

Internationalizing and Privatizing the State : Assessing the Impact
of Adjudication of Trade Disputes

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In the early 1990s some theorists began to advance the  
proposition that the state was being "hollowed out" by processes  
of globalization ( e.g.Ohmae 1990 ). Extreme versions of this thesis  
are not hard to shoot down. States, rather than being the passive  
victims of external processes were, in fact, the architects or "  
midwives of globalization." (Brodie 1996:386; see also Panitch 2000)  
Even international financial integration, acknowledged as the  
leading edge of globalization, was "heavily dependent on state  
support and encouragement", particularly decisions to abolish state  
controls on capital. (Helleiner 1996:193) Such scepticism about  
the demise of the state has been reinforced by the robust revival of  
state centred security considerations since 2001.

Nevertheless, there is something in the argument that the  
state's capacity for action has been limited in certain areas. An  
emerging literature, rooted in international political economy and  
international law, interprets international economic agreements  
(IEAs) as having constitutional effect, rather than being merely  
technocratic trade deals. There is growing recognition of the  
constitutional characteristics of agreements like NAFTA and the WTO.  
In essence rules and constitutions are being redesigned to establish  
and lock-in arrangements that render certain types of future

political change more difficult. Notably, the state's ability to regulate capital is increasingly constrained by the provisions and quasi-judicial mechanisms of the agreements. Clearly the state elites responsible for negotiating these agreements have willingly sacrificed future options.

Even institutionally minimalist IEAs like NAFTA do have institutions and of these the dispute settlement institutions, performing a judicial or quasi-judicial function, are the best developed. Increasingly it can be argued that their decisions impose limits on national governments and define the norms by which they operate.

For many this development is undemocratic and these bodies lack legitimacy. Critics (for example Clarke and Barlow 1998) make the point that these international institutions are remote from scrutiny or influence by national electorates, frequently operate in relative secrecy, and are unaccountable. Less commonly highlighted is the degree to which the adjudication processes and mechanisms established under these agreements constitute private governance, even if it is publicly sanctioned. As such the agreements, especially the North American Free Trade Agreement, represent a privatization as well as an internationalization of part of the state's functions.

Since this trend is most developed in NAFTA that agreement may represent an instructive prototype in gauging how the state has been affected by political globalization. Technically trilateral it can more accurately be described as three bilateral agreements ( Canada - US, Canada-Mexico and Mexico-US ) cobbled together. (Kerr 2001:1175) Given the current difficulty of moving ahead with multilateral trade initiatives -- both the Doha WTO round, at Cancun, and the FTAA negotiations , at Miami, have recently hit stumbling blocks -- the bilateral alternative is viewed favourably by US trade authorities. And US Trade Representative Robert Zoellick quickly identified the bilateral and regional alternative for the United States: " The U.S. strategy on trade has sought to press ahead on global trade liberalization through the WTO. And we hoped that others would, too. And the message we received in Cancun from them was, 'not now'. The U.S. trade strategy, however, includes advances on multiple fronts. We have free trade agreements with six countries right now. And we're negotiating free trade agreements with 14 more." .(U.S. Department of State. 2003) In such a strategy the US may draw upon its NAFTA experience because it provides a prototype that embodies three asymmetries of power that are central to US policy and interests.

### *Asymmetry*

First, the agreement reflects power imbalances between states. For example, NAFTA Article 605 dealing with energy exports essentially applies only to Canada and guarantees some security of supply and price to the US. Second, it reflects power imbalances between social actors or classes, an aspect that is highlighted by the contrast between the guaranteed mobility that capital and goods enjoy when compared to labour, and by the weak non-enforceable labour side-agreement when compared to the robust protection for

investors under Chapter 11.. Third, it privileges the private sphere over the public not only through curtailing state intervention in the economy but also by privatization of certain state governance functions,

We have seen that from a US perspective, NAFTA provides a suitable prototype for de facto regional governance in a period where US objectives are difficult to realize in multilateral forums.. Bilateral negotiations have previously been used to 'model' provisions that the parties, or one of them, might hope to extend to other arenas. This was certainly true of the dispute settlement system under the original Canada - US free trade agreement. ( Kerr 2001: 1171) Moreover, NAFTA'S Chapter 11 investment rules provide the working model for negotiations on the FTAA. (Staff and Lewis 2003: 329) . Afilalo ( 2001:4-5; 14-17) argues that the investment protection provisions of NAFTA, especially Chapter 11 which places enforcement of investor rights in private hands, reflect long-standing aims of US foreign investors in less-developed countries like Mexico, and the ICSID and UNCITRAL rules under which tribunals adjudicate reflect the US view of investment protection. ( see also Gastle 1995: 800-801) And advocates of private sector rights in international agreements also have bemoaned the absence of NAFTA Chapter 19 provisions, which accord a role to private actors, in the draft FTAA. ( Villanueva and Serna 2003: 1032) Indeed substantive private party rights are less entrenched in agreements like the WTO (Reif 2002: 459) and this renders NAFTA a preferable model for capital

It is, of course, true that the developed states in NAFTA, the US and Canada, have been unexpectedly vulnerable to challenges under the agreement. Indeed the US has been depicted as being 'hoist with its own petard', "having contributed to the creation of pro-investor substantive standards applied by international tribunals, and to a blurring of distinctions between state-private proceedings ("mixed arbitration") and commercial arbitration exclusively among private parties." ( Alvarez and Park 2003:388). However, this does not seem to have dampened the enthusiasm of these states, or their business interests, for this type of investor protection. Both Canada and the US favour the inclusion of provisions similar to NAFTA Chapter 11 in a proposed Free Trade Area of the Americas (FTAA) and have incorporated them in Bilateral Investment Treaties (BITs) which have mushroomed in recent years. Many BITs have binding arbitration clauses, like NAFTA , and operate under either ICSID or UNCITRAL rules. These treaties thus serve as one underpinning of the emerging international investment regime (Jones 2002: 530; see also Ortiz Mena 426-30) and some critics have seen NAFTA as an extreme example of "a US bilateral investment treaty on steroids - a dream come true for the US foreign investor." (Jose Alvarez cited in Jones 2002:544)

Much of the attention in NAFTA arbitration has been focussed on Chapter 11. despite the fact that Chapter 11 cases represent a distinct minority of arbitrations. Chapter 19 (Anti-Dumping and Countervailing Duties) appears to be protective of *national* sovereignty since panels are confined to reviewing whether determinations made by member countries correctly applied their own laws and regulations. In practice, as Clarkson (1993) pointed out,

this mainly amounts to protection of American national sovereignty since it can rely on a power imbalance in its favour to take full advantage of Chapter 19 provisions - another example of the previously noted asymmetry between states.

However, it can also be argued that Chapter 19 is less protective of *public* sovereignty, of whatever nationality, than it might seem on the surface. Indeed, Ortiz Mena ( 2002: 427) argues that the novelty of the system, first introduced in the Canada - US Free Trade Agreement lies in its formal inter-state characteristics being embodied in a "private party system" in which the chief actors, apart from governments, are importers and exporters. The US has vigorously applied anti-dumping and countervailing duties - over a thousand investigations since 1980 with nearly three hundred countermeasures currently in place. (Macrory 2002: 3) The Softwood Lumber case affords numerous examples of opportunities for private political influence on the part of vulnerable but powerful economic interests ( see Graham 1996) U.S. trade legislation and its active implementation speak to the strength of protectionist sentiments in the US Congress and administration. Cases normally begin when a domestic industry files a petition . In the United States the Commerce Department investigates whether dumping or subsidization of the products in question is taking place, and the International Trade Commission decides whether the domestic industry is being harmed by the imports. ( see Macrory 2002. 5) This process has been described as a search "that sooner or later will provide a technicality that generates the 'right' result". ( J. Michael Finger cited in Gastle 1995: 740) This situation results from the provisions of section 301 of the US trade law which , while not providing direct access, since US private interests must first request action by the US Trade Representative, nevertheless "affords substantial protection to the American private party." (Gal-Or 1998:22) Chapter 19 provides for a review, if requested , by a binational panel selected from a roster of potential panelists. Private interests such as business have standing, as long as they would do so under the law of the importing country. (NAFTA Article 19.04.7) Whilst lawyers must constitute a majority of each panel (NAFTA Annex 1901-2), thus guaranteeing legal expertise, a distinction may be drawn between lawyers acting in a private capacity as arbitrators, and lawyers in a public guise, as judges. With respect to Chapter 19, it could be argued, as it has been regarding Chapter 11, that the issue is "not just *what* standards apply ... but *who* - courts or arbitrators - decides questions with a direct effect on the economic interests of both the investor and the host state." (Alvarez and Park 2003: 393) The situation is that independent courts are marginalized and arbitrators, who must be presumed more sensitive to private interests, prevail.

Thus, quasi-judicial processes are a central feature of new generation international economic agreements and under NAFTA this trend is combined with a partial privatization of the judicial function -- a development which increases. "judicial" independence from the state, though at the expense of less independence from private interests.

Jessop (2002) has posited a reorganisation of state power in the globalization process generally and the move to transnational

governance arrangements in particular. He views the reorganization of the state as comprising "denationalization" (hollowing out, transfer of functions to other levels besides the national), "destatization" (growing partnership of public institutions with private sector), and "internationalization" of policy regimes. (Jessop 2002 :205-213).<sup>1</sup> Here the focus will be on the interconnection between what Jessop calls denationalization and destatization.

Whilst there is a substantial literature suggesting that some state functions have become internationalized there is growing agreement that this hardly fits the model of nation-state decline. It can be conceded that such a transfer has had major effects: increasing the role of the private sector in governance (privatization), entrenching liberal values while decreasing the scope for democracy (liberalization), and altering the constitutions of states (constitutionalization) without engaging in overt constitutional change. (McBride 2003) But since these developments were authored by powerful states they must be viewed differently from the irrelevance of the state argument posited by Ohmae (1990) and others. They can, however, easily be interpreted within the framework of neo-Marxist state theory. All these tendencies - privatization, liberalization and constitutionalization - can be understood by what Harvey has termed a principle task of the capitalist state, namely "to locate power in spaces which the bourgeoisie controls, and disempower those spaces which the oppositional movements have the greatest potential to command." (Harvey 1989:237; see also Panitch 2002; Tsoukalas 2002) For labour, which achieved a degree of leverage over state policy at the national in the course of the twentieth century, diminution of the national state undermines a central strategic plank. Similarly, transferring decision making to the rarified air of international judicial mechanisms lessens the influence that popular movements might bring to bear upon it.

Our discussion to date has suggested that some internationalization of the state has occurred, particularly involving the transfer of some judicial functions of the state to the supranational level, and that it is associated with liberalization at the expense of democracy, the creation of constitution-like relations with international organizations, and partial privatization of an important state function.

The relative increase in the importance of judicial institutions also serves to reduce democratic input. Much of the discourse amongst prominent international trade experts deals with methods of making the (liberal) rules of the international trading system more stringent in restraining governments operating under pressures of democracy. Jackson (1975: 572) observes that "making the rules more effective will tend to limit or constrain government discretion...(and) ... with making the rules more effective in the face of domestic interest groups, or 'rent seekers' who have sought to reduce trade liberalization so as to enhance their own economic profits, rents, and positions." Clearly, in this framework, the democratically elected legislative and executive branches of government are most prone to be captured by 'rent seekers'. Thus, in the context of the WTO, McGinnis and Movsesian (2000: 604) regard

the absence of a real legislature or executive to be positive. Its quasi-judicial function is more isolated from electoral pressures and the organisation is more able to restrain rent seeking interest groups. Such observations certainly can be extended to other agreements like NAFTA.

Private rights are enhanced and private interests empowered when compared to those of the public authorities. There have been influential attempts to theorize the reconstitution of international economic relations on the basis of enhanced private rights (Petersmann 1991, 1993). Without arguing that NAFTA is explicitly based on such an approach one can discern elements of the agreement which are consistent with it, notably the creation of a set of property rights for investors and owners of intellectual property.

Whenever the opportunity has arisen, Canada has declined to formally guarantee "property rights" in its constitution. Efforts to include them in the Charter and later in the 1991 constitutional round failed. However, a form of property rights has been conferred on foreign investors through NAFTA Article 1116 which permits investors to launch a claim directly without "their" government acting as an intermediary. Thus (private) multinational corporations acquired rights which strengthened their hand vis a vis (public) states -- a provision that was a breakthrough for U.S. policy and established a precedent in international economic agreements by giving corporations, for certain purposes, equal status with states. Current international economic agreements are also highly protective of intellectual property rights. NAFTA is more considerably more protective than the WTO's TRIPS. (Sell 2003; Sell and May 2001; May 1998)

There has been discussion of the constitutional implications of the private role in NAFTA. Clarkson (2002a:381-5) has outlined how transferring jurisdiction over investor - state disputes to what is essentially a system of private international commercial law violates many of the values on which the common law tradition is based. But the innovation continues to have staunch defenders. For example, Dypski, (2002: 234) argues that: "Allowing individuals to directly approach governments and seek redress is fundamental to the democratic expectations of the NAFTA countries, and indicates a greater evolution towards privatization of international law." (see also Byrne 2000) For others the combination of private access and participation, and expansive interpretations reached by panels adds up to a potent and inappropriate constitutional brew. (e.g. Afilalo 2001:38) What might have been conceived as a defensive "shield" for investors has the potential to become an offensive "sword" wielded against NAFTA states by multinational investors. (Jones 2002:528) The content of issues that panels and tribunals deal with is sometimes characterized as "constitutional" in nature. Matiation (2003: 467) comments of Chapter 11 arbitration that it: "is anything but normal commercial arbitration, as it involves much broader issues than contract interpretation or business valuation." And knowledge or concern about anything that might be construed as the "public" interest amongst the private arbitrators who constitute the panels is seen as outside their normal point of reference. (Alvarez and Park 2003:394) Thus, via international

economic agreements, constitution making proceeds quietly (McBride 2003), and to some extent it also proceeds privately.

The degree to which private governance is partially displacing public authority in the judicial sphere has been explored by Claire Cutler. (Cutler 2003) Cutler's basic argument is that: "fundamental transformations in global power and authority are enhancing the significance of the private sphere in both the creation and enforcement of international commercial law. State-based, positivist international law and "public" notions of authority are being combined with or, in some cases, superseded by nonstate law, informal normative structures, and "private" economic power and authority as a new transnational legal order takes shape." (Cutler 2003: 1)

The assertion of the "primacy of the private" (Cutler 2003: 12) is accomplished with the full cooperation of governments which are: "providing a hospitable legal and regulatory framework for private, secretive, and closed arbitration proceedings" (Cutler 2003: 27) which increasingly settle disputes in a wide variety of areas. Moreover, Cutler argues that whilst state authority has been diminished in settling disputes and issues, the state's role has been reinforced when it comes to the enforcement of these privately brokered decisions. (Cutler 2003: 225-6)

Privatization is being accomplished through two complementary processes that Cutler refers to as 'hard' and 'soft' international commercial law. The first of these takes the form of international economic agreements and institutions under which formal dispute resolution mechanisms are established that penetrate deeply into "the autonomy of national legislative and public policy processes." (Cutler 2003: 30) Soft law, on the other hand, the preferred corporate strategy, involves increased separation of the "private" from the "public" spheres by devolving the settlement of disputes to private arbitration services and reasserting the concept of merchant autonomy. (Cutler 2003: 13) Deference to private dispute settlement mechanisms is also common in disputes between companies and states -- mixed arbitrations -- as long as the parties, as has become increasingly common, agree to submit disputes to such tribunals. (Collier and Lowe 1999: 38-9)

NAFTA goes beyond this system of voluntary and ad hoc agreement to embed in the agreement foreign investors' rights equivalent to those of states in some areas and (Article 1136.7) provides that investor - state disputes "shall be considered to arise out of a commercial relationship or transaction for the purposes of the New York Convention and Article I of the Inter-American Convention." Essentially this pre-commits the signatories to treat disputes between themselves and foreign investors as commercial rather than regulatory matters and to have such disputes settled according to the private international commercial arbitration system. As Scott Sinclair (2001:4) notes, this renders the task of governments that might want to argue that the relationship is regulatory rather than commercial, as Mexico did in the Metalclad case and Canada in S.D. Myers, very difficult if not impossible. Moreover, states generally have adopted legislation and rules that limit domestic review of international arbitral outcomes. (Cutler 2003: 225-6, 231-3)

This produces the following situation: "The arbitrators act as private judges, holding hearings and issuing judgements. There are few grounds for appeal to courts, and the final decision of the arbitrators, under the terms of the widely adopted 1958 New York Convention, is more easily enforced among signatory countries than would be a court judgement." (Dezalay and Garth 1996:6) Whilst Cutler gives primacy of agency to transnational corporations and associated transnational actors -law firms, accountancy and consulting firms, and private associations like the International Chamber of Commerce (Cutler 2003: 21-2), it is also clear, as this description indicates, that states are active agents in constructing a "merging of public and private authority in a transnational managerial and commercial elite committed to neoliberalism and the privatization and globalization of authority" in which "private authority operates with the full support of state authorities." (Cutler 2003: 51)

The attraction of arbitration includes its capacity for parties to avoid being subject to the laws of the another party's state. The process is generally also more secretive than through courts. Historically this has been particularly attractive to foreign investors in developing countries ( Dezalay and Garth 1996: 5,86). For business, there is some assurance that selected arbitrators will have appropriate expertise (Dore 1985:5) and, perhaps more subtly, since arbitrators do not enjoy judicial independence but rely for their career on future selection, a broadly sympathetic view of business' concerns can be anticipated. ( Dezalay and Garth 1996: 117)

International commercial arbitration has emerged as a "generally accepted private legal process applicable to transnational business disputes." (Dezalay and Garth 1996:59) Yet its scope has ranged and continues to range wider than this rather anodyne description as Alan Redfern's summary of a major case (the Aminoil dispute) illustrates: " At the core of the dispute was one of the most difficult and politically sensitive problems of State contracts - the public right of a developing country to exercise sovereignty over its natural resources, set against the private rights of a foreign corporation under a concession agreement." ( cited in Dezalay and Garth 1996:85) Thus, international commercial arbitration may be a system of private justice, with a rather closed cadre of arbitrators<sup>2</sup>, but it is inherently political, an attribute that may be enhanced by its inclusion as a system of dispute resolution in new state-to-state international economic agreements. In this system, the rule of law, as established by international commercial arbitrators, is heavily infused by the interests of business and of lawyers who service business.(Dezalay and Garth 1996:3) This raises a number of key questions relating to the balance between the autonomy of (private) arbitrators and the public interest: "arbitration is a private system of dispute resolution, but does this imply that the arbitral process is to remain totally unregulated by national laws? Is arbitration in essence a system of private justice unfettered by national interests?" (Chukwumerije1994: 202)

A number of NAFTA cases have highlighted concerns that arbitrators are not well equipped to navigate these fine lines



satisfactorily. Yet, as a subsequent section makes clear, the ability of the public authorities to control arbitral outputs is limited. The *Metalclad* and *S.D.Myers* cases, two of only three cases to proceed thus far to judicial review of tribunal decisions, illustrate both points. In each case state environmental regulatory acts were judged to have infringed investment rights and damages awarded.<sup>3</sup>

The *Metalclad* case arose when a U.S. investor (*Metalclad*) initiated a claim against Mexico under NAFTA Chapter 11. ( see *The United Mexican States v. Metalclad Corporation* 2001 BCSC 664: Paras 2 through 18) In 1993 *Metalclad* had acquired a Mexican-owned company, *Coterin*, which had operated a hazardous waste transfer station under authority of the Mexican federal government. Those authorities ordered the site closed between 1991 and February 1996 as the waste had not been transferred from the site. During this period *Coterin* applied for leave to construct a hazardous waste landfill. This was refused by the municipality though, in 1993, the company received two federal and one state permits relating to the site. It was at this point, April 1993, that "*Metalclad* entered into an option agreement to purchase *Coterin*. The option agreement... provided that the payment of the purchase price was subject to, among other things, the condition that either (a) a municipal permit was issued to *COTERIN* or (b) *COTERIN* had received a definitive judgement from the Mexican courts that a municipal permit was not required for the construction of the landfill. *Metalclad* completed its purchase of *COTERIN* without either of these conditions being satisfied ( although *Metalclad* alleged in the arbitration, and the Tribunal found, that Mexican federal officials had assured *Metalclad* that *COTERIN* had all the authorities required to undertake the landfill project." (*The United Mexican States v. Metalclad Corporation* 2001 BCSC 664: para 8)

*Coterin* began construction of the site and received a federal construction permit. However, the municipality issued a "stop-work" order and refused a subsequent application for a construction order in 1994. The facility was completed in 1995 though local protests prevented from being opened and operated. Though federal permits were issues the municipality continued to deny its permission. In October 1996 *Metalclad* delivered a notice of intent to file a NAFTA Chapter 11 claim. On September 20, 1997 the State governor issued an ecological decree declaring the site an ecological preserve. On August 30, 2000 the NAFTA tribunal delivered its verdict.

The Tribunal decision ( see *Metalclad v. United States of Mexico*, ICSID Additional Facility Case No. ARB(AF)/97/1) found in favour of *Metalclad* and awarded damages of \$16.685 million. The tribunal's reasoning was that one objective of NAFTA was to increase cross-border investment opportunities in part through enhanced "transparency". This it construed to mean that "all relevant legal requirements ...should be capable of being readily known to all affected investors of another Party." (Para 76) The tribunal found that Mexican federal officials had assured *Metalclad* that it had all permits necessary, an assurance on which it was entitled to rely (Para 80, 89). The lack of clarity on whether a municipal permit was also required amounted " a failure on the part of Mexico to ensure

the transparency required by NAFTA." ( Para 88) These actions, coupled with the subsequent enactment by the state-level of an ecological decree meant that Metalclad was not treated "fairly or equitably" as required under NAFTA Article 1105. Such a breach of Article 1105 was considered a measure "tantamount to expropriation in violation of NAFTA Article 1101(1)". (Paras 104 to 107) Further the Ecological Decree, in the Tribunal's view' had the effect of "barring forever the operation of the landfill" and was a further ground for concluding that expropriation had occurred. ( Para 109)

In the second case, S.D. Myers, a US processor and disposer of hazardous wastes, decided to acquire Canadian PCBs to sustain its business. It therefore began to lobby the US to remove its existing ban on the import ( or export) of these materials. It established a Canadian subsidiary to arrange export of these materials to the US and recruited several potential Canadian customers to support its campaign. On October 26, 1995 the US Environmental Protection Agency (EPA) issued an "enforcement discretion". This meant that the regulations against the importation of PCBs remained in force, but the EPA, subject to certain conditions, would not enforce them against Myers, if it imported PCBs from Canada. On November 20, 1995, Canada issued an interim order that had the effect of banning the export of PCBs.

Before the tribunal Canada identified the concerns that led to its decision. They included whether : the administrative ruling complied with US law; exports of PCBs would violate the Basel convention; disposal of PCBs in the US would be environmentally sound; allowing exports would violate Canada's own 1989 policy on domestic disposal; Canadian disposal facilities would remain viable, and concerns over the consequences should the US once more close the border to this traffic. (see *S.D.Myers v. Canada*. Partial Award 13 November 2000 Para 121).

As the tribunal conceded, these may have been legitimate concerns (ibid.). However, the tribunal agreed with S.D. Myers' claims that Canada's actions constituted disguised discrimination against Myers and its investment in Canada, breaking the article's "national treatment" provisions and, in the process, failing to meet the minimum standard of treatment under international law.<sup>4</sup>The tribunal concluded that "there was no legitimate environmental reason" for the export ban and that "Insofar as there was an indirect environmental objective - to keep the Canadian industry strong in order to ensure a continued disposal capacity - it could have been achieved by other measures." ( Para 195)

First, the tribunal addressed the question of the intersection of NAFTA with other relevant international agreements, including the Vienna Convention on the Law of Treaties and the Basel Convention on the Control of Transboundary Movements of Hazardous Wastes and their Disposal. NAFTA article 104 holds that in the event of any inconsistency between NAFTA and "the specific trade obligations" of certain international environmental agreements the provisions of the latter should prevail "to the extent of any inconsistency, provided that where a Party has a choice among equally effective and reasonably available means of complying with such obligations, the Party chooses the alternative that is the least inconsistent " with NAFTA. The tribunal concluded that: "Where a state can achieve its

chosen level of environmental protection through a variety of equally effective and reasonable means, it is obligated to adopt the alternative that is most consistent with open trade." (Para 221 )

Second, the tribunal addressed the question of "like circumstances", which, as with the "like products" language of the GATT, is crucial in determining whether state interventions of various kinds are consistent with the agreements. In its submission alleging violation of National Treatment, S.D. Myers had claimed that the measure had the aim and effect of favouring Canadian producers. Canada claimed that the ban "established a uniform regulatory regime under which all were treated equally ( Para 241 ) In depicting Canada's response as "one dimensional the tribunal made comments on "like circumstances" and "motive or intent" that are useful in interpreting the constitutional effect of NAFTA.

Regarding "like circumstances", the tribunal took note of and imported wholesale WTO case law on "like products". The WTO case law has emphasised that interpretation of 'like' must depend on all the circumstances of each case. The case law suggests that close attention must be paid to the legal context in which the word 'like' appears; the same word, 'like, may have different meanings in different provisions of the GATT." (Para 244) The tribunal went on to cite with approval the accordion image that a WTO Appellate body ( in *Japan - Alcoholic Beverages*) had drawn upon.

Additionally, despite having paid considerable attention to Canada's intentions, the tribunal argued that "Intent is important, but protectionist intent is not necessarily decisive on its own." (Para 254 ) If the intent failed to produce an adverse effect, it would not constitute a violation. Similarly, good intentions could produce adverse effects. Even treating similarly situated investors in the same manner is unsafe since all depends on a tribunal's analysis of context and specific circumstances.

The result of both the *Metalclad* and *S.D.Myers* cases is to inhibit governments from enacting environmental regulations on their own merits or in accordance with democratic accountability to their publics.. Regulatory actions must anticipate the trade impact of such measures, as this will be construed by arbitration tribunals. This a new and higher level of (undemocratic) accountability intrudes into the democratic process. Governments contemplating 'measures' thus face uncertainty "regulatory chill".

*A weak ability for public authorities to correct the results of privatised justice*

The capacity of the public authorities to correct what are, in effect, decisions of a private justice system are limited. Five means of correction can be identified. The first is withdrawal from NAFTA which can be accomplished by any one of the signatories on six months notice.(NAFTA Article 2205) Clearly, as long as prevailing elite opinion considers NAFTA beneficial this is a draconian and unlikely response. Secondly, the agreement can be amended. This requires unanimity on the part of the signatories ( Article 2202) and would not lightly be initiated by one of them given the possibility of facing demands to open up other parts of the agreement. Thirdly, under chapter 11 (Article 1128) parties (i.e.

governments of member countries) can make submissions to a tribunal on questions of interpretation under the agreement. Fourthly, also under Chapter 11 (Article 1131.2) the Free Trade Commission can issue an interpretation of the agreement that shall be binding on a Tribunal. Similarly, when an issue arises as to whether a measure is covered by reservations or exceptions made in annexes to the agreement, the interpretation of the Commission shall be binding on a tribunal. (Article 1132). Finally, there is the possibility of judicial review of panel and tribunal decisions. Given the inherent difficulties involved in withdrawal from the agreement, or formal amendment of it, discussion will focus on the last three of these possibilities.

According to Sampliner (2003:30) submissions under Article 1128 have been made frequently. Even if the submissions are jointly made by all three parties they are not binding on tribunals although the Parties have argued that such joint interpretations are technically 'subsequent agreements' which, under the Vienna Convention on the Law of Treaties, must be taken into account by tribunals. However he notes that the issue of whether tribunals are bound by such joint interpretations under Article 1128 has not been conclusively tested, some tribunals having rendered decisions that appear consistent with agreed interpretations, though in one instance at least a tribunal may have disregarded such an interpretation. ( Sampliner 2003:30-31)

The Free Trade Commission's ability to bind Tribunals seems assured under Article 1131.2 since the language is explicit: " An interpretation by the Commission of a provision of this Agreement shall be binding on a Tribunal...". As with amendment, however, it is necessary for unanimity to prevail amongst the parties. In the absence of such unanimity tribunals enjoy considerable leeway. For example, a trilateral Investment Expert Group was established in 2001 to work towards a common understanding of Article 1110 which deals with expropriation. To date no agreement has emerged leaving it open, as Mann puts it: " to investors who wish to pursue broad readings of the expropriation provision, under which normal regulatory measures with an economic impact on foreign investors can be challenged under Chapter 11." Panels have varied in their receptiveness to such challenges and until an authoritative interpretation is issued uncertainty will continue. (Mann 2003)

The Free Trade Commission has issued Notes of Interpretation of Certain Chapter 11 Provisions promoting limited transparency and providing clarification of certain definitions. (Free Trade Commission 2001) This interpretative note was to clarify Article 1105 ( minimum standard of treatment) and transparency provisions. On transparency the interpretation held that "Nothing in the NAFTA imposes a general duty of confidentiality on the disputing parties to a Chapter Eleven arbitration" and promised "to make available to the public in a timely manner all documents submitted to, or issued by, a Chapter Eleven tribunal" subject to certain specified exceptions. (Free Trade Commission 2001) However, reaction has been mixed. Sampliner (2003: 31) considers that as a result of the note many of the procedural criticisms of NAFTA arbitration have been addressed satisfactorily such that: " NAFTA arbitrations have become largely public proceedings, with open access on the Internet

to awards, pleadings, and even in many cases, hearings, transcripts; acceptance of amicus curiae briefs from concerned public interest groups, and most recently, hearings open to the public." And indeed there is much more information available than formerly. However, VanDuzer ( 2002:7 ) has highlighted the limited but significant exceptions to transparency that the FTC note permits, and which stem from the arbitral rules that govern Chapter 11. He emphasizes the veto power left to the investor in a Chapter 11 case. In his view the interpretation amounts only to a commitment to " seek the consent of the investor to disclosure and a tribunal order permitting disclosure. "

Moreover, it has even been doubted whether the interpretations are binding on tribunals. Matation (2003: 479; see also Shapren 2003: 349; Staff and Lewis 2003: 328) has pointed out that the commission has the right to interpret but not change or amend the agreement. Thus one NAFTA panel argued, though in dicta not its decision and without relying on the point, that it viewed the interpretation as an amendment. (Sampliner 2003: 32) The agreement, as a state-to-state treaty, is governed by principles of international law that may place limits on its interpretive capacity. Thus, the Commission's authority to issue interpretations that address concerns arising about the agreement's impact on public policy and the common good is not "unfettered". (Matation 2003:495)

The final public control mechanism is that of judicial review of arbitration decisions. To date three judicial reviews of NAFTA Chapter 11 arbitration decisions have been completed - the Myers, Feldman and Metalclad cases. In the Myers and Feldman cases the arbitration decisions were sustained; in the Metalclad case portions of the arbitration decision were overruled, others were sustained. Three cases is obviously not a large 'n'. Yet notwithstanding the partial overrule of the tribunal in the Metalclad case, there are grounds for thinking that the extreme difficulty of using judicial review as a means of overturning damaging decisions by arbitrators is amply demonstrated. This is because the grounds for judicial review are quite narrow and because judges show great deference to the decisions of arbitrators and, consequently, exhibit considerable self-restraint in deciding whether to overturn their decisions.

Chapter 11 arbitrations take place under one of three sets of rules - the ICSID, ICSID Additional Facility or UNCITRAL rules. Only the latter two are operative since neither Canada nor Mexico has yet ratified the ICSID convention. (VanDuzer 2002: 2-3). NAFTA does not provide for judicial review of arbitrations so the arbitration rules being followed determine this. Both the ICSID Alternative Facilities and UNCITRAL rules provide that the results of arbitrations, whilst final and binding, may be subject to judicial review under national ( or subnational) law. In practice, the applicable law is deemed to be that of the place of arbitration. VanDuzer (2002:18) comments: " Under Canadian federal law and laws of each province the main grounds upon which a court may set aside an arbitral award are as follows: a party was not given proper notice of the appointment of an arbitrator, the award deals with a dispute not contemplated by or falling within the terms of the submission to arbitration, or the

award is contrary to the public policy of the state in which the award is sought to be enforced." The latter concept could, in the ordinary sense of the term, be construed as wide-ranging, but in fact narrow interpretation of public policy renders it more of a theoretical than practical constraint on arbitrators. ( see Cutler2003:220-30)

In the *Metalclad* case Mr. Justice Tysoe did strike down parts of the arbitration decision. In this case the standard of review was governed by the International Commercial Arbitration Act of British Columbia rather than the (domestic) Commercial Arbitration Act. ( The scope for judicial review is broader under the latter.) Thus in finding that the International Commercial Arbitration Act applied Judge Tysoe was opting for a more limited scope for review. The relevant sections of British Columbia legislation, closely modelled on the UNCITRAL Model Law, provide that an arbitration award may be set aside by the court if: it "deals with a dispute not contemplated by or falling within the terms of the submission to arbitration, or it contains decisions on matters beyond the scope of the submission to arbitration..., or "the composition of the arbitral tribunal or the arbitral procedure was not in accordance with the agreement of the parties..." or "the arbitral award is in conflict with the public policy in British Columbia". *United Mexican States v. Metalclad Corporation 2001* : para 50)

The determination that the dispute was commercial was made on the basis that the dispute pertained to an investment and thus commercial in nature (*United Mexican States v. Metalclad Corporation 2001* Paras 39-49). Given the terms of NAFTA Article 1136 (7), which expressly states that disputes under Chapter 11 are commercial in nature this would seem legally unobjectionable. Similarly, other features of Chapter 11 confirm that the state signatories conceived the process as one of international commercial arbitration. (Olasalo 2002: 195) However, as Olasalo argues (195-6): " as NAFTA article 1136(7) implicitly points out, it is not clear, at all, that the underlying relationship between foreign private investors and a NAFTA state party is commercial in nature." This is apparent from a case like *Metalclad* where " a legitimate public interest goes far beyond the commercial private interests for which adjudication under the UNCITRAL Rules of Arbitration were designed." (Olasalo 2002: 196) Yet the states which signed on to this provision assigned decision making on these broader matters of public interest to the private arbitration system that is embodied in Chapter 11.

The judicial review of the *Metalclad* decision concluded that the Tribunal imported into NAFTA Article 1105 ( minimum standards) a provision (transparency obligations) that was not there ( *United Mexican States v. Metalclad Corporation 2001* : paras 67-76). In so doing so, the Tribunal "decided a matter beyond the scope of the submission to arbitration." (para 76) Since the Tribunal relied on the transparency obligations it had imported in to NAFTA to determine that there had been a measure tantamount to expropriation this determination, too, was struck down. (para 79). However, other findings of the arbitration tribunal were sustained by the judicial review.<sup>5</sup>

Critics ( for example, sympathetic ones like Olasolo 2002,; and unsympathetic ones like Weiler 2003) have argued that whilst the

BC Supreme Court (Mr Justice Tysoe) formally proclaimed a narrow scope for judicial review he did, in practice extend well beyond the anticipated limits. (Olasolo 2002: 190) For Olasalo this was the result of the unsuitability of the commercial arbitration system to deal with the issues arising in Chapter 11 cases, of: "having tried to assimilate NAFTA Chapter 11 arbitrations into pure commercial international arbitrations. ...important public interests are adjudicated in NAFTA Chapter 11 arbitrations, and, therefore, it is necessary to profoundly reform the current system of arbitration that mirrors the one created to adjudicate pure private interests." (ibid.) In the *Metalclad* case the BC Supreme Court interpreted its role broadly and acted, in some respects, to protect the public interest. For this it attracted considerable criticism. The other cases, however, indicate much more self-restraint on the part of the courts and much greater deference to the arbitrators. Unsurprisingly, these decisions have been welcomed by the international arbitration community ( see Herbert Smith 2004; Weiler 2003 )

In the *S.D.Myers* case Canada applied to set aside the results of the arbitration on two grounds. First, Canada alleged that the award exceeded the scope of the NAFTA agreement by dealing with matters not contemplated by NAFTA Chapter 11. Second, Canada alleged that the award contravened the public policy of Canada. Both these are among the very limited grounds on which judicial review may set aside arbitration awards. (Attorney General of Canada 2003: Paragraphs 6 and 7)

In pursuit of this claim Canada raised a number of aspects of fact ( such as whether S.D. Myers was an 'investor' within the meaning of NAFTA ) and legal process ( such as how much 'deference' is due to arbitrators). The Federal Court ( Mr.Justice Kelen) was unreceptive to any of the arguments advanced by Canada. His arguments highlight the very limited nature of judicial review that must be presumed normal. *Metalclad* notwithstanding, in such cases.

First, the judgement identifies the rules for interpreting international treaties and the applicable document. These include the Canadian Commercial Arbitration Act and Commercial Arbitration Code ; the NAFTA itself; UNCITRAL Arbitration Rules, and the Vienna Convention on the Law of Treaties . Reference to these authorities, and judicial interpretation of them makes it clear, for example, that if a matter is within the scope of an arbitration tribunal, there is no allowance for "judicial review if the decision is based on an error of law or an erroneous finding of fact." (Federal Court of Canada 2004: para 42) In arriving at this conclusion the judge rejected Canada's argument that arbitration tribunals should be held to a standard of "correctness" .

Canada argued that the arbitration decision violated "public policy:", construed by Canada in this case , as respecting the US environmental statutes which prohibited the import of PCBs (notwithstanding the administrative waiving of statutory provisions described above) and respecting Canada's international obligations under the Basel Convention. (Attorney General of Canada 2003: paras228-232) Justice Kelen, however, rejected this definition : " 'Public policy' does not refer to the political position or an international position of Canada but refers to 'fundamental notions

and principles of justice'. To cast aside the tribunal decision it would be necessary to find the tribunal's decisions exceed its jurisdiction and be "patently unreasonable", "clearly irrational", "totally lacking in reality" or a "flagrant denial of justice". These are high thresholds for an appellant against an arbitration tribunal to clear, and a hurdle, in the judges opinion, not cleared by Canada. (Federal Court of Canada 2004: paras 55-56)

Running through the judgement, and citations from relevant jurisprudence, plus the terms of the various rules applied to judicial review of arbitration decisions, is a very high degree of judicial deference to the pronouncement of arbitrators. This includes the observation that the parties, having created the rules by which arbitrators are selected, must have confidence the persons who will be adjudicating (Federal Court of Canada 2004: para 16), the citation, with approval, of Justice Chilcott, who reviewed the Feldman case: "I accept the proposition that judicial deference should be accorded to arbitral awards generally and to international commercial arbitrations in particular." (Federal Court of Canada 2004: para 37)

In the Feldman case an arbitration tribunal ruled that Mexico had discriminated against a foreign investor involved in the export of cigarettes by not extending to it a tax rebate that had been awarded domestic corporations employed in the same activity. The judicial review was heard in the Ontario Supreme Court where the legislation to be applied is the UNCITRAL Model Law. In denying Mexico's attempt to have the ruling overturned Mr. Justice Chilcote made a number of comments and citations of case law that reinforce the view that judicial review is a very limited instrument. He noted ( *United Mexican States v Marvin Roy Feldman Karp* Ontario Supreme Court of Justice Court File No. 03-CV-23500 :para 77) that " very high level of deference should be accorded to the Tribunal" especially considering that Mexico was attempting to challenge the facts of the case: "The panel who has heard the evidence is best able to determine issues of credibility, reliability and onus of proof." In any case the grounds for review under the Model Law did not provide for a review of a finding on facts.(Para:81) Case law suggested to the judge that: "It is meet... as a matter of policy, to adopt a standard which seeks to preserve the autonomy of the forum selected by the parties and to minimize judicial intervention when reviewing international commercial arbitral awards..." ( cited in Para 78). The judge went on to praise the expertise of the panel with respect to international commercial arbitration and to conclude that there had been no breach of Ontario public policy. His remarks on the score serve to illustrate how limited a ground that is for a successful appeal to judicial review: "The courts of this province have consistently held that for an arbitral award to be interfered with as being against public policy, it 'must fundamentally offend the most basic and explicit principles of justice and fairness in Ontario, or evidence intolerable ignorance or corruption on the part of the arbitral Tribunal' ...." The Applicant must establish that the awards are contrary to the essential morality of Ontario." ( Para 87). Mexico's case was dismissed.

The reluctance to intervene in arbitral awards is thus firmly ensconced in the rules surrounding the arbitration process and in



judicial attitudes. These considerations emanate from private international commercial law and are applied, in NAFTA Chapter 11, to situations that go far beyond the disputes that gave rise to them. This point was made, without effect, in Canada's case memorandum before the Federal Court : "137. NAFTA Chapter 11 arbitrations differ substantially from a private commercial arbitration in terms of the extent to which their decisions might affect interests beyond those of immediate parties to the dispute. Claims under NAFTA Chapter 11 are not contractual disputes but challenges to government 'measures', a term NAFTA Article 201(1) defines as including ' any law, regulation, procedure, requirement or practice'. 138. The decisions of NAFTA Chapter Eleven Tribunals have important public policy implications that impact upon, and are of interest to Canadians generally and non-disputing NAFTA Parties." . (Attorney General of Canada 2003: paras 137-138) Such arguments, of course, are undercut by Article 1136.7 as discussed above.

## Conclusions

NAFTA assigns judicial power over non-commercial matters, in which states have a significant regulatory interest, to a system of private arbitration. Few corrective devices to assert the public interest are available. To a significant degree a vital state function has been privatised ( as well as internationalised). Given the difficulties currently being encountered in negotiating new multilateral trade agreements the US is likely to turn to bilateral alternatives. In doing so it has at hand a prototype, NAFTA, which embodies the interests of the US state and of US international investors. NAFTA does this by advancing liberal rules and in effect constitutionally entrenching them , and thus protecting them from democratic pressures. A significant part is played in this process by the double transfer of the state's quasi-judicial function from the national to the international level and from the public to the private sphere. The mechanisms available for protection of the public interest from the results of this transfer are weak and inadequate.

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<sup>1</sup>The last of these must be approached with caution but will not be addressed here The continued capacity of states to differ from presumed global norms finds expression in continued policy divergence and only uneven policy convergence. ( see for example, Boltho 1996; Garrett 1998; McBride and Williams 2001)

<sup>2</sup> see Dezalay and Garth (1996:10,23-4) on the personal attributes and class background of arbitrators;

<sup>3</sup> the other case,*Feldman*

<sup>4</sup> Myers' other claims that Canada's actions violated Article 11.06 (Performance Requirements) and 1110 (Expropriation) were rejected.

<sup>5</sup> But see Olasolo 2002: 208-9 for a critique of the BC Supreme Court's reasoning.