA arbitration.

118. See NAFTA, *supra* note 2, at art. 1121.

119. Stefan Matiation, *Arbitration with Two Twists: Loewen v. United States and Free Trade Commission Intervention in NAFTA Chapter 11 Disputes*, 24 U. PA. INT'L ECON. L. 451, 468 (2003).

120. *Id.* at 461.

121. 1st Partial Award, *Methanex v. United States*, (Aug. 7, 2002), <http://www.state.gov/documents/organization/12613.pdf>.

122. *Id.* ¶ 11.

123. *Id.* ¶ 26.

124. Claimant Methanex Corp. Reply to the Response of Respondent United States of October 26, 2001 to Methanex's Submission Concerning the NAFTA Free Trade Commission's July 31, 2001 Interpretation at 2, *Methanex Corp. v. United States* (Nov. 9, 2001), <http://naftaclaims.com/Disputes/USA/Methanex/MethanexInvestorSecondSubRe1105.pdf>, [hereinafter *Methanex Reply Submission*].

125. See NAFTA, *supra* note 2 at 1121(2).

Consequently, any interpretation limiting the scope of investment protection, including the interpretation suggested by the United States, would be an impermissible amendment.<sup>126</sup> Methanex argued, therefore, that the tribunal must interpret Article 1105's "fair and equitable treatment" provision in accordance with its ordinary meaning.<sup>127</sup>

In support of its proposition, Methanex cited rules of treaty interpretation, NAFTA jurisprudence, international law, and domestic law. First, Methanex asserted that the Vienna Convention on the Law of Treaties required the tribunal to interpret Chapter 11 in light of its purpose, which is to provide investment protection. Therefore, the words "fair and equitable treatment" should be interpreted by their plain meaning.<sup>128</sup> Second, Methanex contended that the *Loewen* tribunal had previously ruled that "Chapter 11 should be given a liberal interpretation" in order to provide investment protection.<sup>129</sup>

Third, Methanex rejected the United States' argument that the definition of fair and equitable treatment is too "unknown" or "subjective" to be given its ordinary meaning. Methanex asserted that the definition of "fair and equitable treatment" is well known in both international and domestic law.<sup>130</sup>

While the fair and equitable treatment standard may not be reducible to a single formulation applicable to every set of circumstances, the standard is routinely applied by international and U.S. judges in a variety of different contexts. There is no reason why this tribunal cannot apply the same standard to the California measures.<sup>131</sup>

Finally, Methanex argued that the text of NAFTA must be given its ordinary meaning: "international law" under Article 1105 must be read expansively to include both customary and treaty law.<sup>132</sup>

The United States, however, asserted that the Interpretation negated Methanex's arguments based on Article 1105(1);<sup>133</sup> the scope of "customary international law" as defined in the interpretation was consistent with "thirty years of state practice."<sup>134</sup> The United States also argued that "fair and equitable treatment" did not encompass broad concepts of "equity, fairness, due process and appropriate protection."<sup>135</sup> Finally, the

---

126. See Methanex Reply Submission, *supra* note 124 at 2.

127. *Id.* at 3.

128. *Id.* at 4.

129. *Id.*; See also *International Centre for Settlement of Investment Disputes (ICSID): Loewen Group, Inc. v. United States*, 42 I.L.M., 811 (June 26, 2003).

130. Methanex First Submission Re: NAFTA FTC Statement on Article 1105 at 4, *Methanex Corp. v. United States*, (Sept. 18, 2001), <http://www.state.gov/s/l/c5823.htm>.

131. *Id.* at 5.

132. *Id.*

133. Response of Respondent United States of America to Methanex's Submission Concerning the NAFTA Free Trade Commission's July 31, 2001 Interpretation at 1, *Methanex Corp. v. United States* (Oct. 26, 2001), <http://www.state.gov/documents/organization/6028.pdf>.

134. *Id.* at 4.

135. *Id.* at 6.

United States argued that Article 1105 did not permit claims “based on violations of WTO or other conventional international obligations.”<sup>136</sup>

The tribunal rejected all of Methanex’s Chapter 11 substantive claims, including those based on Article 1105(1). The tribunal applied the FTC Interpretation’s restrictive “fair and equitable treatment” standard and held that the United States did not violate Article 1105.<sup>137</sup> Although earlier cases indicated an increasingly expansive view of NAFTA’s investment protection provisions, the Interpretation directs Chapter 11 arbitral tribunals to narrow the scope of “fair and equitable treatment” to what customary international law provides.<sup>138</sup> Even if the FTC Interpretation was a substantive change, “[a] treaty may be amended by agreement between the parties,”<sup>139</sup> and “any subsequent agreement between the parties regarding the interpretation of a treaty or the application of its provisions”<sup>140</sup> shall be taken into account.

The tribunal also held that California’s ban was a permissive regulation—a non-discriminatory action, for a public purpose, in accordance with due process of law, and fair and equitable treatment—and not an expropriation.<sup>141</sup> Methanex entered the US market aware that government environmental and health protection institutions “continuously monitored the use and impact of chemical compounds and commonly prohibited or restricted the use of some of those compounds for environmental and/or health reasons.”<sup>142</sup>

#### IV. SUBSTANTIVE PROVISIONS OF CHILE FTA CHAPTER 10

The Chile FTA Chapter 10 text attempts to address the major concerns surrounding NAFTA Chapter 11 dispute resolution. Like NAFTA Chapter 11, Section A of Chapter 10 provides substantive obligations that the parties must follow with respect to foreign investments. These provisions stand to promote an open investment policy between Chile and the United States. Chapter 10, however, explicitly incorporates the NAFTA parties’ FTC Interpretation narrowing the scope of Chile FTA Chapter 10 investor-state arbitration. This section will discuss Chapter 10’s “fair and equitable treatment” and “expropriation” provisions.

The main purpose of Chile FTA Chapter 10 is to “ensure a predictable, commercial framework for business planning and investment”<sup>143</sup> and to “substantially increase investment opportunities in the territories of the

---

136. *Id.* at 8.

137. *Methanex v. United States Final Award on Jurisdiction and Merits*, Part IV, Chapter C, ¶ 27, (Aug. 3, 2005), <http://www.state.gov/documents/organization/51052.pdf>.

138. *Id.* ¶ 9-10 (Discrimination between nationals and aliens contravenes customary international law only by way of exception—Methanex failed to establish that a specific customary rule required equal treatment under the circumstances).

139. *Id.* ¶ 21.

140. *Id.*

141. *Id.* at Part IV, Chapter D, ¶. 9-10.

142. *Id.*

143. *See* Chile FTA, *supra* note 1, at preamble.

Parties.”<sup>144</sup> Chapter 10 sets forth “fair and equitable treatment” and “expropriation” standards for the protection of investors and investments.<sup>145</sup>

#### A. ARTICLE 10.4: MINIMUM STANDARD OF TREATMENT

Compared to NAFTA Article 1105, Chile FTA Article 10.4 provides more detail “with respect to the standards of treatment of aliens and their property found in customary international law.”<sup>146</sup> The United States and Chile structured 10.4(1) to ensure the applicability of “customary international law,” rather than “international law.” Article 10.4(1) requires that the parties “accord to covered investments treatment in accordance with customary international law, including fair and equitable treatment and full protection and security.”<sup>147</sup>

Similarly, the parties clarified that “fair and equitable treatment” and “full protection and security” are not additive to the requirement of compliance with customary international law, but rather are subsumed in that concept.<sup>148</sup> “Fair and equitable treatment” is not limited to avoiding a denial of justice and the concept of due process embodied in the world’s principal legal systems.<sup>149</sup>

Chile FTA Article 10.4(2) avoids reducing “fair and equitable treatment” to no more than non-discriminatory treatment, where national treatment does not meet minimum standards of customary international law.<sup>150</sup> Indeed, a “minimum standard” provision is necessary to avoid harsh, injurious, and unjust treatment to foreign investors, even if a government did not act in a discriminatory manner.<sup>151</sup> Article 10.4(2) also equates fair and equitable treatment under customary international law with U.S. standards of due process, so the former is not broader than the latter.<sup>152</sup>

---

144. *Id.* at art. 1.2(1)(d).

145. *Id.* at art. 10.4.

146. *Id.*

147. *Id.* art. 10.4(1).

148. *Id.* art. 10.4(2).

149. *Id.* at art. 10.4(2)(a). The “principal legal systems of the world” language is contrary to the United States’ argument in the *Methanex* case (fair and equitable treatment does not include broad concepts of “equity, fairness, due process, and appropriate protection”). See *Methanex v. United States*, NAFTA Arb. Trib., (Aug. 7, 2002), <http://www.state.gov/documents/organization/1213.pdf>. If, however, the principal legal systems of the world use concepts of equity and fairness to define “fair and equitable treatment,” then it is difficult to argue that those concepts are irrelevant in defining the substance of customary international law. See Gantz, *supra* note 12, at 726. The due process language advocates the United States’ position in the *Loewen* case (customary international law does not require the United States to provide a perfect justice system only one that is “fundamentally adequate”).

150. See 19 U.S.C. § 3802(b)(3)(E) (2002) (trade negotiating objective seeking to establish standards for fair and equitable treatment consistent with United States legal principles and practice including due process).

151. *Pope & Talbot Inc. v. Government of Canada*, May 31, 2002, 41 I.L.M. 1347.

152. *Loewen Group, Inc. v. United States*, July 26, 2003, 42 I.L.M. 811.

Additionally, Chile FTA Article 10.4(3) essentially adopts paragraph three of the FTC Interpretation. “[A] determination that there has been a breach of another provision of this Agreement, or of a separate international agreement, does not establish that there has been a breach of this Article.”<sup>153</sup> Article 10.4(3), therefore, eliminates the holding of *S.D. Myers*, which based a NAFTA Article 1102 violation on finding an Article 1105 “fair and equitable treatment” violation.<sup>154</sup> Article 10.4(3) also prevents the *Metalclad* tribunal’s use of a NAFTA Article 1105 violation to support a finding of indirect expropriation under Article 1110.<sup>155</sup>

Finally, Chapter 10 defines customary international law:<sup>156</sup> the Parties confirm their shared understanding that “customary international law” generally and as specifically referenced in Articles 10.4 and 10.9 results from a general and consistent practice of States that they follow from a sense of legal obligation. With regard to Article 10.4, all customary international law principles that protect the economic rights and interests of aliens are being referenced in the customary international law minimum standard of treatment of aliens.<sup>157</sup>

The Chile FTA, however, does not address the current scope of customary international law. Consequently, the United States only incorporated due process into the “fair and equitable treatment” standard, and no more.<sup>158</sup>

#### B. ARTICLE 10.9: EXPROPRIATION AND COMPENSATION

Chile FTA Article 10.9 addresses the concerns expressed by governments and environmental groups regarding the distinction between compensable expropriation and valid regulation. Chile FTA Article 10.9 provides:

Neither Party may expropriate or nationalize a covered investment either directly or indirectly through measures equivalent to expropriation or nationalization except: (a) for a public purpose; (b) in a non-discriminatory manner; (c) on payment of prompt, adequate, and effective compensation in accordance with paragraphs 2, 3, and 4; and (d) in accordance with due process of law and Articles 10.4(1) through (3).<sup>159</sup>

Article 10.9 substitutes NAFTA’s “equivalent to expropriation or nationalization” language with “tantamount to nationalization or expropriation.”<sup>160</sup> The significance of this language change, however, is not substantive. The *S.D. Myers* tribunal suggested that the terms “tanta-

---

153. See Chile FTA, *supra* note 1, at art. 10.4(3).

154. *S.D. Myers, Inc. v. Government of Canada*, 40 I.L.M. 1408 (Nov. 12, 2000).

155. *Metalclad Corp. v. United Mexican States*, 40 I.L.M. 36 (Aug. 30, 2000).

156. See Chile FTA, *supra* note 1, at Annex 10-A.

157. *Id.*

158. See Gantz, *supra* note 12, at 727.

159. See art. 10.9 of Chile FTA, *supra* note 1.

160. See Gantz, *supra* note 12, at 743.

mount” and “equivalent” were functionally the same.<sup>161</sup>

Actually, the Chile FTA provisions with the most significant changes related to expropriation appear in Annex 10-D. First, Annex 10-D provides that Article 10.9 not go beyond customary international law for investment protection.<sup>162</sup> Second, Annex 10-D limits expropriation claims to interference with tangible or intangible property rights.<sup>163</sup> Consequently, Annex 10-D may exclude from coverage trade based claims, including those in *Pope & Talbot* and *S.D. Myers*.<sup>164</sup>

Third, “indirect expropriation claims are highly circumscribed.”<sup>165</sup> Annex 10-D(4) stresses the need for the “equivalency” of indirect takings to direct takings, absent only the formal transfer of title or outright seizure.<sup>166</sup> Accordingly, a case-by-case approach is necessary to determine whether government interference is reasonable. Factors to consider include the economic impact of the government action. Even though an action by a party has an adverse effect on the economic value of an investment, this effect by itself does not establish that an indirect expropriation has occurred.<sup>167</sup> “[T]he extent to which the government action interferes with distinct, reasonable investment-backed expectations”<sup>168</sup> and “the character of the government action” are also considered.<sup>169</sup>

Finally, Chile FTA Annex 10-D states that non-discriminatory actions protecting “legitimate public welfare objectives, such as public health, safety, and the environment” are not actionable expropriations “[e]xcept in rare circumstances.”<sup>170</sup> Consider the *Methanex* case; California’s MTBE ban would not be an actionable expropriation because it is a non-discriminatory action, for a public purpose, in accordance with due process of law, and fair and equitable treatment.

## V. DISPUTE RESOLUTION: A COMPARATIVE LOOK

The Chile FTA Chapter 10 dispute resolution provides more transparency, “public input into the dispute settlement, mechanisms to improve the investor-state process by eliminating frivolous claims,” and the possibility of establishing a future appellate mechanism to review arbitral awards under the agreement.<sup>171</sup>

FTAs between developed and developing countries have increased in popularity. Consequently, it is logical to look to NAFTA for lessons as

---

161. *Id.* The Spanish language version of the Chile FTA uses the same phrase as the Spanish language version of NAFTA Chapter 11, “equivalente a la expropiación.” See Chile FTA, *supra* note 1. See also NAFTA, *supra* note 2, at art. 1110.

162. *Id.* at Annex 10-D.

163. *Id.*

164. See Gantz, *supra* note 12, at 745.

165. *Id.*

166. See Chile FTA, *supra* note 1, Annex 10-D(4).

167. *Id.* at Annex 10-D(4)(a)(i).

168. *Id.* at Annex 10-D(4)(a)(ii).

169. *Id.* at Annex 10-D(4)(a)(iii).

170. *Id.* at Annex 10-D(4)(b).

171. See Chile FTA Implementation Act, *supra* note 15.

the United States negotiates with several developing countries. Indeed, the Chile FTA was intended to be a bellwether for future FTAs in Latin America and simultaneously provide an incentive for countries in the western hemisphere to continue FTAA negotiations.<sup>172</sup>

Section B of Chile FTA Chapter 10 details the investment dispute settlement process and several annexes clarify that process. Predictable rules for the adjudication and enforcement of foreign investors' rights are critical to achieving an open investment regime. Arbitration provides a neutral mechanism characterized by private proceedings, flexible procedures, expert decision-makers, relative finality, and enforceability of the result. A host state will often prefer private adjudication and the potential for specialized legal expertise within a relaxed procedural framework to litigation in an investor's home state.

#### A. ARTICLE 10.15: SUBMISSION OF A CLAIM TO ARBITRATION

Chile FTA article 10.15 grants private investors direct access to an international arbitration panel for the resolution of an investment claim when an investment dispute cannot be settled by consultation and negotiation.<sup>173</sup> An investor may submit a claim to arbitration on its own behalf or on behalf of an enterprise owned or controlled by the investor.<sup>174</sup> A claim may be based on an alleged breach of "an obligation under Section A or Annex 10-F," "an investment authorization," or "an investment agreement," as long as the investor has suffered loss or damage from the alleged breach.<sup>175</sup> NAFTA Chapter 11, however, never refers to "investment authorizations" or "investment agreements." Actually, these additions expanded the scope of Chile FTA arbitration provisions and NAFTA's governing law clauses.<sup>176</sup>

Other provisions in Article 10.15 detail and limit the arbitration process and are identical to those found in NAFTA Chapter 11. For instance, except as permitted under Article 12.18 regarding financial services, an investor may only utilize Chapter 10 dispute resolution for alleged breaches of Section A or Annex 10-F.<sup>177</sup>

Additionally, an investor must provide a party with "written notice of its intention to submit the claim to arbitration ('notice of intent') and specify "the legal and factual basis for each claim" and "the relief sought and the approximate amount of damages claimed" at least ninety days

---

172. See Weintraub, *supra* note 18, at 79. The Chile FTA's importance lies in its precedent setting effect on future FTA's in Latin America. *Id.* Arguably, however, Chile FTA's influence on FTAA negotiations has been minimal. Official negotiations have effectively stalled and the FTAA-Trade Negotiations Committee (TNC) has resorted to informal consultations with delegations of other FTAA countries since the Miami Ministerial November 20-21, 2003.

173. See Chile FTA, *supra* note 1, art. 10.15.

174. *Id.* at art. 10.15(1).

175. *Id.*

176. See Gantz, *supra* note 12, at 753.

177. See Chile FTA, *supra* note 1, at art. 10.15(2).

before the investor submits the claim to arbitration.<sup>178</sup> An investor, moreover, must wait six months after the events giving rise to the claim to submit to Chapter 10 arbitration.<sup>179</sup>

Finally, under Article 10.15—as under NAFTA Chapter 11—an investor may submit a claim to arbitration under ICSID, ICSID Additional Facility Rules, or the UNCITRAL rules.<sup>180</sup> Unlike NAFTA Chapter 11, however, Article 10.15 allows the parties to elect “any other arbitration rules” to govern the dispute.<sup>181</sup>

Annex 10-E also grants an investor the opportunity to choose between the Chapter 10 dispute resolution process and litigating in the parties’ domestic courts.<sup>182</sup> Annex 10-E prohibits parallel litigation thus eliminating the possibility that a party will be subject to liability twice for the same claim; the Annex also rejects the exhaustion requirement.<sup>183</sup> These provisions are identical to NAFTA Article 1121. But a national court action is barred only if the parties are identical and if the claimant in the court action alleges a breach of Section A.<sup>184</sup> Therefore, if parties allege the same facts, but contend that these facts show a violation of local law or of the constitution, then a submission to arbitration pursuant to Chapter 10 would likely be permissible.

#### B. ARTICLE 10.17: CONDITIONS AND LIMITATIONS ON CONSENT OF EACH PARTY

Article 10.17 establishes a three-year limitation on claims, beginning the date “on which the claimant first acquired, or should have first acquired, knowledge” of the Article 10 breach.<sup>185</sup> Also, a claim can only be submitted to arbitration under Chapter 10 with the claimant’s written waiver of any right to initiate or continue suit against the party in any other court or under any other dispute resolution procedure.<sup>186</sup> Consequently, an American investor in Chile may not seek arbitration under Chapter 10 if she has already alleged the breach of Section A or Annex 10-F in a national court or administrative tribunal. Except for interim injunctive relief,<sup>187</sup> once an action is filed in the national courts, etc., no waiver is possible.

NAFTA Chapter 11, however, does not prohibit a claimant from filing a subsequent claim under Chapter 11. The claimant merely relinquishes

---

178. *Id.* at art. 10.15(4).

179. *Id.* at art. 10.15(5).

180. *Id.* at art. 10.15(a)-(c). *See also* NAFTA, *supra* note 2, at art 1120.

181. *See* Chile FTA, *supra* note 1, at art. 10.15(d). *See also* NAFTA, *supra* note 2, at art. 1131.

182. *See* Chile FTA, *supra* note 1, at Annex 10-E.

183. *Id.* at Annex 10-E.

184. *Id.* at Annex 10-D.

185. *Id.* at art. 10.17.

186. *Id.* at art. 10.17(2).

187. *Id.* at art. 10.17(3). The investor may seek interim injunctive relief from a domestic court, provided that the action is brought for the sole purpose of preserving the investor’s investment pending the arbitration, rather than monetary damages.

the right to return to the domestic courts once an arbitral claim is initiated.<sup>188</sup> Annex 10-E's election requirement, compared to NAFTA Chapter 11's waiver approach, significantly narrows an investor's options.

### C. ARTICLE 10.19: CONDUCT OF THE ARBITRATION

Article 10.19 establishes a dispute resolution framework that is explicitly inclusive and open. Chile FTA Chapter 10 allows parties to choose where Chapter 10 arbitration will take place, provided that, for enforcement purposes, the place of arbitration is in a country that is a signatory to the New York Convention.<sup>189</sup> "A non-disputing party may also make oral and written submissions to the tribunal regarding its interpretation" of Chapter 10 during the course of arbitration.<sup>190</sup>

Additionally, unlike NAFTA Chapter 11, the Chile FTA explicitly provides that a tribunal may "accept and consider *amicus curiae* submissions from a person or entity that is not a disputing party."<sup>191</sup>

Chile FTA Chapter 10, compared to NAFTA, also requires tribunals to decide jurisdictional issues at the outset of the dispute rather than joining them to the merits. A respondent, therefore, may raise an objection that a dispute is not within a tribunal's competence.<sup>192</sup> Upon receipt of an objection, the tribunal must suspend any proceedings on the merits and consider the objection as a preliminary matter.<sup>193</sup> Where a request is made for a decision on an expedited basis, the tribunal must issue a decision on the objection within 150 days of the request, 160 if there is a hearing, and 180 if the tribunal shows "extraordinary cause."<sup>194</sup>

Additionally, the tribunal may

award to the prevailing disputing party reasonable costs and attorneys' fees incurred in submitting or opposing the objection. In determining whether such an award is warranted, the tribunal shall consider whether either the claimant's claim or the respondent's objection was frivolous, and shall provide the disputing parties a reasonable opportunity to comment.<sup>195</sup>

Presumably, these provisions eliminate frivolous claims.

A Chapter 10 tribunal, moreover, "may order an interim measure of protection to preserve the rights of a disputing party, or to ensure that the

---

188. See NAFTA, *supra* note 2, at art. 1121(1).

189. Chile FTA, *supra* note 1, at art.10.19(1). See also NAFTA, *supra* note 2, at art. 1130.

190. Chile FTA, *supra* note 1, at art. 10.19(2).

191. *Id.* at art. 10.19(3). The NAFTA FTC, however, recently clarified NAFTA Chapter 11 dispute resolution, noting that nothing in NAFTA precludes a Chapter 11 tribunal from accepting *amicus curiae* submissions. See Unofficial Statement of the Free Trade Commission on non-disputing party participation, Oct. 7, 2003, <http://www.ustr.gov/regions/whemisphere/nafta2003/statement-nondisputingparties.pdf>.

192. See Chile FTA, *supra* note 1, at art. 10.19(4).

193. *Id.* at art. 10.19(4)(b).

194. *Id.* at art. 10.19(4)-(5).

195. *Id.* at art. 10.19(6).

tribunal's jurisdiction is made fully effective, including an order to preserve evidence in the possession or control of a disputing party" until a final award is issued.<sup>196</sup> A tribunal cannot, however, order attachment or enjoin the challenged governmental measure.<sup>197</sup> Also, at a disputing party's request, the tribunal must send a copy of its proposed award to the disputing and non-disputing parties. Within sixty days, the disputing parties may submit written comments to the tribunal concerning any aspect of the proposed award.<sup>198</sup>

Finally, Article 10.19 leaves open the possibility that "a separate multi-lateral agreement" may establish "an appellate body for purposes of reviewing awards rendered by tribunals" and consequently, "the Parties shall strive to" establish an appellate review mechanism to review decisions rendered by Chapter 10 tribunals under Article 10.25.<sup>199</sup> The appellate review mechanism's principal purpose is to protect the parties from the liability of an international arbitration panel. In addition, Article 10.25(6) permits a party to petition domestic courts for review of a final arbitral award.<sup>200</sup> Annex 10-H gives the parties three years to establish a Chapter 10 appellate review mechanism.<sup>201</sup>

NAFTA Chapter 11, however, does not have an appellate review mechanism—review of NAFTA arbitral decisions are subject to the courts of the "situs" of the arbitration. Since these reviews will take place before different courts, in different countries, and under different standards of review, the desirability of a consistent review process is obvious.

#### D. ARTICLE 10.20: TRANSPARENCY OF ARBITRAL PROCEEDINGS

Chile FTA Chapter 10 has important language regarding transparency and public access to the arbitral process. Article 10.20 requires that the notices of intent and arbitration, pleadings, memorials and briefs, minutes or transcripts of hearings of the tribunal, orders, awards, and decisions be made available to the public.<sup>202</sup> Furthermore, a Chapter 10 tribunal "shall conduct hearings open to the public."<sup>203</sup> These changes represent a significant departure from the traditional veil of confidentiality that nor-

---

196. See Chile FTA, *supra* note 1, at art. 10.19(8).

197. *Id.*

198. *Id.* at art. 10.19(9).

199. *Id.* at art. 10.19(10).

200. *Id.* at art. 10.25(6).

201. *Id.* at Annex 10-H. Interestingly, the Central American-Dominican Republic Free Trade Agreement (CAFTA-DR), a post-Chile FTA free trade agreement, provides more details regarding the development of an appellate mechanism. Once CAFTA-DR enters fully into force, the [Fair Trade] Commission must within ninety days initiate a one-year negotiating process to establish an appellate process. Central America-Dominican Republic Free Trade Agreement, annex 10-F, Aug. 5, 2004, [http://www.ustr.gov/Trade\\_Agreements/Bilateral/CAFTA/CAFTA-DR\\_Final\\_Texts/section\\_Index.html](http://www.ustr.gov/Trade_Agreements/Bilateral/CAFTA/CAFTA-DR_Final_Texts/section_Index.html). Whether the CAFTA-DR partners will conclude negotiations regarding the appellate mechanism within one year of the agreement going fully into effect is open to speculation.

202. See Chile FTA, *supra* note 1, at art. 10.20.

203. *Id.* at art. 10.20(2).

mally surrounds investor-state arbitration. NAFTA does not require public hearings or the publication of pleadings and awards.<sup>204</sup> Still, Article 10.20 does not require “a respondent to disclose confidential business information or information that is privileged or otherwise protected from disclosure under a Party’s law or to furnish or allow access to information”<sup>205</sup> protected under other provisions of the Agreement.

#### E. ARTICLE 10.21: GOVERNING LAW

Chile FTA Article 10.21(3) clarifies an interpretation’s scope as previously explained in NAFTA Article 1131(2). Recall that Article 1131(2) stated that “An interpretation by the Commission of a provision of this Agreement shall be binding on a Tribunal established under this Section.”<sup>206</sup> Article 10.21(3), however, provides that “A decision of the Commission declaring its interpretation of a provision of this Agreement under Article 21.1 (Free Trade Commission) shall be binding on a tribunal established under this Section and any award must be consistent with that decision.”<sup>207</sup>

Also Article 10.21(3) clearly defines the meaning of “binding”; put simply, the tribunal must follow the interpretation. Thus, Chile FTA Chapter 10 arbitral tribunals may not encounter the situation the *Pope & Talbot* and *Methanex* tribunals faced, namely, whether the Interpretation amended NAFTA without the approval of each party’s constitutional processes.

### VI. THE CHILE FTA AND FUTURE INVESTMENT AGREEMENTS IN THE AMERICAS

To ascertain the United States’ opinion with regard to the interpretation of NAFTA Chapter 11 by arbitral tribunals, look no further than Chile FTA Chapter 10.<sup>208</sup> Chapter 10 investor-state dispute resolution attempts to address the major concerns voiced about NAFTA Chapter 11 dispute resolution by providing “more transparency, public input into the dispute settlement, mechanisms to improve the investor-state process by eliminating frivolous claims,” and the possibility of establishing a future appellate mechanism to review arbitral awards under the agreement.<sup>209</sup>

The impact of Chile FTA Chapter 10’s new provisions on future investment arbitrations remains unclear. Nevertheless, Chapter 10 represents an important step for both Chile and the United States by officially linking the applicability of international law to foreign investment in the Americas. Chapter 10 limits violations of fair and equitable treatment to the high standard imposed by customary international law. As explained

---

204. See NAFTA, *supra* note 2, at art. 1137.4.

205. *Id.* at art.10.20(3).

206. See NAFTA, *supra* note 2, at art. 1131(2).

207. See Chile FTA, *supra* note 1, at art. 10.21(3).

208. See Gantz, *supra* note 12, at 763.

209. See Chile FTA Implementation Act, *supra* note 15.

earlier, this standard evolves over time and must reflect both treaty law and the growing jurisprudence of arbitral decisions rendered under Chapter 11.<sup>210</sup> Alleged expropriations based on government regulatory action will also be more difficult for a claimant to prove as reasonable government interference is not actionable.

Additionally, Annex 10-A of the Chile FTA, which defines customary international law, and Annex 10-D, which addresses expropriation and regulatory takings, will likely be applied retroactively to interpret NAFTA Chapter 11 (NAFTA does not define these terms) and future FTAs.

The most important developments in Chapter 10 investor-state arbitration, however, are found in Articles 10.19 and 10.20. Article 10.19 permits a Chapter 10 tribunal to consider claims based on the merits and jurisdictional objections separately.<sup>211</sup> This provision, with the threat of payment of costs and attorneys' fees if the moving party is unsuccessful, may discourage new claims, particularly for claimants without deep pockets.

The United States and Chile also included provisions in Chapter 10 to establish a more inclusive, transparent investor-state dispute resolution process. Article 10.20 permits a Chapter 10 tribunal to "accept and consider" briefs from non-disputing parties, and if requested, a tribunal must send copies of an award proposal to the disputing parties and the investor's home country for comments before rendering a final award.<sup>212</sup> Furthermore, Article 10.20 provides explicit guidelines for document sharing during the course of arbitration and requires Chapter 10 investor-state dispute resolutions to be open to the public.<sup>213</sup>

Finally, while the Chile FTA does not establish an official appellate review mechanism for Chapter 10 awards, the text does allow the parties to include one if created in the future.<sup>214</sup>

---

210. *See Gantz, supra* note 12, at 765.

211. *See Chile FTA, supra* note 1, at art. 10.19.

212. *Id.* at art. 10.25.

213. *Id.* at art. 10.20.

214. *Id.* at Annex 10-H.