

**INVESTMENT AND TRADE IN LATIN
AMERICA:
THE CHILEAN EXPERIENCE.
PRESENTATION OF GONZALO BIGGS ON
SETTLEMENT OF DISPUTES**

A. INTRODUCTION

1. Our panel has been assigned to discuss the different international and domestic mechanisms available to an investor for settling any investments disputes that may arise. In terms of US/Chile investor disputes because there is no bilateral investment treaty between the two countries, the applicable rules are established in Chapters Ten and Twenty Two of the US/Chile FTA. Moreover, under the rules of Annex 10-E of Chapter Ten, access to an administrative or judicial tribunal of Chile is not a practical option for a US investor. Indeed, under these rules, if a US investor submits to those domestic tribunals a claim for breach of the investor obligations of the Treaty or investment agreement or authorization under Chile's Foreign Investment Statute, DL 600, that election is definitive and the investor forfeits its right to submit a claim to international arbitration. Having said that, my presentation and that of my colleague Andrea Menaker will refer to the international mechanisms available to investors under the US/Chile FTA. In this regard, because no investor/state disputes have yet arisen, I believe that the way international tribunals have resolved the exercise of investors' rights under NAFTA is a useful precedent to any future investor/state dispute under the US/Chile FTA. Although arbitration tribunals under both treaties are not

controlled by stare decisis, in practice, awards will consider previous decisions on related subjects. In my presentation I shall refer to two categories of Nafta cases. The first are foreign investor disputes against Mexico. The second is a Canadian investor dispute against the United States. I will, then, summarize the main legal issues and list the relevant differences between the two free trade agreements

2. The cases of US investors against Mexico are Azinian, Feldman, Gami, Waste Management and Metalclad and were administered by ICSID under its Additional Facility. The case against the US was brought by the Canadian company Methanex under the rules of UNCITRAL.

B. NAFTA JURISPRUDENCE

3. AZINIAN

Mr. Robert Azinian was a shareholder in the Mexican company, DESONA, which challenged the Municipality of Naucalcan's annulment of a solid wastes concession. They alleged breach of NAFTA articles 1105 on minimum standard of treatment, and 1110 on expropriation and compensation, and sought \$19.2 million in damages. The respondent stated that the concession was void due to misrepresentations or failure of performance. The Arbitral Tribunal observed that, while DESONA's recourse to the Mexican courts did not foreclose arbitration, at the same time the Tribunal was not a court of appeal but confined to determining whether NAFTA articles 1105 and 1110 had been breached by the Mexican courts. It rejected the claim because it concluded that the

Claimants had entered into the concession with false pretenses and had lacked the technical and financial capacity to perform. Consequently, “the annulment of the concession contract did not violate the Government of Mexico’s obligations under NAFTA” (pg..574).

1. FELDMAN.

Feldman as a shareholder of the company- CEMSA, brought a claim against Mexico for refusing to rebate excise taxes on cigarettes exported or to be exported by CEMSA. It stated that these measures breached NAFTA articles 1102, on national treatment, 1105 on minimum level of treatment, and 1110 on expropriation. Regarding the proceedings still pending in Mexico, the arbitration tribunal resolved that, although the claimant had waived its rights before the local courts, that waiver did not apply to declaratory relief. At the same time, it stated that “an action determined to be legal under Mexican law by Mexican courts is not necessarily legal under NAFTA or international law” (p.78). On the substance, the tribunal stated that the claimant never possessed “a right to export” of which he could be deprived by Mexico. Moreover, its investment continued to operate normally. However, it concluded that the claimant, because of his nationality, had been discriminated because, in like circumstances, a Mexican company obtained the rebate denied to the claimant. The decision had the dissenting vote of the Mexican arbitrator which, among other considerations, stated that CEMSA had no legal right to a tax rebate.

4. GAMI.

GAMI was a corporation with a 14.18% interest in a Mexican holding company, owner of five sugar mills expropriated by the government. GAMI claimed that Mexico's measures: i) by failing to accord "fair and equitable treatment and full protection and security in accordance with international law", breached NAFTA article 1105; ii) by treating GAMI's investments less favorably than Mexican investments which, in like circumstances, were not expropriated, breached NAFTA article 1102 on national treatment, and iii) were an indirect expropriation of GAMI's minority shares in the Mexican corporation and, therefore, a breach of NAFTA article 1105. After the arbitration tribunal was established, the parties were informed that the Mexican judiciary had annulled the expropriation of three of the sugar mills and that due compensation would be paid for the expropriation of the remaining two sugar mills. However, GAMI's grievance was that the value of its minority shares in the holding company had been adversely affected by the above measures. Together with noting that neither GAMI nor the holding company had direct contracts with the government, the tribunal refused to evaluate GAMI's complaint that Mexico had failed to implement its commitments with the sugar industry, and that, in any event, it could not conclude that such failures were attributable to the government or a cause of GAMI's alleged injuries. The tribunal rejected the claim of discrimination and ruled that valid policy reasons determined that only insolvent industries, such as the holding company, would be expropriated. Finally, it rejected the claim of indirect expropriation because the holding company's value as an enterprise had not been impaired nor the claimant had proved that its shares had been expropriated for the purposes of article 1110.

5. WASTE MANAGEMENT.

Waste Management was the sole owner of the Mexican company, Acaverde, which had a public waste concession from the Municipality of Acapulco. Both companies claimed that the refusal by Acapulco and its guarantor to pay certain invoices breached NAFTA articles 1105, on fair and equitable treatment, and 1110 on indirect expropriation. The notice and consent to arbitration reiterated that the condition precedent to arbitration of NAFTA article 1121(2)(b) had been fulfilled, namely, the claimant's waiver of its "right to initiate or continue before any administrative tribunal or court under the law of any NAFTA party, or other dispute settlement procedures, any proceeding with respect to the measures taken by Mexico alleged to be a breach of NAFTA Chapter Eleven and applicable rules of international law, except for proceedings for injunctive relief, declaratory, or other extraordinary relief, not involving the payment of damages". However, the claim added that "this waiver did not apply to any dispute settlement proceedings involving allegations that Mexico has violated duties imposed by other sources of law, including the municipal law of Mexico". After confirmations and clarifications were requested in connection with the above waiver, the tribunal held that it lacked jurisdiction because the complaint breached one of the prior requisites of NAFTA article 1121(2)(b) and ordered the claimant to pay the costs of the dispute. It stated that, as from its submission to arbitration, the claimant had continued litigating before the Mexican courts and even filed a suit in arbitration against the City Council of Acapulco. The majority ruled that, as the legal actions before the local courts resulted from the same measures,

they could not continue and enable the claimant to obtain double benefits, in violation of article 1121. Arbitrator Keith Highet differed with the majority because, in his view, the proceedings in Mexico were substantially different from those of the arbitration.

6. METALCLAD.

Metalclad, owned the Mexican company, COTERIN, which received federal and state government's authorizations to operate a hazardous waste site in San Luis de Potosi. Although it failed to obtain the municipal construction permit, Metalclad went ahead and completed the construction. However, a fierce public opposition prevented it from opening and operating the site. The Municipality, then, denied the permit and obtained a judicial injunction preventing the operation of the landfill. Metalclad sued Mexico for having been expropriated without compensation, in violation of NAFTA article 1110, and failing to provide fair and equitable treatment under NAFTA article 1105. Relying on the International Law Commission articles on State Responsibility, the arbitration tribunal concluded Mexico was internationally responsible for the acts of its state organs at all three levels of government. Regarding fair and equitable treatment, the tribunal included transparency which it understood to mean "that all relevant legal requirements for the purpose of initiating, completing and successfully operating investments made, or intended to be made, should be capable of being readily known to all affected investors of another Party". It noted Metalclad had been led to believe that the federal and state permits allowed for the construction and operation of the landfill. Thus, Mexico did not provide a transparent and predictable framework and the totality of the acts of the State and

Municipality- and therefore the acts of Mexico- failed to provide fair and equitable treatment in accordance with international law and, thus, breached Nafta article 1105. Also, by permitting the Municipality to deny the construction permit, Mexico had indirectly expropriated Metalclad's investment and violated article 1110.

Regarding an Ecological state decree, which barred the operation of the landfill, issued some six months after Metalclad filed its claim, the tribunal ruled that the decree, in and by itself, constituted an act tantamount to expropriation. After the award was rendered, in Vancouver, the site of the arbitration, Mexico invoked the British Columbia Commercial Arbitration and International Commercial Arbitration Acts and requested the Supreme Court of British Columbia to set aside the award. The Canadian court ruled that the NAFTA panel erred when it imported the transparency provisions of Nafta's Chapter 18 into Chapter 11 and struck down the panel's findings that a violation of article 1105 constituted a violation of article 1110. However, it agreed that the Ecological decree was an act tantamount to expropriation. Mexico paid the damages ordered by the Canadian court but withheld federal funds for that amount to the state of San Luis de Potosi. The State refused and challenged the action before the Mexican Supreme Court which ruled in favor of the state.

7. METHANEX,

Methanex is a producer of methanol, an ingredient of MTBE, designed to reduce harmful auto emissions. Methanex claimed that the State of California's ban of the sale and use of MTBE favored US producers of the gasoline additive ethanol in violation of NAFTA articles 1102 on national treatment, 1105(1) on fair and equitable

treatment, and 1110 on expropriation, because it prevented it from maintaining its market share and in effect transferred it to US ethanol producers. The US justified the ban on the fact MTBE had been found to contaminate drinking water wells and systems and been associated with human neurotoxicological effects. The arbitration tribunal validated the State's ban because it was based in the scientific findings of the University of California. It, thus, rejected the claim under article 1102, on national treatment, because the ban did not differentiate between foreign and domestic MTBE or methanol producers. Based on the FTC's interpretation that a breach of a provision of the NAFTA did not establish a breach of article 1105(1) and that there was no rule of non-discrimination under customary international law, the tribunal rejected the claim of breach of NAFTA article 1105(1) on fair and equitable treatment and 1110 on expropriation.

C. OBSERVATIONS

8. From the above summary, the following can be noted:

- i) Out of six investor/state disputes, the State of Mexico prevailed in three case (Azinian, Gami and Waste Management), the US, in one (Methanex). and investors prevailed in two cases (Feldman and Metalclad)
- ii) Foreign investor claims were made by shareholders of the totality or of a percentage (14.18% in the case of Gami) of enterprises established in the State of the investment.

- iii) Investor claims were limited to the following breaches of State's obligations: i) Article 1102 on national treatment; ii) Article 1105, on minimum standard of treatment in accordance with international law, including fair and equitable treatment and full protection and security, and iii) article 1110 on expropriation and payment of compensation, including indirect expropriation.
- iv) With the exception of Waste Management which dealt with non compliance of State obligations, every other claim disputed regulatory measures at the federal, state or municipal levels. Of these, in three cases the subject matter was related to environmental protection and, in the rest, to financial or economic policy decisions.
- v) A claimant's waiver of judicial or administrative proceedings before the local courts, as a prior condition to investor/state arbitration under article 1121, remains controversial as a result of the Waste Management minority vote.
- vi) A state is internationally responsible for the acts of the Executive, Legislative and Judicial branches of government, including those of local municipalities.
- vii) An action determined to be legal by a domestic court or under the laws of a given state is not necessarily legal under international law.

**D. DIFFERENCES IN THE SETTLEMENT OF
INVESTOR/STATE DISPUTES UNDER
NAFTA
AND THE US/CHILE FTA**

9. Description.

The US/Chile FTA Chapter on settlement of investor/ state disputes has procedural and substantive differences with NAFTA's Chapter Eleven.

10. Procedural Differences or Innovations.

They are the following:

- i) The FTA authorizes arbitration tribunals to accept and consider amicus curiae from persons and entities which are not disputing parties provided the submitter identifies the source of the financing (art.10.19(3);
- ii) The requirement of transparency in arbitral proceedings with exceptions on the disclosure of confidential or privileged information (art.10.20(2),(3),(4) and (5)
- iii) Making tribunal's audiences open to the general public (art.10.20(1) and (2);
- iv) Allowing claimants to submit their claims, in addition to ICSID, ICSID's Additional Facility and Uncitral, under "any other arbitration institution or under any other arbitration rules"(art.10.15 (5)

11. **Substantive Differences.**

Some of the substantive differences are the following:

i) **The concept of Investment.**

Instead of listing the activities which would constitute an

investment under the Nafta, the FTA gives an all inclusive

definition and, then, lists the different forms of investments

(article 10.27).

ii) **Covered Investments.** The Agreement substitutes the concept of “investment of an investor of a Party” by that of “covered investment” which means, with respect to a Party, “an investment in its territory of an investor of the other Party in existence as of the date of entry into force of the Agreement or established, acquired, or expanded thereafter.” Its significance is that the Treaty applies to investments materialized before the entry into force of the Agreement y

iii) **Measures applied to Covered Investments.** The FTA establishes covered investments as the basic standard assessing a Party’s measures on investor/state disputes (art.10.1), to the rules on national treatment(art.10.2(2), most favored-nation treatment (art.10.3), minimum standard of treatment(art.10.4), expropriation and compensation(art.10.9)

- iv) **Indirect Expropriation.** The FTA defines indirect expropriation (Annex 10-D) and adds that “except in rare circumstances, non-discriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives, such as public health, safety, and the environment, do not constitute indirect expropriation” (art. 4(b) Annex 10-D.)
- v) **Causes of Action.** The agreement expands the causes of action of investment disputes to the breach by a state party of its obligations under Chile’s Foreign Investment Statute (DL 600), an investment authorization or an investment agreement.(art.10.15)
- vi) **Minimum standard of treatment.** The FTA substitutes international by customary international law as the standard under which a Party must provide minimum standard of treatment, including fair and equitable treatment and full protection and security (art.10.4(1). This standard applies to the obligations on expropriation and payment of compensation and is supplemented by the Parties understanding that the minimum standard of treatment refers to “ all customary law principles that protect the economic rights and interest of aliens” (Annex 10-A)

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APRIL, 2007.