

*Profesores  
extranjeros  
invitados*





## Presentación



El Tratado de Libre Comercio de América del Norte —NAFTA— sin lugar a dudas ha marcado un hito en el campo de la integración económica al ser el primer acuerdo de este tipo que incluye temas que van más allá de los puramente comerciales —comercio de bienes—. En efecto, el NAFTA no sólo contempla un capítulo relativo al comercio de servicios, sino que además prevé reglas especiales en materia de propiedad intelectual, compras del Estado, competencia e inversiones extranjeras.

En el campo de las inversiones extranjeras, el capítulo 11 del Tratado, además de establecer las reglas y principios que rigen la inversión extranjera, prevé un mecanismo especial para la solución de controversias, que siguiendo los lineamientos trazados en los acuerdos bilaterales para la promoción de inversiones, le otorga al inversionista extranjero la posibilidad de demandar directamente al Estado receptor de la inversión, en caso de incumplimiento o violación del acuerdo. De este modo se aparta de las directrices clásicas del derecho internacional que disponen que los Estados sólo pueden ser demandados por otros Estados, previo el agotamiento de las respectivas vías diplomáticas.

En este contexto el capítulo 11 del NAFTA contempla además la posibilidad de que dichas controversias sean resueltas bien mediante el empleo de los mecanismos previstos en el acuerdo del Centro para la Solución de Disputas en materia de Inversiones —CIADI<sup>1</sup>—, para



<sup>1</sup> El Centro Internacional para el Arreglo de Disputas sobre Inversiones, CIADI (International Centre for Settlement of Investment Disputes - ICSID), se fundamenta jurídicamente en el Acuerdo para la Solución de Controversias sobre Inversiones entre los Estados y los Ciudadanos de otros Estados, de 1965.

el caso en que ambas partes contendientes sean Estados parte del Acuerdo CIADI; a través del Mecanismo Complementario del CIADI<sup>2</sup>, cuando sólo una de las partes sea miembro del Acuerdo CIADI, o acudiendo a la aplicación de las reglas de arbitraje de CNUDMI (UNCITRAL).

La razón para incluir en el acuerdo el mecanismo de solución de controversias contemplado en el CIADI, estriba en el hecho que éste ofrece a los inversionistas privados mayor seguridad jurídica que la que ofrecería tanto la jurisdicción nacional como cualquier otro tipo de tribunal de arbitramento. El CIADI, además, es un tribunal especializado en la solución de controversias en materia de inversiones, y dada la especialidad de este tema, esto lo hace el foro idóneo.

En los artículos que se presentan en seguida no sólo se analizan de manera profunda las reglas en materia de solución de controversias contempladas en el Capítulo 11 del NAFTA, sino que además se traen casos prácticos que permiten ilustrar la especialidad de los temas, así como la forma en que éstos deben abordarse. Estos estudios contribuirán sin lugar a dudas a comprender y analizar tan importantes temas, y servirán de base para las negociaciones de los diversos acuerdos de libre comercio que Colombia se encuentra negociando en la actualidad.



<sup>2</sup> Los "Mecanismos Complementarios" ("Additional Facility") fueron establecidos el 27.9.1978 por el Consejo de Administración del CIADI. Cfr. Doc. ICSID/11, Additional Facility for the Administration of Conciliation, Arbitration and Fact Finding (1979).

# *Examples of chapter 11 NAFTA disputes, a trade-investment-environment experience*



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## **LIST OF ABBREVIATIONS**

AD/CV	Antidumping and Countervailing
CEC	Commission for Environmental Cooperation
CLC	Commission for Labour Cooperation
ECC	Extraordinary Challenge Committee
ECE	Evaluation Committee of Experts
FTC	Free Trade Commission
ICSID	The International Centre for Settlement of Investment Disputes Convention
NAAEC	North American Agreement on Environmental Cooperation
NAALC	North American Agreement on Labour Cooperation
NAFTA	North American Free Trade Agreement
NAOs	National Administrative Offices
SCR	Special Committee Review
UNCITRAL	United Nations Commission on International Trade Law

## **INTRODUCTION**

The North American Free Trade Agreement (NAFTA) has just celebrated its fifth year of existence, in this context it is interesting to make a review of how has it work so far. This paper will analyze the investment provisions of Chapter 11, first we will review the norms established for guaranteeing the well being of the investments, later we will see the provision related to the settlement of disputes in this subject.

Nevertheless, this analysis would not be complete if we do not take a look at the practice of the Dispute Settlement Mechanism (DSM), for that purpose 12 cases will be analyzed here. We will focus on the legal arguments of the parties, specially to that referring to "regulatory takings", which are one sort of indirect expropriation by the enacting of a regulation that limits or modifies the investment.



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Those kind of cases have become to be a central issue in the discussion of the NAFTA, not only between scholars, but also between the three governments. The problem with this kind of argument is that, as will be seen, it puts in danger the regulatory capacity of the States, but at the same time, it has damaged the protection of the environment by forcing the reverse of some laws which had such objective.

Finally, it will be done an analysis of the different positions this problematic has created, within the governments, the non governmental organizations (NGO), and the tendencies for the solution of the problem through an uniformed interpretation of the provisions.

### **1. THE NAFTA AND ITS DISPUTE SETTLEMENT MECHANISMS**

The NAFTA was signed on December 1992, and came into force on January 1st 1994. This trilateral treaty, between Canada, Mexico and the United States of America (USA), was based on the Canada-USA Free Trade Agreement.

The purpose of the NAFTA is to eliminate all tariff and non-tariff barriers on the trade of goods and services between the three countries. It is divided in 22 chapters, several annexes, and two "side agreements", one on labour and one on environment protection. It contains a large set of provisions and various complex dispute resolution mechanisms to ensure its application; these consist of a general scheme for controversies concerning the interpretation, application or breach of the Agreement (Chapter 20), a specific device for resolving antidumping and countervailing duty disputes (Chapter 19), and a method for the settlement of disputes between an investor from one NAFTA Member State and another Member State (Chapter 11). In addition, the North American Agreement on Environmental Cooperation (NAAEC) and the North American Agreement on Labour Cooperation (NAALC) contain their own dispute resolution mechanisms, but these are linked to the rest of the NAFTA by references to its benefits, provisions and general dispute settlement mechanism.

Since the purpose of this paper is to analyze the investment disputes in the NAFTA framework, and in order to fully understand the complexity and importance of the Chapter 11 dispute settlement mechanism, a look at several of the NAFTA chapters is needed, as this will allow us to realize the importance of the way the investment disputes have arisen and have been settled in the NAFTA framework.

### **1.1 The dispute resolution under the NAFTA Chapter 19: Antidumping and Countervailing Duties**

Chapter 19 deals with the establishment of clear rules concerning the imposition of antidumping and compensatory duties, the aim being to avoid their arbitrary application. The relevance of this dispute settlement mechanism is because one of the propositions for the modification of Chapter 11 is to make it more like the DSM of Chapter 19.

#### **1.1 a) Disputes about amendments to national laws**

Each country retains its domestic Antidumping (AD) and Countervailing (CV) laws, and reserves the right to amend them under certain conditions<sup>2</sup>. Given this, any NAFTA Member State may request the formation of a binational panel to analyze an amendment suggested by another Member State. The panel may issue a declaratory opinion as to whether the amendment conforms to the requirements or not; if the panel finds the amendment incompatible with the NAFTA, and after an unsuccessful round of consultations between the governments, the complaining Party may take comparable legislative or executive action or terminate the NAFTA with respect to that State.<sup>3</sup>

#### **1.1 b) Panel Revision of AD/CV duties**

The main dispute resolution mechanism under the Chapter 19, is a type of appeal to a prior ruling by a government agency imposing antidumping or countervailing duties, and can be initiated only by the governments.<sup>4</sup> The panel, which is a substitute for the national judicial review, must apply the same standard of review, the same domestic substantive law and general principles, than a reviewing domestic court would if its decisions were challenged.<sup>5</sup>



<sup>2</sup> The amendment must specify that it applies to the other NAFTA Parties; the amending country must notify and consult with the other NAFTA Parties prior to enactment of any amendment; and the amendment has to be consistent with the World Trade Organization (WTO) and the trade-liberalizing objectives of NAFTA. Arts. 1902 and 1903 NAFTA. cf. AGUILAR ALVAREZ, Guillermo *et al.*; "NAFTA Chapter 19: Binational Panel Review of Antidumping and Countervailing Duty Determinations" In: LEYCEGUI, Beatriz *et al.*, *Trading Punches: Trade Remedy Law and Disputes Under NAFTA*, Mexico-Washington, 1995, ITAM-Howe Institute-National Planning Association, p. 27.

<sup>3</sup> Art. 1903 NAFTA.

<sup>4</sup> Art. 1904 NAFTA.

<sup>5</sup> Those vary from country to country. For details see HORLICK, Gary and DEBUSK, Amanda: "Disputes Resolution Under NAFTA: Building on the U.S.-Canada FTA, GATT and ICSD" *Journal of World Trade*, Vol. 27, No. 1, February 1993, p. 28.

In its final decision, the Panel may either uphold the importing Party's final AD/CV determination, or if found unlawful, remand it to the Party for an action not inconsistent with the panel's decision.

The NAFTA AD/CV panel decisions are binding for the Parties involved with respect to the particular matter that is before the panel. In order to guarantee the enforcement of the decision it is forbidden for all the Member States to establish in their domestic legislation an appeal on a panel decision; however, the NAFTA provides an Extraordinary Challenge Committee (ECC) proceeding that allows, under very specific circumstances<sup>6</sup>, a Party to challenge the decision of a panel. The decisions of the ECC are binding and they can vacate or uphold the decision of the binational panel; if it vacates the decision, a new panel will be established.

### ***1.1 c) National laws and the implementation of the panel system***

To assure the implementation of the decision, the NAFTA establishes another mechanism, the Special Committee Review (SCR), that can be invoked by any Member State which alleges that another NAFTA Member's domestic law frustrated or interfered with the binational panel review system. The precondition is that the two governments entered into consultations and did not find a solution.

If the SCR finds the complaint affirmative, and if after consultations, no resolution is agreed, the complaining Party may suspend with respect to the offending Party, either the operation of the Chapter 19 panel review system, or trade benefits. When the SCR finds that the problem has been corrected, any suspension of benefits must be terminated.



<sup>6</sup> The ECC challenge must satisfy three tests: first, it must be demonstrated that a member of the panel was guilty of gross misconduct, bias or a serious conflict of interest, or otherwise materially violated the rules of conduct; the panel seriously departed from a fundamental rule of procedure; or the panel manifestly exceeded its powers, authority, or jurisdiction by, for example, failing to apply the appropriate standard of review. Second, the ECC must find that any such action materially affected the panel's decision; and third, that such action threatens the integrity of the binational panel review process. Art. 1904, cf. AGUILAR ALVAREZ, Guillermo *et al.*; *op. cit.*, p. 29.



## **1.2 Chapter 20 Dispute Settlement System: the general mechanism**

This mechanism covers disputes between the Parties concerning:

- (i) the interpretation or application of the NAFTA,
- (ii) an alleged violation of the NAFTA, and
- (iii) the nullification or impairment of benefits of the NAFTA.

Its relevance to the matter of this study is that it can be the continuation of a Chapter 11 proceeding, therefore it is indispensable to have a full view of the way disputes are settled in general.

### **1.2 a) Dispute Settlement Procedure**

The Chapter 20 dispute settlement mechanism provides a procedure in three phases: consultations, a meeting of the Free Trade Commission (FTC)<sup>7</sup>, and non-binding panel arbitrations. After failed consultations, any of the Parties may request a meeting of the FTC, which will seek the settlement through the use of good offices, conciliation, mediation or other procedures.<sup>8</sup>

If the FTC does not arrive to a resolution, any of the disputing Parties may request the formation of an arbitral panel, which will examine the matter in light of the NAFTA provisions, and will make findings, determinations and recommendations.<sup>9</sup>

Once the Member States receive the panel's final report, they are to agree on the solution of the dispute, which normally, but not necessarily, will conform with the recommendations of the panel. If they do not agree on a solution, the complaining State may suspend to the offending Party, NAFTA benefits in the same trade sector or sectors affected by the measure until an agreed solution is reached,<sup>10</sup> If the offending State considers that the retaliation is excessive, it may obtain a panel ruling on the question



<sup>7</sup> The FTC is composed of 3 ministers of the Member States, and is set to supervise the implementation of the agreement, see its further elaboration , resolve the disputes, and in general to consider any matter related to the operation of the NAFTA.

<sup>8</sup> BRISTOW, David and RALPH, Julianne; *op. cit.*, p. 11.

<sup>9</sup> LOPEZ, David. "Dispute Resolution Under NAFTA: Lessons from the Early Experience" *Texas International Law Journal*, Vol. 32, N° 2, 1997, p. 167.

<sup>10</sup> Arts. 2017, 2018, and 2019 NAFTA.

### **1.3 The North American Agreement on Environmental Cooperation (NAAEC) Dispute Settlement Mechanism**

Environmental protection being a difficult subject, it was decided to deal with it in a separate agreement: the NAAEC Member States agreed to establish and effectively enforce domestic laws for high levels of environmental protection; for these purposes, they created a Commission for Environmental Cooperation (CEC), which consists of a Council, a Secretariat and a Joint Public Advisory Committee.<sup>11</sup>

#### **1.3 a) The Environmental Provisions**

The NAAEC was established to foster the protection and improvement of the environment by cooperation between Member States for developing and improving environmental laws, and their compliance and enforcement, as well as for promoting pollution prevention policies.<sup>12</sup>

To this effect the governments engaged in making periodical public reports on the state of the environment, and in promoting scientific research and technology in environmental matters. In relation to the transportation of toxic substances the NAAEC establishes that "...art 2(3)" The Member States agreed that each of them has the right to establish its own levels of environmental protection, development policies and priorities, and to adopt or modify its laws, as long as they provide high levels of environmental protection.<sup>13</sup>

Enforcement of the environmental laws through judicial, or quasi-judicial or administrative proceedings is left to the governments so long they provide appropriate sanctions or remedies to violations. The proceeding shall be available to private persons with a legally recognized interest, who can request that the Member State investigates the alleged violations.

#### **1.3 b) The Private's standing for submission of claims on enforcement matters**

Any private person or Non-Governmental Organization (NGO) residing or established on the territory of a Member State, may present

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<sup>11</sup> Art. 8 NAAEC.

<sup>12</sup> NAAEC Art. 1.

<sup>13</sup> NAAEC Art. 3.



to the Secretariat a complaint asserting that a Member State is failing to effectively enforce its environmental laws. The Secretariat determines if the case submission merits a response from the defending Member State. Upon the response, if any, the Secretariat decides if the matter merits a factual record that will be presented to the Council, which will decide whether to make it public or not.

### ***1.3 c) The Settlement of disputes between Member States***

In the NAAEC's dispute settlement mechanism can be invoked by a Member State when another Member State has engaged in a persistent pattern of failure to effectively enforce its environmental law<sup>14</sup>. If after consultations the governments fail to reach a mutually satisfactory solution, any of them may request a special session of the Council to assist them through good offices, conciliation, mediation, or other dispute resolution procedures, and make recommendations.<sup>15</sup>

If the Council fails to settle the controversy, and upon request of any of the disputing Parties, it may convene an arbitral panel. The panel's task is to "examine, in the light of the general provisions of the Agreement whether there has been a persistent pattern of failure by a Party complained against to effectively enforce its environmental law, and to make findings, determinations and recommendations"<sup>16</sup>

The panel presents a final report; if it is affirmative it shall contain a proposed action plan. At this stage the disputing Parties must agree on a mutually satisfactory action plan, which can conform with that of the panel.

## **2. CHAPTER 11 INVESTMENT SERVICES AND RELATED MATTERS**

The purpose of Chapter 11 is to provide a predictable legal framework to create a favorable environment for the increase in investment opportunities inside Member States, specially by means of clear rules and an effective method of dispute settlement between an investor and a NAFTA Member State. The mechanism enables investors to resort



<sup>14</sup> The term "persistent pattern" is defined in Art. 45 NAAEC as "a sustained or recurring course of action or inaction beginning after the date of entry into force of the Agreement"

<sup>15</sup> Arts. 22 and 23 NAAEC.

<sup>16</sup> Art. 28 NAAEC. In LOPEZ, David; *op. cit.*, p. 186.

to binding international arbitration if the host government of a Member State violates the investment provisions of NAFTA.<sup>17</sup>

### **2.1 Part A: Investments protection**

This part of the Chapter contains the principles and obligations of the Member States in respect to treatment and protection of investments and investors. In Chapter 11 the definition of "investment" is very broad, therefore the scope of coverage includes:

- (a) an enterprise,
- (b) an equity security of an enterprise;
- (c) a debt security of an enterprise
  - i. where the enterprise is an affiliate of the investor, or
  - ii. where the original maturity of the debt security is at least three years, but does not include a debt security, regardless of original maturity, to a state enterprise;
- (a) a loan to an enterprise
  - i. where the enterprise is an affiliate of the investor, or
  - ii. where the original maturity of the debt security is at least three years, but does not include a debt security, regardless of original maturity, to a state enterprise;
- (a) an interest in an enterprise that entitles the owner to share in income or profits of the enterprise;
- (b) an interest in an enterprise that entitles the owner to share in the assets of that enterprise on dissolution, other than a debt security or a loan excluded from subparagraph (c) or (d);
- (c) real state or other property, tangible or intangible, acquired in the expectation or used for the purpose of economic benefit or other business purposes; and
- (d) interests arising from the commitment of capital or other resources in the territory of a Party to economic activity in such territory, such as under
  - i. contracts involving the presence of an investor's property in the territory of the Party, including turnkey or construction contracts, or concessions, or



<sup>17</sup> BRISTOW, David and RALPH, Julianne; "Alternative Dispute Resolution: The Sticks and Stones of the NAFTA" *North American Free Trade Agreements, Commentary*, James HOLBEIN and Donald MUSCH (eds.), Booklet C.7B, New York, Oceana Publications, 1994, p. 20.

- ii. contracts where remuneration depends substantially on the production, revenues or profits of an enterprise;
- but investment does not mean,
- (a) claims to money that arise solely from
    - i. commercial contracts for the sale of goods or services by a national or enterprise in the territory of a Party to an enterprise in the territory of another Party, or
    - ii. the extension of credit in connection with a commercial transaction, such as trade financing, other than a loan covered by subparagraph (d); or
  - (a) any other claims to money, that do not involve the kinds of interests set out in subparagraphs (a) through (h)"<sup>18</sup>

Another important definition which presents the same broadness is that of an "enterprise of a Party" which "means an enterprise constituted or organized under the law of a Party, and a branch located in the territory of a Party and carrying out business activities there"<sup>19</sup>, therefore including any subsidiary of a company of a non-member State of NAFTA.

The broadness of the definitions has the purpose of achieving a maximum range of investments that could be protected through the provisions; with the idea of fighting any possible measure taken by the Mexican government against investors from the other two countries. At the beginning this broadness was considered as one of the greatest achievements of the Chapter, however it has now become one of the most controversial aspects in the trilateral relation.

## 2.1 a) The principles

The principles that are contemplated in Chapter 11 are of two kinds: those contained through the NAFTA (like national treatment, most favored nation, minimum standard of treatment, prohibited performance requirements), and those specific to the investment matters, such as no obligation to appoint senior management board of directives positions, and no obstacles to transfers related to an investment/investor.

<sup>18</sup> NAFTA Art. 1139.

<sup>19</sup> *Ibid.*

### **2.1 b) The obligations**

The obligations established for the Member States are related to conditions authorizing the expropriation/nationalization of investments and are intended to make the process as transparent as possible. Therefore it was agreed that "No government can directly or indirectly: nationalize or expropriate an investment of an investor of another Party; or to take a measure tantamount to nationalization or expropriation of an investment of an investor of another Party, except:

- (i) for a public purpose;
- (ii) on a non-discriminatory basis;
- (iii) in accordance with due process of law and minimum standards of treatment; and
- (iv) on payment of compensation."<sup>20</sup>

### **2.1 c) Environmental provisions**

As part of the general effort to make the NAFTA environment friendly, some provisions regarding environmental protection related to investments were set. As will be demonstrated later, these have become a core aspect of the Chapter and of the NAFTA in general. Article 1114 establishes that the parties are not construed from adopting measures to ensure that investments are undertaken in an environmentally friendly manner, and that a Member State should not lower its environmental, health and safety protection levels to encourage investment.

### **2.2 Part B: The dispute settlement mechanism**

This part of the Chapter was designed to give the investors better guarantees for their investments against actions by the governments that tend to damage them.

It is the logical complement to the first part, and encompasses a series of procedural rules for cases when a government breaches any of the



<sup>20</sup> DEARDEN, Richard G.; "Arbitration of Expropriation Disputes between an Investor and the State under the North American Free Trade Agreement" *Journal of World Trade*, Vol. 29, N°. 1, February 1995, Geneva, p. 117.

provisions in Part A. Even though this kind of substantive norms already existed in international investment treaties, Chapter 11 introduced an important change by passing the capacity to initiate the proceeding of compulsory arbitration from the governments to private persons.

### **2.2 a) Nature of the proceedings**

The Dispute Settlement Mechanism of this chapter allows any private investor, on his own behalf or on behalf of an enterprise incorporated in the jurisdiction of a Member State, to initiate an arbitral proceeding against another Member State. Nevertheless, there are some preconditions to submit a claim to arbitration:

- (i) the investor must have incurred a loss or damage by reason of, or raised of, a breach of NAFTA provisions;
- (ii) the claim must be lodged before three years have elapsed from the date on which the investor knew, or should have known, of the breach and the damage;
- (iii) the aggrieved investor must attempt consultations and negotiations prior to resorting to arbitration;
- (iv) the investor must give notice of its intent to submit a claim to arbitration to the offending Party;
- (v) at least six months must have elapsed since the events gave rise to the claim; and
- (vi) the investor must consent to arbitration and waive its right to initiate or continue the dispute in another forum.<sup>21</sup>

The preconditions were established in order to make arbitration as the last resort for the settlement of disputes, favoring consultation and negotiation. This proceeding encompasses all actions taken by Federal, State, and/or Provincial Governments, and those taken by publicly held monopolies with some exceptions and reservations.<sup>22</sup>



<sup>21</sup> HORLICK, Gary and DEBUSK, Amanda; "Disputes Resolution Under NAFTA: Building on the U.S.-Canada FTA, GATT and ICSD" *Journal of World Trade*, Vol. 27, No. 1, February 1993, p. 23.

<sup>22</sup> The Exceptions and Reservations for each country are established in the Annexes of the Chapter; they include, for example, for Mexico the oil and telecommunications industries, and decision of the National Commission on Foreign Investment with respect to whether or not to permit an acquisition that is subject to review.

## 2.2 b) Types of procedure

The Chapter 11 mechanism does not establish a new procedural regime, rather it allows investors to seek arbitration for violations of NAFTA under:

- (i) the International Centre for Settlement of Investment Disputes (ICSID) Convention, provided that both Member States, that of the investor and that where the investment is made, are Parties to the Convention;
- (ii) the Additional Facility Rules of the ICSID, for cases in which only one of the States is a Party to the ICSID Convention; or
- (iii) to the United Nations Commission on International Trade Law (UNCITRAL) Arbitration Rules.<sup>23</sup>

These different rules of arbitration were considered because only the USA is a member of the ICSID Convention, therefore the disputes between it and the other two Member States would be resolved according to the Additional Facility Rules of ICSID, whereas the rules of UNCITRAL would apply to the Canada-Mexico disputes. However, the ICSID rules were considered in foresight of possible evolution.

The arbitration rules are chosen by the investor, and govern the arbitration except to the extent that the NAFTA provisions modify them. In order to understand the way the proceedings work, we will take a quick look at the three procedural rules.

The ICSID was established under the auspices of the World Bank; an specialized and autonomous arbitration system was created under the Convention to provide an alternative to domestic forum and diplomatic negotiations. It is important to notice that under the ICSID rules, the country of the disputing investor cannot intervene on behalf of its nationals unless the other State does not comply with the decision.<sup>24</sup>

The ICSID's jurisdiction relies on prior consent by the States, which once given cannot be revoked unilaterally. Even when, in order to

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<sup>23</sup> Art. 1120 NAFTA.

<sup>24</sup> EKLUND, Cheri D.; "A Premier on the Arbitration of NAFTA Chapter Eleven Investor-State Disputes" *Journal of International Arbitration*, Vol. 11, N° 4, December 1994, pp. 144-145.



assure the implementation of the ruling, the ICSID rules exclude the possibility of judicial review by a national court, they do not complement the voids of the NAFTA, because the term “investment”, “nationalization or expropriation” nor “tantamount to nationalization or expropriation” are not defined.

The ICSID Additional Facility Arbitration Rules were created in 1978 to settle disputes between Member States to the Convention and nationals of non-Member States, and between nationals of a Member State and non-Member States.

The jurisdiction has to come from a compromise or a compromissory clause between the parties, and the applicable rules, even when based on the ICSID rules are not the same. One of the main differences is that the decisions rendered under the Additional Facility rules are exposed to review by a judicial organ of any of the parties to the dispute. The UNCITRAL arbitration rules were approved by the United Nations General Assembly in 1976 stating the importance of solving the investment disputes.

After this quick review of the applicable rules of procedure it is indispensable to point out the difference in procedure introduced by the NAFTA. We can identify two sets of changes: those where NAFTA norms modified existing ones, and those where it introduced rules that were not contemplated in the other procedures.<sup>25</sup>

Once the preconditions for starting the arbitral procedure have been met, the arbitrators are selected. According to the NAFTA, the number of arbitrators is three: each of the disputing parties select one, and the third one, who is the president of the Tribunal, has to be selected by agreement of the Parties.<sup>26</sup>

In order to avoid a deadlock, it is established that in case the parties fail to appoint its arbitrator, or do not agree on the president of the Tribunal, it is the Secretary General of the ICSID who makes the appointment or appointments.<sup>27</sup> Nevertheless, it is important to remark



<sup>25</sup> For a detailed comparison of the procedural norms modified and introduced by the NAFTA, see to Annex 1 of this paper.

<sup>26</sup> NAFTA Art. 1123.

<sup>27</sup> NAFTA Art. 1124.

that this procedure is not automatic, since the Secretary General of the ICSID can only appoint the missing arbitrator (s) upon request of either of the disputing parties, therefore there still is space for negotiations between the parties.

Finally three important points must be mentioned before going on to analyze the award: First, once a Tribunal has been established and when two or more claims have been submitted to arbitration have a question of law or fact in common, and after hearing the disputing parties, the Tribunal may consolidate the claims. In the event that some of the parties to the dispute question the consolidation, another Tribunal, whose members are all appointed by the Secretary General of the ICSID, decides on the issue. After consolidation, the Tribunal may assume jurisdiction over one or all of the claims, and/or decide on all or part of them.

Second, the Tribunal has the power to appoint experts to report on any issue concerning environmental, health, safety or other scientific matters raised by the disputing parties. It is important to notice here that the Tribunal may do the appointment upon the request of any of the disputing parties, or from its own initiative, as long as the parties do not oppose it.<sup>28</sup> Thirdly, the Tribunal may order interim measures in order to preserve the rights of a disputing party, and/or to ensure its effective jurisdiction.<sup>29</sup>

### ***2.2 c) The decision: Legal basis and consequences***

The Arbitral Tribunal decide upon the dispute in accordance with the provisions of NAFTA and the applicable rules of international law. In this sense, it is important to remark that upon demand by any of the disputing Parties, the Tribunal may request the Free Trade Commission (FTC)<sup>30</sup> to interpret the NAFTA provisions; if the FTC agrees on an interpretation it is binding, if not, the Tribunal decides.<sup>31</sup>

The FTC's role does not end here: when a disputing Member State argues that the measures alleged to be a breach are within the scope

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<sup>28</sup> NAFTA Art. 1133.

<sup>29</sup> NAFTA Art. 1134.

<sup>30</sup> The Article 2001 establishes the creation the FTC which consist of cabinet-level officials of the NAFTA Parties, it is responsible for supervising NAFTA's implementation and resolve disputes concerning its interpretation or application; all its decisions are to be taken by consensus.

<sup>31</sup> NAFTA Art. 1131.

of its reservations, the Tribunal must request that organ to decide on the issue; again if it is not able to agree on a solution, the Tribunal decides.<sup>32</sup> Therefore, the interpretative power of the FTC can influence how broadly or narrowly the investment provisions are interpreted and applied; nevertheless, the importance of this power depends on the capacity/will of the governments to agree on the definitions.<sup>33</sup>

If the Tribunal finds that one of the Parties has breached its obligations as contained in NAFTA, it may award separately or in combination any of the following:

- (i) monetary damages
- (ii) restitution of property
- (iii) costs in accordance with the applicable rules

Where restitution of property is ordered, the Tribunal has to allow monetary damage and applicable interests to be paid instead of the restitution. Finally the Tribunal may not order the payment of punitive damages.<sup>34</sup>

## ***2.2 d) Revision, implementation, and non compliance of decision***

According to the NAFTA provisions, an award has binding force but only for the disputing parties and in respect to the particular case. When a Tribunal decides against a Member State, the latter has to comply with the decision without delay, nevertheless, given the possibility to review the ruling, its enforcement varies from one procedural rule to another, it is then necessary to analyze each separately.

A final ruling made under the ICSID Convention cannot be challenged by an action before a national court or tribunal; the only possible remedies are those provided for within the Convention. The challenge is limited to a procedural review, therefore a request for annulment can only be brought on the grounds that:

- (i) the Tribunal was not properly constituted;
- (ii) the Tribunal has manifestly exceeded its powers;
- (iii) there was corruption on the part of a member of a Tribunal;

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<sup>32</sup> NAFTA Art. 1132.

<sup>33</sup> DEARDEN, *op. cit.*, p. 125.

<sup>34</sup> NAFTA Art. 1135.

- (iv) there has been a serious departure from a fundamental rule of procedure ; or
- (v) the award has failed to state the reasons on which it is based.<sup>35</sup>

The body of appeal is an *ad hoc* Committee, whose three members are appointed by the Chairman of the Administrative Council of the ICSID, and which has the authority to annul the award in part or in total. Even so, the Committee "may even refuse to exercise its authority where annulment is clearly not required to remedy procedural injustice and annulment would erode the binding force and finality of ICSID awards."<sup>36</sup>

Therefore, under the NAFTA a decision rendered under those rules cannot be enforced until 120 days have elapsed from its rendering and only when there has not been a request for revision or annulment, or if this proceeding has confirmed the sense of the award.

For cases when an ruling is rendered under the ICSID Additional Facility Rules or under the UNCITRAL Arbitration Rules, the procedure follows the same steps, and the NAFTA establishes the same periods. Under those two rules of procedure, the possibility of judicial review by a national organ is not excluded and the applicable norms are the National law and the NAFTA provisions, therefore the grounds and sorts of challenge vary from country to country. Given this, a disputing party may only seek the enforcement of a decision rendered under those two procedural rules after three months have elapsed from its rendering and no party has started a proceeding to revise or annul it, or until a court has failed to maintain the decision and no further appeal is possible.

The Tribunal may award a Party either monetary damages, or restitution of property, and each country must enforce it. In case a Member State fails to comply with an award there are two recourses left for the investor:

- try to convince his/her government to initiate a proceeding under the Chapter 20 Dispute Settlement Mechanism.

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<sup>35</sup> EKLUND, Cheri D.; *op. cit.*, p. 154.

<sup>36</sup> *Ibid*, p.154.



- to seek the enforcement him/her self under the ICSID Convention, the New York Convention, or the Interamerican Convention on International Commercial Arbitration, regardless of whether the government has started a Chapter 20 proceeding.

It is important to recall that, first of all, the capacity to initiate a Chapter 20 proceeding is exclusive to Member States, and therefore these have total discretionary power. Secondly, the Chapter 20 proceedings end-up with a non-binding arbitral award, and once it has been rendered, it is up to the governments to agree on a solution; therefore this proceeding is not only highly politicized, and lengthy, but also out of the investors direct control.

As a partial conclusion, we can observe that even though the Chapter 11 investment protection provisions represent a considerable advance in giving the parties directly concerned, the investors, the capacity to initiate proceedings for dispute settlement, many of the provisions were left "uncompleted" leaving room for problems, as will be demonstrated next.

### ***2.3 A few problems with Chapter 11***

The first problem that calls attention is the absence of basic definitions, for example for "nationalization or expropriation" and "measures tantamount to nationalization or expropriation", which constitute the core of the Chapter. Some authors, like Dearden, seek to solve this problem by referring to the interpretation derived from national jurisprudence from the three Member States. Yet, if the purpose of the Chapter was to create a predictable legal framework to promote investments three problems can be identified:

First of all, the lack of a unique definition creates the problem of having different outcomes of proceedings according to the applicable national law. Secondly, NAFTA Article 1131 establishes that the arbitral tribunal decides on the issues in "accordance with this agreement and applicable rules of international law", but given the possibility of applying three different sets of jurisprudence, which give a different definition of those basic concepts this creates a problem in deciding the applicable interpretation. Thirdly, leaving the definition to the jurisprudence of the national tribunals would mean that it would be a function of the tendencies in the national sphere, and therefore doesn't provide the sought security legal framework for promoting investments.

A few other concepts that are not defined either in the NAFTA and that are central to the Chapter are of "public purpose", "non discrimination" and "due process of law". On the contrary, the concept of "payment of compensation" is quite elaborated:

- "(i) compensation shall be equivalent to the fair market value of the expropriated investment immediately before the expropriation took place;
- (ii) the fair market value cannot reflect any change in value occurring because the intended expropriation had become known earlier;
- (iii) valuation criteria shall include going concern value, asset value, including declared tax value of tangible property, and other criteria, as appropriate, to determine fair market value;
- (iv) compensation must be paid without delay and be fully realizable;
- (v) if payment is made in a G7 currency, compensation shall include interest at a commercially reasonable rate for that currency from the date of expropriation until the date of actual payment; and
- (vi) on payment, compensation shall be freely transferable."<sup>37</sup>

In spite of all its faults, the Chapter was considered a success because it put an end to an old dispute between the USA and Mexico about due compensation, and because it gave the directly affected person, the investor, the legal capacity to initiate a proceeding against a State, without any further need for consent by the State. This kind of proceeding is very rare in international public law.

### **3. THE CHAPTER 11 DISPUTE SETTLEMENT MECHANISM IN PRACTICE**

When studying Chapter 11 cases, we are soon faced with a problem: there is no provision to make the publication of the documents of the cases compulsory, not even the filing of the case, therefore analysis has to be based on the "good will" of the disputing parties to inform about the proceedings.

From what has been available to the public, we have information about twelve Chapter 11, cases, but it is important to remark that none of them has been the subject of a final decision by an arbitral tribunal. They have either not been pursued, settled outside the arbitration, or are in progress.

For the purpose of this paper we will divide the analysis of the cases in 3 periods:

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<sup>37</sup> *Ibid.*, pp. 120-121.



1. The pre-Ethyl Corporation period. It consists of two cases characterized by companies not pursuing proceedings to the end.
2. The Ethyl Corporation case, and the beginning of the definitions debate. We will analyze the facts, the legal arguments, the way of settling the dispute, and the consequences for Chapter 11 DSM.
3. The post-Ethyl Corporation Period. Here a distinction must be made between those cases which followed the interpretation given to certain provisions in the Ethyl case, and those that were based on disputes concerning a non-regulatory taking, or other type of investment related matters.

### 3.1 The Pre-Ethyl Corporation Period

This period runs from January 1994, with the come into force of the NAFTA, to September 1996, when the Ethyl Corporation Case was filed; it covers two cases filed by USA companies: one against Mexico and the other against Canada.

The first record of a NAFTA investment dispute dates from August of 1995, and involves a Canadian-American company, Hachette Distribution Series, who had an airport shop concession in Mexico. The company filed the case but later did not pursue it.<sup>38</sup>

The Second case was one initiated by a pharmaceutical Mexican company, Sigma SA de CV, in March 1996 against Canada: The company filed a claim for USD 50 millions, but did not pursue it beyond the initial filing.<sup>39</sup>

The obvious characteristic of this period is the lack of pursuance of the cases; maybe the companies were not really considering use of the DSM to settle the dispute, but just trying to exert pressure on the governments. Another characteristic is the lack of information about the cases, because the Member States did not informed about the filing of the cases, actually the public did not find out about the filing of the intention to submit to arbitration much time later, and there is some tendency to not even consider those as cases of the Chapter 11.<sup>40</sup>



<sup>38</sup> In SOLOWAY, Julie A. "NAFTA's Chapter 11 — The Challenge of Private Party Participation" *Journal of International Arbitration*, Vol. 16, N° 2, June 1999, p. 12.

<sup>39</sup> In *Ibid*, p. 12.

<sup>40</sup> For example, during our research we could see that journals specialised in North American commerce problems like *Americas Trade*, *Inside NAFTA* and *Inside U.S. Trade* do not even have registers of the existence of those disputes and consider the Ethyl Corporation case as the first one of Chapter 11.



### **3.2 The Ethyl Corporation Case and the beginning of the definitions debate**

In September of 1996, the Ethyl, a USA based company operating in Canada through a subsidiary, filed an intent to bring to arbitration a complaint against the government of Canada arguing that by passing a law prohibiting the interprovincial and international trade of the fuel additive MMT, it had incurred in a breach of the following NAFTA provisions: national treatment, prohibition for imposing performance requirements, and non-compensated action "tantamount to expropriation".<sup>41</sup>

According to the Canadian government the ban on MMT was established "... in order to protect the health of the Canadians, for the positive and progressive harmonization of North American fuel standards, and to protect jobs and consumers from adverse economic impacts, due to increased engineering costs for auto companies." However, it is important to remark that MMT was not banned as a toxic substance under the Canadian Environmental protection Act due to insufficient proof.<sup>42</sup>

The Ethyl Corp. filed its complain on April 1997 under the UNCITRAL rules and nominated the president of the American Society of International law as its arbitrator.<sup>43</sup> In order to understand the complaint, we will take a look at the arguments of the breaching centering in the one of a "measure tantamount to expropriation".

#### **3.2 a) Article 1102: National Treatment Provision**

Ethyl Corporation argued that the MMT ban violated the requirement of non discriminatory treatment between foreign and domestic firms on the ground that by not prohibiting the sale of Canadian made MMT, while prohibiting its movement, the Canadian government prevented the sale of foreign made MMT in Canada. It is important to notice that Ethyl Corporation held the patent and is the sole North American producer of MMT, so there was no Canadian competitor company.

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<sup>41</sup> In SOLOWAY, Julie A.; "Environmental Trade Barriers Under NAFTA: The MMT Fuel Additives Controversy" *Minnesota Journal of Global Trade*, Vol. 8, Issue 1, Winter 1999, p. 84.

<sup>42</sup> In *Ibid*, p. 5.

<sup>43</sup> In *Inside NAFTA*, April 17, 1997.



Nevertheless, Ethyl Corporation further argued that there was a breach of the obligation because there was no difference between the MMT produced in Canada and that produced in USA, and thus the MMT prohibition gave "... an unfair marketing and promotional advantage to investors based in Canada over non-Canadians selling the same product."<sup>44</sup>

### **3.2 b) Article 1106: Prohibition of performance requirements**

As we have seen in the previous section, under the NAFTA the establishment of certain measures as a condition for an investment are prohibited. Therefore, Ethyl Co. argued that its subsidiary was forced to buy MMT produced in Canada, and that this was similar to imposing a requirement. What is more, given that no other company produced MMT in North America, Ethyl was forced to build manufacturing and blending plants in each province or territory of Canada in order to be able to continue with its business.

### **3.2 c) The "action tantamount to expropriation" provision**

As noted before, the main concern of American and Canadian negotiators during the making of the NAFTA was to establish definitions wide enough to contain a wide range of measures against which the investor could be protected from; the best example is the lack of definition of a "measure tantamount to nationalization or expropriation" of an investment.

Using this lack of clearness, the Ethyl Co. argued that the ban of MMT intraprovincial and international commerce, was equivalent to an expropriation in the form of a "regulatory taking", therefore it was a measure for which it should be compensated for. The Company alleged that it had suffered loss in sales and profits, a loss in value of its manufacturing plant in Canada, a decline in future sales, and a damage to its reputation; all those added up to a compensation of USD 251 millions, the biggest claim ever made under the NAFTA until that moment.

The importance of the case comes directly from this type of claim, which has been used in other cases and that has become a central



<sup>44</sup> In *Ibid*, p. 6.

problem with Chapter 11. The core of the problem is that it has opened a way of interpreting the NAFTA provisions that the Member States had not thought of. The government's capacity to make laws was put in danger due to the lack of differentiation between actions which can and cannot obtain compensation.

The problem is laid down by Soloway, who states that "In a sense, every regulation will alter the costs and opportunities for individuals and firms."<sup>45</sup> The question is how to differentiate those alterations that should be compensated from those that should not?

Unfortunately, in the Ethyl Corp. case the question was left without an answer; in July 1998 the Canadian Government and the corporation agreed on an extra judicial arrangement by which the company received USD 12.5 millions, the annulment of the ban on MMT commerce, and a declaration by the Canadian Government that there was no proof that MMT was dangerous to health. The declaration is being used by the company to promote a world wide campaign for the use of MMT.

This settlement created a precedent that has been used in later cases, for filing complaints against environmental laws arguing "regulatory takings". The problem is not exclusive of the NAFTA, it is a problem in general public international law; the Chapter 11 states that "the applicable rules of international law" govern the question of when a regulatory taking is compensable, however under international law the problem of expropriation through regulatory measures has not been widely treated. As Soloway remarks "... international law jurisprudence provides little guidance as there does not appear to be any universally agreed set of principles as to when one government action should fall into one category and another into other."<sup>46</sup>

Even though the problem existed before, it took importance with this treaty because of the capacity of private persons to present claims without needing the support of their governments or the consent of the State against which are filing the complaint. Thus, though the lack of definitions was present before, it was not widely used, because



<sup>45</sup> In SOLOWAY, Julie A. "NAFTA's Chapter 11 ... *op. cit.*, p. 7.

<sup>46</sup> In SOLOWAY, Julie A.; "Environmental Trade Barriers Under NAFTA ... *Op. cit.*, p. 87

in most cases the investors needed to convince their governments to present the claim; and/or the consent to bring the matter to arbitration from the breaching State, in order to initiate a case, and were highly unlikely to obtain either. Therefore, the NAFTA Chapter 11 DSM introduced a time bomb, through the granting of the initiative to the private persons, and the lack of definitions that permits a wide interpretation of what investment is and what kind of measure can be subject to compensation and which not.

### ***3.3 The Post-Ethyl Corp. Case Period***

From January 1997 until march 1999, at least 9 cases were filed under the NAFTA Chapter 11 DSM. Of those, 4 cases have to do with common kinds of expropriation and/or problems of compensation, and in 5 cases an environmental law, or some other kind of new regulation, was accused of being tantamount to expropriation through a regulatory taking. Even though we will take a quick look at the first four cases, we will mainly concentrate on the following five that continue the problem of interpretation of concepts in the NAFTA and its effects to the environmental law and the sovereign capacity of the State to enact laws applicable within their territory.

#### ***3.3 a) Cases of non-regulatory taking***

The first of this kind of cases was introduced by a Mexican Company, Desechos Sólidos de Naucalpan (DESONA), whose principal investors are USA nationals; on November 1996 submitted a notice of intent to resort to arbitration against the government of Mexico for the actions of a municipality. It is important to recall that according to the NAFTA provisions, the federal government can be held responsible for the acts of governments inside the State, in this case, local government.

The investors complained that even though they were invited to build a waste landfill, they never received payment and were eventually forced to leave. In the end, the landfill was taken by the municipality. In March 1997, an arbitration tribunal was constituted under the ICSID Additional Facility Rules (AFR), with a claim for \$17 millions USD, and according to the information available the affair is still pending.<sup>47</sup>



<sup>47</sup> In *Inside NAFTA*, Vol. 4 No. 6, March 20, 1997, p. 12.

The next claim of this type was introduced by Company USA Waste, due to the unpaid services of its subsidiary ACAVERDE, a company in charge of cleaning the streets of the port of Acapulco, in Mexico. The notice of intent to submit to arbitration was filed on February 1998, and the argument was that the Mexican Development Bank and the Government of the State of Guerrero had guarantee to pay for the Acapulco, but that they had failed to do so, and that the investors were later forced to abandon their investments. The claim was filed in June 1998 under the ICSID AFR seeking a compensation of \$60 millions USD, and is still pending.<sup>48</sup>

The third claim of this group was presented by the Loewen Group, a Canadian funeral Services Company, against the government of the USA for the treatment they received in a 1995 Mississippi Court case. The original dispute arose because a deal by which the Loewen Group purchased funeral homes in Mississippi: after negotiating an agreement with the local competitor, the Group was sued by the American company which later had gone to bankruptcy and accused it of breach of contract and fraud.

The case was adjudicated against the Loewen Group, which was commanded, by a Court of Mississippi, to pay \$500 millions USD. The NAFTA case was filed on October 1998 under the ICSID AFR, and a \$725 millions USD compensation was demanded. The alleged breach of NAFTA provisions arose from the fact that in order be able to present an appeal to the judgment, the Canadian Company was required to pay 125% of the verdict; it therefore argued a breach of the following provisions: national treatment, minimum standard of treatment, and expropriation without due compensation. The case is still pending.<sup>49</sup>

The last case of this group was introduced by the Sun Belt Water Inc., a USA company which filed a notice of intent to recur to arbitration on December 1998, arguing that the British Columbian government had failed to give it a fair and equitable settlement for the company's 1991 contract to buy and export Canadian water from Snow Cap, its Canadian partner to the USA.<sup>50</sup>



<sup>48</sup> In *Americas Trade*, June 11, 1998; and March 25 1999.

<sup>49</sup> In *Americas Trade*, Vol. 5 No. 24, November 26, 1998; and in SOLOWAY, Julie A. "NAFTA's Chapter 11 *op. cit.*, p. 12.

<sup>50</sup> In *Inside US Trade*, Vol. 16 No. 50, December 18, 1998.

The conflict arose when in March 1991 Sun Belt and Snow Cap won a contract to supply water from Canada to a city in California, and a few days later the British Columbian government imposed a moratorium on the issuance of water licenses. After long negotiations, in 1995 the companies were invited to seek separately judicial settlement, and Snow Cap received compensation while Sun Belt did not. For this reason it claims a breach of NAFTA provisions on: national treatment, minimum standard of treatment, and presents a request for compensation of damages that amounts to \$220 millions USD.<sup>51</sup>

### **3.3 b) Cases of regulatory taking cases**

This group of 5 cases is characterized by a company filing a case against a government by enacting a law that altered its investment. As established before, the danger here is for the regulatory capacity of the governments, a problem that has become a central issue in trilateral discussions, and that is far from solved.

The first case that followed Ethyl Corp.'s interpretation by questioning an environmental law, was introduced by the USA's Metalclad Corporation which argued a discrimination against its ability to open a hazardous waste landfill facility in the Mexican State of San Luis Potosí. The Mexican federal government is being held responsible for the actions of a government of one of its states.<sup>52</sup>

According to Metalclad Corp., it was invited by the federal authorities to build a hazardous waste disposal, but later the State governor declared a 600, 000 acres, including the landfill site, an ecological preserve. The case was submitted for arbitration under the ICSID AFR on October 1996, demanding a compensation of \$65 millions USD.<sup>53</sup>

The Mexican government filed its submission on February 1998 arguing that "... the decree by the state governor does not impose a blanket prohibition on use of the land for commercial activity .... Instead, the decree states that companies that have obtained all their necessary government permits to operate could do so in the designated area ... Metalclad did not obtain all the necessary permits for operation

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<sup>51</sup> "Sun Belt filing against Canada", *Americas Trade*, Vol. 5 No. 26, December 24, 1998.

<sup>52</sup> *Inside NAFTA*, Vol. 4 No. 6, March 20 of 1997.

<sup>53</sup> In SOLOWAY, Julie A. "NAFTA's Chapter 11 *op. cit.*, p. 12.

of its facility before the decree went into effect ..."<sup>54</sup> The case, which is still in process, represents one of the most typical cases of regulatory taking, in which a government if well does not materially take possession of the investment, it prevents its use by the investor by the limiting the ways in which the investment can be used.<sup>55</sup>

The next case under Chapter 11 that challenged an environmental law arguing a regulatory taking was introduced by the Ohio-based S.D. Myers Inc. against the government of Canada for damages caused to its Canadian investment by the enactment of a law in November 1995 which prohibited the exporting of PCB waste from Canada to the USA, this being the activity of the company.

S.D. Myers filed its intention to recur to arbitration on July 1998, and in October it filed the complaint under the UNCITRAL rules asking for a compensation of \$20 millions USD. The company alleges a breach of the following NAFTA provisions: national treatment, minimum standard of treatment, performance requirements, and expropriation.<sup>56</sup>

The case arose from the 1990 Canadian ban of exports of PCB wastes to all countries except the USA, prior approval of the United States Environmental Protection Agency (EPA). On November 1995, Canada modified the law, including the USA in the ban. According to S.D. Myers "The effect of these measures was to prohibit S.D. Myers from conducting business in Canada. Through this time, Canadian based investments which disposed of PCB wastes in Canada were permitted to conduct business in Canada. The inability of the Investor to have continued access to the Canadian PCB disposal market has resulted in damage to the Investor arising directly from Canada's NAFTA inconsistent measures."<sup>57</sup>

In the S.D. Myers Notice of Intent to submit to Arbitration, we can find some very remarkable paragraphs in relation to regulatory takings. For example in stating the violation of the minimum standard of treatment,



<sup>54</sup> In *Americas Trade*, March 5, 1998, p. 4

<sup>55</sup> Dearden gives some interesting examples under Canadian jurisprudence of this kind of expropriation. In DEARDEN, Richard G.; "Arbitration of Expropriation Disputes ... *op. cit.*", pp. 117-120.

<sup>56</sup> In *Americas Trade*, Vol. 5 No. 23, November 12, 1998, pp.1, 12-13.

<sup>57</sup> In "S.D. Myers Incorporated Notice of Intent to Submit a Claim to Arbitration under Section B of Chapter 11 of the NAFTA"; in *Americas Trade*, Vol. 5 No. 18, September 3, 1998, p. 25.

the company argued that "The PCB Export bans were promulgated in a discriminatory manner which constituted a denial of justice as well as a violation of Canada's domestic practice for the making of regulations", and when arguing against the expropriation that followed the Company by saying that "The effect of the PCB Export Bans has been to totally frustrate the Canadian operations of the Investor. This has resulted in *deprivation of the benefits of the Investor's investment in Canada, constituting a measure tantamount to an expropriation.*"<sup>58</sup>

The interesting thing is that here the claim attacks Canada's government capacity of enacting laws directly by arguing a violation of the domestic practice, this could be a very dangerous precedent, because given the wideness of the NAFTA definitions the problem for governments would be to manage changes in their national policies without being accused of breaching NAFTA provisions. It remains to be seen what comes out of the arbitration, and how governments will try to manage this kind of claim.

On December 1998, the USA's company Pope & Talbot Inc. filed an intent to submit to arbitration a claim arguing that its Canadian subsidiary Pope & Talbot Ltd.'s three saw mills and forestry division in British Columbia are treated unfairly compared with companies from provinces not listed in the 1996 Softwood Lumber Agreement. It is seeking a \$30 millions USD compensation for damages.<sup>59</sup>

The Softwood Lumber Agreement came into force on May 1996 between Canada and the USA, establishing a limit on the free export of softwood lumber by Canadian producers of certain specific provinces to the USA. The agreement was implemented by the Canadian government by a series of controls on the exports of these provinces: once the given quota of softwood lumber had been attained they were subjected to an export tax. The company alleged breach of national treatment due to the failure to "... extend the best treatment available in Canada to the Investments of Investors harvesting softwood lumber who operate in the listed provinces."<sup>60</sup>



<sup>58</sup> *Ibid.*, Italics added, pp. 25-26.

<sup>59</sup> In *Americas Trade*, Vol. 6 No. 4, February 25, 1999; and in "Pope & Talbot, Inc. Notice of Intent to submit to Arbitration under Section B of Chapter 11 of the NAFTA" in *Americas Trade*, March 25, 1999; pp. 7-9.

<sup>60</sup> In *Ibid.*, p. 8.



The complaint that was formally filed in March 1999 under UNCITRAL rules, and is still pending, presents a claim for over \$507 millions USD in damages alleging a breach of NAFTA provisions concerning minimum standard of treatment, national treatment, most favored nation treatment, performance requirements and expropriation.<sup>61</sup> In this claim the regulatory power of the government, that allegedly breached the NAFTA by "depriving the Investor of its ability to carry out its otherwise legal business operations on a discriminatory basis"<sup>62</sup>, is question rather the Softwood Lumber Agreement and the way the Canadian government implemented it, this is new under the NAFTA DSM.<sup>63</sup>

Here we can observe that the NAFTA provision on investments protection are being used to challenge many different sorts of laws, and what is more important, even the making of international treaties between States is under examination. As will be seen with the next case the scope of areas that can be included in those challenges are presenting an enlargement, creating more problems and more criticism of NAFTA.

Another case of this group is the claim presented by the American citizen Martin Feldman, owner of the *Corporación de Exportaciones Mexicanas S.A. (CEMSA)*. The case, which was filed in May 1999 under the ICSID AFR, arose from an alleged persistent refusal to rebate exercise taxes for the cigarette exporting company for as required by Mexican law.

The dispute started by the passing of a law in 1991 to disallow rebates on taxes on all cigarette exports except those of cigarette producers. Even though CEMSA challenged the law in the Mexican Supreme Court with a favorable ruling in 1993, the government did not apply the rebates until March 1994 and did not permit CEMSA to resume exports until June 1996.

The USA government got involved in 1996 through its ambassador in Mexico, and in December 1997 the tax law changed again, eliminating

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<sup>61</sup> In "Executive Summary of NAFTA Investor-State dispute claim by Pope & Talbot, Inc."; in *Americas Trade*, April 8, 1999; pp. 5-6.

<sup>62</sup> In *Ibid*, p. 6.

<sup>63</sup> *Americas Trade*, Vol. 6 No. 4, February 25, 1999; p. 11.



cigarette tax rebates for resellers, a measure which has been challenged in Mexican Courts.<sup>64</sup> The company claims a breach of the NAFTA provisions from January 1992 until December 1997, and a measure "tantamount to expropriation". It is asking a compensation of \$50 millions USD for damages plus interests; it argues that the Mexican action is tantamount to expropriation through a confiscatory tax measure. The case which is still pending, represents another premier in the NAFTA Chapter 11 context; this shows that the problematic of the interpretation of the concepts is just beginning and that it may expand to different domains limiting the capacity of the governments to act.

The last case of this section is also the latest case filed under the NAFTA Chapter 11 and refers to the claim introduced by Canadian Methanex Corporation against the government of the USA; it is an example of the danger into which the NAFTA provisions on investment protection have become, and shows the necessity to narrow their interpretation. It is also a unique claim, because the company is not only seeking compensation for the damages already suffered, but also for those it will suffer, claim that, if accepted, will constitute a very wide and dangerous interpretation of the Chapter 11 provisions.

Methanex Corporation filed on June 1999 a notice of intent to submit to arbitration a claim against the government of the USA for the passing of a law by the government of the State of California. The law in question was issued on March of 1999, and provided for the ban of MTBE, a gasoline additive, is set to take effect at the end of the year 2002. The law was passed as a consequence of finding MTBE in groundwater.<sup>65</sup>

The Company is claiming a compensation of USD 970 millions due to the fact that:

"The ban on MTBE has caused and *will* cause losses including, inter alia;



<sup>64</sup> In "CEMSA Chapter 11 Filing", in *Americas Trade*, Vol. 6 No. 11, June 3, 1999.

<sup>65</sup> In *Inside US Trade*, Vol. 17 No. 24, June 18, 1999; pp.1, 17-18. And *Americas Trade*, July 1, 1999; pp. 9-10.

- a) the loss of Methanex and Methanex US of a substantial portion of their customer base, goodwill and market for methanol in California and elsewhere;
- b) the losses to Methanex and Methanex US as a result of *the decline the global price of methanol*;
- c) *loss of return* to Methanex and Methanex US on capital investments they have made in developing and serving the MTBE market;
- d) the loss to Methanex of a substantial amount of its investment in Methanex US."<sup>66</sup>

Methanex also claims that its *stock price has dropped* as a result of the Californian law, but some non-governmental organizations claim that the stock price has dropped for the same reason spot prices of methanol dropped over the last years. The company is the world's largest producer of MTBE, and has accepted that it has chosen to present the case through the NAFTA DSM "... because the *expropriation language in Chapter 11 is very broad and would therefore encompass this claim.*"<sup>67</sup>

The case sums up the problematic of the wide definitions of Chapter 11, and is an excellent example of the dangers of the regulatory capacities of the State. The interesting thing is that this kind of case has not only been questioned the regulations in one area, but is starting to expand to very different subjects. This has started a vivid debate not only in the civil society, but also between the governments, who are seeing their capacity to enact laws being put in question, its is therefore necessary to complete the analysis to take a look at the standing that the governments have taken in relation to this subject, as well as the opinion and actions of some non-governmental organizations (NGO).

### 3.4 Different reactions to the functioning of NAFTA Chapter 11

The five cases listed above have provoked a great deal of discussion between different levels of society, among NGOs, between NGOs and governmental institutions, and between the three governments. In order to fully understand the debate and its consequences we will first



<sup>66</sup> In "Methanex Chapter 11 Notice of Intent" in *Americas Trade*, July 1, 1999; p. 11. Italics added.

<sup>67</sup> In *Inside US Trade*, Vol. 17 *op. cit.*, p 17. Italics added.

analyze the government's positions, and later those of the NGOs. This will give us a full view of the problems, the possible solutions and the tendencies and implications of the NAFTA Chapter 11 cases that were studied.

For the governments, the issue has become a corner stone in trilateral relations: their positions are almost opposite which provokes a great deal of tension. The government of Canada is the one that is most concerned with the implications of the NAFTA provisions: since 1998 it has tried relentlessly to press the other two Member States to agree to clarify the Article 1110 (1) which includes the problematic "measure tantamount to nationalization or expropriation of such an investment" provision. Under that initiative an *ad hoc* group is examining the definitions of expropriation under the different international law agreements, in order to find a suitable one.<sup>68</sup>

The first proposal by Canada went far in modifying the provisions: they explored the possibility of changing "...the NAFTA investor-state provisions to use nations domestic expropriation laws as the terms of reference for cases brought under the Chapter 11."<sup>69</sup> This would be mean make this chapter equal to Chapter 19 DSM. As we saw in one of the previous sections of this analysis, Chapter 19 proceedings are based on the laws of the country against which the proceeding is filed, nevertheless, this poses the problem that it would annul the stable legal framework based on rules and proceedings different from the national ones that is sought.

The point of view of the Mexican government is completely contrary to such a proposition and, in general, to any measure that looks like a modification of the NAFTA provisions. In a meeting of the Ministers of Trade, the Mexican Trade Minister stated his position by saying that "... Chapter 11 needs no tinkering, but panelist need to be properly informed of what the right interpretation of the chapter is."<sup>70</sup>

In April 1999 a meeting of the NAFTA Commission was held, formed by the Ministers of Trade of the three countries. Canada made a new



<sup>68</sup> In *Inside U.S. Trade*, Vol. 16 No. 50, December 18, 1998.

<sup>69</sup> In *Americas Trade*, Vol. 6 No. 4, February 25, 1999; p. 3.

<sup>70</sup> In *Ibid.*

proposal to narrow the interpretation of the provision through an interpretation by the Commission, what is more, according to the Canadian point of view that interpretation should be retroactive in order to be applicable to the cases still pending.<sup>71</sup> Even though the Member States could not agree on the matter, they did agree that they will not seek to reopen the NAFTA negotiations.

As for the USA its position on the subject is not defined. The problem is that it has started a discussion between the different governmental agencies involved in the matter: on the one side the US Trade Representative (USTR) is unwilling to narrow the definition of the provisions, and on the other side the Environmental Protection Agency (EPA) and the Department of Justice, are advocating its constraint.<sup>72</sup>

This lack of clearness on behalf of the USA creates a huge problem due to the inability to make things move one way or the other, nevertheless their position might change in the immediate future due to the multimillionarian complaint against the USA filed last march by Methanex Inc. As a matter of fact, the issue is starting to become important, as some Californian Democrats are lobbying to make the USA government take a clear position on the matter.<sup>73</sup>

Finally, concerning the governmental proposals it is important to remark that the Canadian government, as part of a general review of the NAFTA, is trying to make Chapter 11 proceedings more transparent, in order to let the public know about the starting of the proceedings, the position of all the parties, as well as their arguments.<sup>74</sup>

As for NGO's, even though they have been quite active promoting a narrowing of the investment protection provisions, and there are two important facts that have to be mentioned about them: First of all, the creation of a trilateral coalition of environmental NGO's, that has launched a lobby criticizing the way environmental issues are being handled under Chapter 11 disputes. This initiative is important due to the fact that they represent the only group that has been able to get



<sup>71</sup> In *Inside U.S. Trade*, Vol. 17 No. 17, April 30, 1999; pp. 1, 22-23.

<sup>72</sup> *Americas Trade*, Vol. 6 No. 9, May 6, 1999.

<sup>73</sup> See *Americas Trade*, August 26, 1999; pp. 6-7.

<sup>74</sup> *Americas Trade*, February 25, 1999.

organized through the boundaries in order to present a common point of view on the matter.<sup>75</sup>

Secondly, the coalition is pressing the Council of the Commission for Environmental Cooperation, the head organ created under the NAAEC and made up of the Environmental Ministers of all three countries, to suspend the Chapter 11 cases still pending until an appropriate process for ensuring environmental protection is agreed between them, and to cooperate with the NAFTA Commission to provide an interpretation that takes into account the protection of the environment.<sup>76</sup>

As we can see, an interpretative agreement on the investment provisions something governments will have to face in one moment or another, however it remains to be seen if they are able to find a solution that fits the different necessities: solving the regulatory power problem of the governments, guaranteeing the stability of the NAFTA as well as the investor's trust in the well-being of their investments, limiting the sort of claims that the investors can file in seek of compensation, and last, but not least, an interpretation that meets the necessity of environmental protection.

## CONCLUSIONS

The NAFTA Chapter 11 cases, specially those arguing to regulatory taking measures, are a prove that the provisions concerning investment protection that were included there have become to be rather a problem than a solution for the investment disputes.

The negotiators cared more in defining the way the compensation was going to be made, than in defining what they meant for "investment" and for "a measure tantamount to expropriation or nationalization"; actually the lack of definition may have been on purpose, to encompass as many kind of investments as possible, and to protect them against all the possible measures taken by the Mexican government.



<sup>75</sup> In *Americas Trade*, July 1, 1999; pp. 3-5.

<sup>76</sup> In *Ibid*, and *Americas Trade*, Vol. 5 No. 23, November 12, 1998.

Nevertheless, the negotiators did not take into account that those provisions would also be applicable to the actions of Canada and the USA, therefore creating some of the regulatory taking cases studied.

As for the cases themselves, the problem of the interpretation given to the mentioned provisions might take a big step in the coming months with the first final decision of a arbitration tribunal of Chapter 11, the question is in which sense it will be?

If the panel ratifies the argument of the companies against the measures "tantamount to expropriation or nationalization", the government of the three Member States will have a big incentive to agree on a definition by the NAFTA Commission, on what is meant by the different concepts established there, nevertheless this might have to happen in a climate of strong political pressure by the different parties interested in the matter, which means that it will be a politically costly process, involving negotiations not only at the inter-governmental level, but also at the national one.

Other problem that will face the agreed interpretation, if such comes to exist, will be on its application to the already existing cases. As seen, Canada is pressing for an interpretation with retroactive application, but it is highly doubtful that the Mexican government will accept that, although it may change its opinion if the cases concerning Mexico are settled against the country and in favor of the companies.

The definition of the USA position in the matter, will be a very problematic process, especially with the coming presidential elections next year. The political pressures from both groups, those in favor of narrowing the investment provisions and those against, will be strong and will play a decisive role, rests to see if the environmental NGOs and different governmental institutions in favor of the narrowing, can exercise more pressure than the USTR and the companies.

As for the legal implications of a final arbitral decision supporting a wide interpretation of the "tantamount to expropriation" provision, are quite interesting, because it may established a precedent that may start a series of filing of similar cases. This would represent a problem for the regulatory capacity of the States, capacity which must be carefully guarded. So the problem will be to find a definition that

while enabling the Governments to enact regulations without being afraid of being suit for, at the same time protects the investors and their investment from non justifiable laws, not an easy task.

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