INTERNATIONAL CENTRE FOR SETTLEMENT OF INVESTMENT DISPUTES

ICSID CASE No. ARB(AF)/00/1

BETWEEN:

ADF GROUP INC.

CLAIMANT/INVESTOR

AND

THE GOVERNMENT OF THE UNITED STATES OF AMERICA

RESPONDENT/PARTY

Post-Hearing Submission of the Claimant ADF Group Inc. on NAFTA Article 1105(1) and the Damages Award in *Pope & Talbot and Canada*

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1. In accordance with the Tribunal's Orders of June 17, 2002 and July 1, 2002, the Investor respectfully submits these further observations on the applicability of NAFTA Article 1105(1) and the Damages Award rendered in the claim of *Pope & Talbot Inc. and Canada* on 31 May 2002 (hereinafter: the "Pope Damages Award").

2. The Tribunal has invited the parties to make a final written submission examining and commenting on the Pope Damages Award and, at the same time, to address what factors, or kinds of factors, a Chapter Eleven tribunal may take into account in applying in a concrete case the "fair and equitable treatment and full protection and security" standard referred to in NAFTA Article 1105(1).

3. Counsel for the United States ("the US") has answered the Tribunal by indicating that there are no factors that it may take into account in interpreting and applying Article 1105(1) because the US has constructed an unnecessarily elaborate test for the provision under which the Investor's arguments – unsurprisingly – do not fit[1]. It does so without even addressing the alternative that its view may be wrong. It then attempts to take the Pope Tribunal to task, separately, for what is clearly an important, and thoughtful, set of reasons for decision.

4. With its observations, the Investor aims to be of greater assistance to the Tribunal. These observations contain three interrelated sections. First, the Investor will describe the Pope Damages Award within its proper context. Second, it will address the criticisms of the Award leveled by the US. Finally, the Investor will outline the kinds of factors that should be considered by this Tribunal as it makes its decision.

A. What the Pope Tribunal Said

The issue before the Pope Tribunal

5. On April 10, 2001, the Pope Tribunal issued its Award on the Merits of Phase 2 in which it found that Canada had breached its obligations to the Investor under Article 1105 of the NAFTA in respect of what was referred to as the Verification Review Episode. The tribunal then began the procedures which led eventually to its award on damages.[2]

6. While those procedures were in progress, and before any decision on damages was made, the FTC issued its interpretation in relation to Article 1105.

7. The Pope Tribunal was therefore forced with accessing the effect of the FTC Interpretation on its earlier Merits Award and, in particular, determining whether the FTC Interpretation could have retroactive effect and, if so, whether the original Merits Award should stand. A close examination of the nature, content and impact of the FTC Interpretation was, therefore, central to the Pope Damages Award.

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[1] Post Hearing Submission of Respondent United States of America on Article 1105(1) (US Post Hearing Submission), pg 2 et. s.

[2] *Pope & Talbot Inc*. and *Canada*, Merits Award on Phase 2, April 10, 2001.

The Mandate of a Chapter Eleven Tribunal

8. The Pope Tribunal was confronted with similar issues to those which confront this Tribunal. Both tribunals have been presented with claims under NAFTA Article 1105(1). As stated in NAFTA Article 1115, both have been established to provide "equal treatment" to the investors in accordance with "the principle of international reciprocity" and both must ensure that the investors receive "due process before an impartial tribunal." Under NAFTA Article 1131(1), both tribunals must "decide the issues in dispute in accordance with this Agreement and applicable rules of international law."

9. Both tribunals must also regard an FTC Interpretation as "binding." That is, when the FTC has taken the time and effort to set out a particular interpretation, that interpretation cannot be disregarded by a tribunal. A tribunal cannot disregard an FTC Interpretation any more than it can disregard the applicable rules of international law mandated in Article 1131(1). Rather, a Chapter Eleven tribunal must treat an FTC Interpretation with care and attention ensuring, at the same time, that it does not shirk its responsibility under NAFTA Articles 1115 and 1131(1) by merely deferring to whatever words might be contained within such an interpretation.

10. A NAFTA tribunal is obliged to interpret NAFTA provisions in accordance with "the applicable rules of international law" and virtually every single Chapter Eleven and Chapter Twenty tribunal which has issued a determinative award thus far has confirmed that the relevant rules are the customary international law rules of treaty interpretation that have been encapsulated in Articles 31 and 32 of the *Vienna Convention on the Law of Treaties*[3]. As such, tribunals must identify the plain and ordinary meaning of the terms contained within a provision, in the context in which they appear and in light of the object and purpose of the treaty.

11. The second paragraph of Article 1131 does not override the first paragraph. It does not say "notwithstanding paragraph 1… FTC interpretations shall be binding on Chapter Eleven tribunals." Accordingly, Chapter Eleven Tribunals are obliged to observe the applicable rules of international law ***and*** interpretations issued by the FTC. Thus, tribunals must consider interpretations provided by the FTC alongside the objects and purposes of the NAFTA and the plain and ordinary meaning of the terms in the context in which they appear.

12. A number of Chapter Eleven tribunals have now been presented with an almost inconceivable conundrum: what if, on its face, an FTC Interpretation is clearly not reconcilable with the applicable rules of international law? The Pope Tribunal was the first to grapple with this question, and noted the facial differences between the text of Article 1105(1) ("international law") and the FTC Interpretation ("customary international law") stating that: "[i]t is well accepted that the content of "international law" is a good deal broader than "customary international law"".[4]

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[3] See, e.g.: Re: *S.D. Myers, Inc.*and *Canada*, Final Merits Award, at paras. 196-204.
[4] Pope Damages Award, at para 20.

13. The Pope Tribunal therefore found it necessary to examine "whether the Commission's action can properly be qualified as an "interpretation" and the answer to that question obviously depended "on what a proper interpretation of Article 1105 might be".[5] To aid it in resolving that question, the Tribunal sought to determine whether there was a body of negotiating history relating to Article 1105. In its award, the Pope Tribunal recounts at length the difficulty it encountered in obtaining documents respecting the negotiating history of Article 1105.

14. The Pope Tribunal was not overwhelmed by assistance from representatives of the NAFTA Parties in this task. In fact, even a cursory reading of the Award reveals the enormous frustration felt by the Tribunal in the face of the foot-dragging by the relevant government officials. That frustration must have been the more keenly felt by the Tribunal laboring to reconcile apparently irreconcilable texts.

15. That the FTC would apparently choose to ignore the applicable rules of international law in the interpretation of a NAFTA provision – and then permit counsel for the three NAFTA governments to refuse to provide tribunals with access to negotiating materials that would support its seemingly incomprehensible "interpretation" – is almost inconceivable. Yet, that is what continued to occur as the NAFTA governments continued to argue that "international law" in Article 1105 means "customary international law" [6], yet declined to produce any "travaux préparatoires" which might assist the Tribunal.

16. Placed in this most unenviable of positions, the Pope Tribunal navigated its way through the conundrum, with little assistance from the NAFTA Parties.

The Absence of Travaux Préparatoires

17. The Pope Tribunal addressed what appeared to be one of the most vexing problems that it faced during the arbitration: the inability to review any available negotiating materials (*travaux préparatoires*) in order to shed light on the actual intentions of the NAFTA's drafters in agreeing upon Article 1105(1). All three NAFTA Parties made arguments about what the drafters intended, but none would provide any proof to support them. Supported, at least in silence, by the US and Mexico, Counsel for Canada even went so far as to actually claim that no *travaux* existed. As it turned out, a wealth of negotiating documents did exist. Unfortunately, Canada only managed to provide a selection of forty drafts of Article 1105(1) – remarkably without *any* accompanying documents that would explain the Parties' positions on the various versions which existed within those forty drafts or why those versions changed or were eventually agreed upon.[7]

18. In *Methanex Corp*. v. *United States*, the US and Mexico have apparently refused to provide *any* access to their cache of negotiating materials. A former senior Mexican Chapter Eleven negotiator filed an affidavit in that case indicating that the Parties had

[5] *Ibid* at para 24.
[6] See: Pope Damages Award, at footnote 37.
[7] *Ibid*, at para. 28-38, in particular footnote 23.

discussed using the phrase "customary international law" in Article 1105 but had rejected the idea. The United States, while acknowledging that a history of negotiating drafts exists "steadfastly refuse[d]" to produce those drafts.[8]

19. The Pope Tribunal appeared genuinely frustrated by the actions of the NAFTA Parties:

> Canada has not told the Tribunal where the documents resided, or how a diligent search would have failed to find over forty iterations of Chapter 11. The documents themselves show that Canada possessed them at one time. It is not credible that the negotiators would have forgotten their existence. Surely the other NAFTA Parties would have been willing to refresh recollections and provide copies. If Canada did not want to release them, it surely knew how not to do so, as the very letter transmitting the documents to the Tribunal included a refusal to provide other documents. Finally, it is almost certain that the documents provided, which included nothing in explication of the various drafts, are not all that exists, yet no effort was made by Canada to let the Tribunal know what, if anything, has been withheld.[9]

Similarly, the Pope Tribunal stated:

> In this sense, the failure of Canada to provide the documents when requested in November 2000 was unfortunate. Forcing the Tribunal to chose after the documents as it did is not acceptable.[10]

and later:

> This incident's injury to the Tribunal's work can now be remedied. But the injury to the Chapter Eleven process will surely linger.[11]

While the actions of Canada were the primary focus of the Pope Tribunal's frustration, it is clear that counsel for the other NAFTA parties were active participants in the arbitration and did nothing to shed light on the question of the existence of negotiation text, all the while knowing of the Tribunal's interest in those texts and of Canada's denial of the existence of such texts.

20. As a result, this Tribunal should be skeptical about the pretensions of any of the NAFTA Parties respecting the intent of the drafters – unless those Parties are now willing to provide the Investor and the Tribunal with access to the complete catalogue of negotiating materials that would shed light on the subject. If the U.S. fails to provide all available negotiating materials concerning Article 1105(1) to this Tribunal, it would only be appropriate to draw an adverse inference against arguments made by the U.S. in respect of Article 1105. While it did not feel the need to be explicit in this regard, it is

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[8] Pope Damages Award, at para's. 28-38.
[9] *Ibid*, at para. 41.
[10] *Ibid*, at para 39.
[11] *Ibid*, at para 42.

clear that the Pope Tribunal drew an adverse inference against the NAFTA Parties in explaining why it was prepared to conclude that the FTC's purported "interpretation" was actually an amendment that should have been made under NAFTA Article 2202.

21. In light of the serious controversy generated by the FTC Interpretation, a controversy confirmed by the Pope Damages Award, the U.S. cannot at the same time argue in support of a particular interpretation of the treaty and withhold from this Tribunal the documents which would support or undermine its arguments. This Tribunal should draw an adverse inference from the failure of the U.S. to provide it with any negotiating history. While there may be no general obligation on the U.S. to cooperate with this Tribunal and assist it in its work, this Tribunal has the legal authority to draw adverse inferences in appropriate circumstances.[12]

22. The Iran-US Claims Tribunal has drawn adverse inferences from the failure of a party to submit evidence. Judge Charles Brower has acknowledged that the drawing of an adverse inference from the failure of a party to submit evidence was a commonly applied principle for Iran-US Claims Tribunal, stating:

> When it reasonably should be expected that certain evidence exists and that it is in the control of a party, the failure of that party to produce such evidence gives rise to a justifiable inference that such evidence, if produced, would be adverse to that party. [13]

23. To better assist it in its work, the Tribunal should also ask the US and the other NAFTA Parties to produce any documents which were used to brief the FTC prior to the issuance of the FTC Interpretation. As the Pope Tribunal concluded, given the fact that the FTC was compelled to issue its interpretation, it was "beyond argument" that this provision must be sufficiently ambiguous so as to require recourse to *travaux* under Article 32 of the *Vienna Convention on the Law of Treaties*.[14] If the applicable rules of international law (as found in Articles 31 and 32 of the *Vienna Convention*) and the objectives and goals of the NAFTA (as found in Article 201(1)) have lead three NAFTA Chapter Eleven tribunals in one direction, and the FTC interpretation in another, a review of all available negotiating materials surely would be in order.[15]

Amendment or Interpretation

24. In a nutshell, the Pope Tribunal concluded that, because it had a duty under Article 1115, and international law, to provide the Investor with a fair and impartial hearing, it was required to interpret Article 1105(1) in accordance with the applicable rules of international law. In attempting to reconcile the FTC's Interpretation with those rules, it

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[12] *Canada-Measures Affecting the Export of Civilian Aircraft*, AB-1992-2, WT/DS70/ABIR(99-3221), at para 202. See, in particular, the authorities cited in footnote 128.
[13] Brower, "The Anatomy of Fact-Finding Before International Tribunals: An Analysis and A Proposal Concerning The Evaluation of Evidence" in *Fact-Finding by International Tribunals* at 151.
[14] Pope Damages Award, at para. 26.
[15] *Ibid*, para 25 and footnote 8.

concluded that if it were "required to make a determination whether the Commission's action is an interpretation or an amendment, it would choose the latter"[16].

25. The Pope Tribunal noted that the draft texts provided to it by Canada never mentioned the term "customary" in modification of the term "international law." None of the drafts contained the expression "customary international law minimum standard of treatment of aliens" – an ancient term used to describe the kinds of protections that a foreigner should have enjoyed while abroad in the earliest decades of the previous century. The Tribunal did note that Canada's present negotiation proposals for the Free Trade Agreement of the Americas explicitly endorses the ancient standard in the form of language taken from *Neer* award.[17]

26. The Tribunal also noted that "of all the problems of interpretation of Article 1105, the scope of the term "international law" should have been the least troubling, since the term is plain on its face and is defined in the Statute of the International Court of Justice"[18] and that the actual negotiators and drafters of the NAFTA surely would have been sophisticated enough to know the significance of using a term such as "international law"[19] recognized universally by internationalists.

27. Next, the Pope Tribunal determined that while the issue of whether the FTC Interpretation could have retroactive effect was "a difficult question", the better view of the expression "shall be binding" in Article 1131(2) was that it was "mandatory rather than prospective".[20] The Tribunal noted that viewing the FTC's Interpretation as binding did not necessitate a finding that it overturn its previous Award under Article 1105. That Award "could remain either because the Tribunal's interpretation of Article 1105 is compatible with the Commission's, or, if it is not, because the application of the Interpretation to the facts found by the Tribunal leads to the same conclusion that there was a breach by Canada of its obligations under Article 1105".[21]

28. The Tribunal then moved to the question of whether (a) its original interpretation of Article 1105(1) was consistent with the FTC's Interpretation; or (b) whether on the facts of the case Article 1105 was nonetheless breached, even under the FTC's Interpretation of Article 1105(1).

The Appropriate Customary International Standard Eight Decades after the Neer Claim

29. Working from the proposition that Article 1105 prescribed the customary international law minimum standard of treatment of aliens as the standard of treatment to be afforded to investments of investors of other Parties, the issue to be decided was the content of that minimum standard.

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[16] *Ibid*, para 47.
[17] *Ibid*, at footnote 36.
[18] *Ibid*, at footnote 9.
[19] *Ibid*, at para. 46.
[20] *Ibid*, at para's. 48-51.
[21] *Ibid*, at para 52.

30. It is important to note that the FTC's Interpretation did not provide any insight or direction concerning the content of the minimum standard or the actual threshold to be met in establishing liability under Article 1105. It only purported to establish the standard which was the one that the NAFTA's drafters always intended for Article 1105. The Tribunal noted that the FTC's Interpretation does not require that the concepts of "fair and equitable treatment" and "full protection and security" be ignored, but rather that they be considered included as part of the minimum standard of treatment prescribed by Article 1105. Indeed, any construction of the FTC Interpretation whereby the fairness elements were treated as having no effect, would be to suggest that the FTC Interpretation required the word "including" in Article 1105(1) to be read as "excluding", an approach which clearly had to be rejected. Therefore, the Interpretation required each Party to accord to investments of investors of the other Parties the fairness elements as subsumed in customary international law.[22]

31. Put another way, the Tribunal concluded that the concepts of "fair and equitable treatment" and "full protection and security" still had to have some meaning.

32. Canada argued that the content for the minimum standard of treatment could be found in a passage from the 1926 *Neer* decision:

> [T]he treatment of an alien, in order to constitute an international delinquency, should amount to an outrage, to bad faith, to willful neglect of duty, or to an insufficiency of governmental action so far short of international standards that every reasonable and impartial man would readily recognise its insufficiency.[23]

33. The Tribunal rejected that approach that sees customary international law as "frozen in amber at the time of the *Neer* decision"[24], and gave three reasons for doing so. First, customary international law is not static but evolves through state practice, including international agreements. Second, the range of actions subject to international concern has broadened beyond the international delinquencies considered in *Neer* decision to include the concept of fair and equitable treatment, as evidenced by the work of the OECD on its Draft Convention on the Protection of Foreign Property. Third, the standard of fair and equitable treatment is central to many recent BITs which require fair and equitable treatment, but are not limited to protection against international delinquencies (which in *Neer* involved the allegation of "denial of justice" rather than the breach of any international law standard by an executive or administrative official).

34. The Pope Tribunal recognized that customary international law is to be divined from state practice, which demonstrates a willingness to be bound by international norms.[25] It also implicitly noted that international custom can be evidenced in secondary sources such as the writing of distinguished commentators and by international tribunals.

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[22] Pope Damages Award, at para 53.
[23] Re: *Neer* and *Mexico* (US-Mexico General Claims Commission) (1926) IV RIAA 60..
[24] Pope Damages Award, para 57.
[25] *Ibid*, para. 59.

35. It noted the work of the International Court of Justice in considering a "full protection and security" clause in a US BIT in the *ELSI* case – which provided insight on the type of arbitrariness one should not encounter in operating a foreign investment.[26]

36. In the *ELSI* case, the Court stated:

> Arbitrariness is not so much something opposed to a rule of law, as something opposed to the rule of law … It is a willful disregard of due process of law, an act which shocks, or at least surprises a sense of judicial propriety.[27]

37. It even noted that Sir Robert Jennings considered the standards of "fairness" contained within international investment protection agreements to be aimed at preventing much more than the most serious "international delinquencies."[28]

38. The Tribunal referred to the vast array of international investment protection agreements which – as is generally acknowledged by the academic community – all contain some form of "minimum standard of treatment" requirement that includes "fair and equitable" and "full protection and security".[29] It acknowledged the seminal work of the OECD – of which all three NAFTA Parties are members – and it implicitly acknowledged that the world has changed incredibly since the 1920's, when the *Neer* was issued.

39. Since the award in *Re: Neer and Mexico* was issued, the world encountered a great depression and a terrible global war. In order to forestall future calamities, the world community established the massive institutional superstructures that remain the constitution of international economic law today, including the United Nations and the Bretton Woods system. Numerous GATT rounds led to the founding of the WTO, and enshrinement of more and more detailed rules governing the treatment of foreign economic actors. Human rights protocols were established that recognized the right to hold and enjoy property, and over 1800 bilateral and multilateral investment treaties were established to provide investors with the most direct of remedies to address breaches of international standards.

40. It also is interesting to note that the *Neer* decision was only followed in three other cases encountered by the US-Mexican Claims Tribunal, each of which involved denial of justice claims against the administration of justice by Mexico.[30] It is even more interesting to note that the American judge sitting on the *Neer Claim* dissented from the majority on the high threshold that it eventually employed ***and*** that there were many

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[26] *Ibid*, para's. 63-63.
[27] *Case concerning Electtronica Sicula S.P.A.(ELSI)*, 1989 ICJ 15 at 76.
[28] *Pope Damages Award*, footnote 49.
[29] *Pope Damages Award*, para's. 61-62.
[30] *Walter Faulkner v. Mexico* (1928) IV RIAA 67 at 71 (regarding arrest and imprisonment); *B.E. Chattin v. Mexico* (1927) IV RIAA 282 (regarding an illegal arrest); and *Gertrude Massey v. Mexico* (1927) IV RIAA 155 at 160 (which explicitly explains the narrow application appropriate in applying the high threshold found in the *Neer* claim).

other examples of awards against Mexico (not involving the administration of justice) to which the *Neer* test was never applied.[31]

41. For all these reasons, the Pope Tribunal concluded that – even if the text of Article 1105(1) actually meant "treatment in accordance with the customary international law minimum standard of treatment of aliens" rather than "treatment in accordance with international law, including fair and equitable treatment and full protection and security" – Canada's singular reliance on the *Neer* case to explain the content of the customary international law standard in 2001 could not be countenanced.[32] The weight of decades of development in international economic law could not be ignored in favour of a singularly high threshold mentioned in a solitary, 80-year-old case involving the administration of justice in a Mexico of the 1920s. To accept such a proposition would freeze the kinds of factors to be used in determining an Article 1105(1) breach "in amber" and thus contradict what must be admitted by any sensible observer – that customary international law is not, and cannot be seen as being – static.

B. Why the US' Criticisms Are Unfounded

General Misconceptions of the Law of State Responsibility

42. As mentioned above, the US has not provided any helpful, response to this Tribunal's request for a consideration of possible factors to be used in interpreting and applying Article 1105(1) in the wake of the FTC Interpretation and the Pope Damages Award. Instead, it has clung to a simplistic, and entirely rigid, explanation of how the "customary international law minimum standard of treatment of aliens" should be interpreted. Contrary to the writings of the vast majority of classical international law scholars, such as Vitoria or Grotious, or more recently Lauterpacht, Cheng and Schwarzenberger, the U.S. claims that unless an Investor can fit its claim within the bounds of specific, rigid "tort" compartments (apparently all established by the end of the 19th century), it cannot succeed.[33] This unsupported, and unsupportable, position defies all credulity when applied in an international law – and, even in the common law tort context, is not highly regarded by tort scholars today.

43. The analogy drawn by the U.S. between the customary international law minimum standard and what it refers to as "the common-law approach of distinguishing among a number of different torts potentially applicable to particular conduct"[34] is patently wrong.

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[31] *American Journal of International Law* 555 (1927) at 556. See, e.g.: *Samuel Davies v. Mexico* (1929) IV RIAA 517 (where damages were awarded for damges to his cords of wood which had been seized by a low-ranking official); *Okie v. Mexico* (1926) IV RIAA 55 (in which the claimant was found to be entitled to a customs duty refund, contrary to that which was mandated under a Mexican law of general application); and *G.W. MacNear, Inc.* v. *Mexico* (1928) IV RIAA 373 (in which a tribunal concluded that the improper detention, and eventual sale, of the claimant's wheat at the border constituted a violation of the standards of treatment required under customary international law).

[32] *Pope Damages Award*, para 57-58.

[33] US Submission, pp. 3-4.

[34] U.S. Post Hearing Submission, at p. 4.

44. In *The Law of Torts*, Professor Fleming rejects the notion that there are watertight compartments in torts on both legal and factual grounds in the following terms:

> Some writers, notably Sir John Salmond, have taken the view that there is no such thing as a law of *tort*, but merely a large group of unconnected wrongs, each with its own name, and that a plaintiff seeking recovery must find a pigeonhole in which to fit the defendant's conduct and the harm he has suffered before the courts will afford a remedy:
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> > Just as the criminal law consists of a body of rules establishing specific offences, so the law of torts consists of a body of rules establishing specific injuries. Neither in the one case nor in the other is there any general principle of liability. Whether I am prosecuted for an alleged offence, or sued for an alleged tort, it is for my adversary to prove that the case falls within some specific and established rule of liability, and not for me to defend myself by proving that it is within some specific and established rule of justification or excuse.
>
> This approach is open to at least two objections. First, in so far as it suggests that the burden of proof is on the plaintiff to establish that the facts proved by him will, as a matter of law, result in liability, it is plainly wrong because there is no onus of proof in matters of law. In other words, there is no presumption that the law is in anybody's favour, whether he be defendant or plaintiff. Secondly, tortious liability is constantly expanding and there is ample evidence that a plaintiff's claim is not necessarily prejudiced because he is unable to find a specific label for the wrong of which he complains. New and innominate torts have been constantly emerging in the long course of our history and the courts have shown no inclination at any stage to disclaim their creative functions, if considerations of policy pointed to the need for recognising a new cause of action.[35] [footnotes omitted]

45. The US is attempting to apply what is at best a questionable domestic law approach of "watertight compartments" to the principles of state responsibility in order to whittle down the obligations that its executive and legislative institutions are bound to observe.

46. The analogy to a discredited domestic law concept of pigeonholing causes of action is clearly wrong. However, the basic premise, that such a requirement exists in customary international law is just as wrong. The U.S. tries to support its premise by focusing on the ancient law of "denials of justice" which predominantly (although certainly not exclusively) involve breaches of international law by domestic courts or judicial proceedings. As Professor Hyde wrote in his treatise on international law in 1922:

> A denial of justice, <u>in a broad sense</u>, occurs whenever a State, through any department or agency, fails to observe with respect to an alien, <u>any duty imposed by international law or by treaty with his country</u>. Such delinquency may, for example, be manifest in arbitrary or capricious action on the part of the courts, <u>or in legislative enactments destroying the exercise</u>

[35] Fleming, John G. *The Law of Torts*, 9th Ed, at p. 7.

> of a privilege conferred by treaty, or in the action of the executive department in ordering the seizure of property without due process of law. [emphasis in part in original][36]

47. From its assertion that denial of justice cases are an example of this watertight compartments ("distinct torts") approach, the US makes the unfathomable leap to a blanket assertion that, absent a watertight compartment of an international wrong, all State acts are protected from international review. [37] This naked assertion of immunity for the discretionary acts of government flies in the face of the well-established rules of state responsibility, as described by Professor Cheng below:

> In complexities of human society, either individuals or of nations, law cannot precisely delimit every right in advance. Certain rights may indeed be rigidly circumscribed, as, for instance, the right of self-defence in the territory of a friendly state…
>
> But whatever the law leaves a matter to the judgement of the person exercising the right, this discretion must be exercised in good faith, and the law will intervene in all cases where this discretion is abused…
> Wherever, therefore, the owner of a right enjoys a certain discretionary power, this right must be exercised in good faith, which means that it must be exercised reasonably, honestly, in conformity with the spirit of the law and with due regard to the interests of others. But since discretion implies subjective judgement, it is often difficult to determine categorically that the discretion has been abused. Each case must be judged according to its particular circumstances by looking either at the intention or motive of the doer or the objective result of the act, in light of international practice and human experience. When either an unlawful intention or design can be established, or the act is clearly unreasonable, there is an abuse prohibited by law.[emphasis is ours][38]

The Flaws in Specific Criticisms

48. The US commences its critique labouring under the misconception that the Pope Tribunal concluded that "it need not abide by an FTC interpretation."[39] The Tribunal said no such thing. It considered the FTC Interpretation to be binding, specifically recognizing the mandatory nature of Article 1131(2).[40] It properly concluded that the Commission's Interpretation itself required interpretation. The Pope Tribunal simply considered FTC's Interpretation of Article 1105(1) in light of the goals and objectives of the NAFTA and the applicable rules of international law. In so doing, the Pope Tribunal was simply applying the FTC Interpretation in accordance with its duties under the NAFTA.

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[36] *International Law Chiefly as Interpreted and Applied by the United States*, (1922), Vol. I at 491-492.
[37] US Submission, p. 6.
[38] Cheng, *General Principles of Law* (Grotius Press: 1987, Cambridge UK), pp. 132-134.
[39] U.S. Post Hearing Submission, pg 8.
[40] Pope Damages Award, para. 51.

49. The US argues that the Pope Tribunal's interpretation of the Commission's Interpretation was wrong, but in truth, the Tribunal did what it was required to do. That it interpreted the FTC's Interpretation in a manner that the US did not like is not the same thing as disregarding it. It is particularly ironic that the US assails the Pope Tribunal for violating the principle of effectiveness in respect of the NAFTA[41] – because it was the three NAFTA Parties who attempted to take the far easier road of issuing a so-called "interpretation" under Article 1131(2) that most commentators have suggested is nothing short of an amendment – for which there is clearly another NAFTA provision: Article 2202. The NAFTA Parties' attempt to use the wrong provision to water down the protections afforded in Article 1105(1) is the only act in question that plainly violates the principle of effectiveness.

50. The US claims that the Pope Tribunal's award is not authoritative because it is mostly *obiter dicta.*[42] Since there is no formal system of precedent in Chapter Eleven claims, or in international arbitration generally, it is not relevant whether the Pope Tribunal dispensed its wisdom by way of *obiter* or through *ratio*. International tribunals decide to accord weight to another award based upon the quality of the reasoning and the reputation of the Tribunal's members. This is partially why the Pope Tribunal indicated that the decision of Mr. Jutice Tysoe, who sat in judicial review of the *Metalclad* case, was not to be accorded much weight over that of a tribunal chaired by none other than Sir Eli Lauterpacht.

51. The US also claims that the Pope Tribunal's award is not authoritative because the Tribunal admitted that it was not interpreting Article 1105(1) based on the plain meaning of the text.[43] In doing so, the US fails to apply the golden rule of treaty interpretation by adopting a literalist approach, rather than the customary approach of interpreting a provision based on the plain meaning of its text ***within the context*** of their place in the treaty and its goals and objectives. While the US would like this Tribunal to conclude that the US view of the FTC Interpretation, and of Article 1105(1), is both correct and clear, the past year of controversy prevents anyone other than NAFTA government lawyers from coming to the same conclusion.

52. The US takes the Pope Tribunal to task for concluding that the content of other US bilateral investment treaties (BIT) are relevant in the interpretation of Article 1105(1)[44]. It does so even though all three NAFTA Parties have cited BIT practices when it suited them to explain the original intent of the drafters (instead of providing access to the actual negotiating materials). The US argues that no matter what various commentators and former employees of the Office of the Legal Advisor say, it has consistently believed that all of the "minimum standard" provisions contained within its BITs stand for the same standard: the customary international law minimum standard of treatment of aliens. In doing so, the US essentially argues that all of the differences (highlighted by counsel for ADF during the oral hearing) can be ignored. It comes to this conclusion

[41] US Post Hearing Submission, footnote 25.
[42] *Ibid*, at pg 8..
[43] US Post Hearing Submission, pg. 13.
[44] *Ibid*, at p. 21-22.

notwithstanding the fact that it simultaneously distinguishes the ICJ *ELSI* award as irrelevant because it referred to a different formulation of the minimum standard clause requiring "full protection and security."[45]

53. The US cannot have it both ways. Either all of the differences contained with these treaties are not comparable because of their minor or inconsequential different language, or they can be compared one with the other precisely because the language in each provides for the same standard. The Investor submits that the difficulty that the US is experiencing in trying to argue consistently is a function of its rigid adherence to the hope that some day a tribunal somewhere will cite the *Neer* claim as establishing the appropriate test for the minimum fairness provisions against which it must now defend claims.

54. The US cannot see its way out of the intellectual thicket it has created by basing its defence on a wholly discredited and inappropriate "watertight compartments" approach to state responsibility, bolstered with reference to inapplicable case law from a bygone era[46]. The US has accepted the simple proposition that international custom is a constantly-evolving phenomenon. In oral arguments, Mr. Legum recognised that the rules of customary international law did evolve over time, stating that "it is not the United States' position that those standards are frozen in time. The standards do evolve".[47] He later confirmed the U.S. position that "one can only draw the inference that the free trade commission had in mind customary international law as it exists today".[48]

55. It is obvious that whether one speaks of full protection and security, prohibitions against discrimination, arbitrariness or unreasonableness, or fair and equitable treatment, one is speaking about an evolving minimum standard of treatment. A standard that requires much more of the US today than it did a century ago.

C. The Kinds of Factors Which Should be Considered by this Tribunal

56. Based upon the findings of the Pope Tribunal, there are four ways in which a tribunal can address the text of Article 1105(1) and the FTC Interpretation: (1) one can adopt both the standard set out in the FTC Interpretation and the "egregious" threshold test advanced by the NAFTA Parties to explain its content; (2) one can conclude that the FTC Interpretation is invalid because it cannot be reconciled with the applicable rules of international law and the structure of the NAFTA (which provides a different provision for changes to the treaty text; (3) one can conclude that the FTC Interpretation is valid, and then proceed to determine the content of the customary international law minimum standard of treatment of foreigners today; or (4) one can accept both the FTC Interpretation and the "egregious" test proffered by the NAFTA Parties, but accord a

[45] U.S. Post Hearing Submission, pg 21-22.
[46] The Pope Tribunal noted that Sir Robert Jennings stated that the *Neer* Tribunal was not answering the question of whether a state act was "fair and equitable" but rather whether the act constituted an "international delinquency." Pope Damages Award, at footnote 49.
[47] Transcript Vol II pgs 492-493.
[48] Transcript Vol II pg 501.

higher standard of treatment based upon the MFN rule and other comparable investment obligations owed by the United States.[49]

57. If one chooses the "egregious" test, and – by extension – the "watertight compartments" approach argued by the US, there may not be any factors that would be relevant in this case – because these standards will have been "frozen in amber" as of the state of the law at around the turn of the 19th century. If one chooses the second or third approach, the same factors will generally apply in determining whether state action was "fair and equitable" and accorded "full protection and security."[50] If one adopts the fourth approach, the result would be largely identical to the second approach, because one would seek out a comparable BIT provision under MFN treatment to replace the now-weakened Article 1105(1) obligation.

58. Accordingly, for this Tribunal, it does not matter whether it determines the FTC Interpretation to be invalid because it is not an "interpretation" within the scope of Article 1131(2), or whether it considers the current status of customary international law concerning the treatment of foreigners, or whether it concludes that, while Article 1105(1) provides a very low level of protection, higher levels to be found in other BITs. The result will be the same in all three cases. The clear text of Article 1105, the text of other applicable US BITs and the findings of international tribunals can all be used to determine the kinds of factors which cause a regulatory regime or regulatory treatment to fall below the minimum standard in 2002.

59. As the Investor indicated in its Reply Memorial, BITs signed between the United States and countries such as Estonia or Albania provide evidence of the kind of treatment that falls below applicable standards.[51] This Tribunal will also recall that the NAFTA Parties explicitly reserved the application of MFN treatment under Article 1103 to BITs signed after 1994.[52] Thus, if this Tribunal concludes that the FTC-modified Article 1105(1) text applies in this case – subject to the requirement of Article 1103 MFN treatment, it should refer to minimum standard provisions such as those contained within the Albania and Estonia BITs. In addition, if the Tribunal decides that minimum standard provisions set out in various BITs are evidence of evolving custom, it may refer to these two recent BIT provisions as examples of the current minimum standard of treatment required.

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[49] The Investor set out its MFN arguments at para's. 219-221 of its Reply Memorial. The Pope & Talbot Tribunal mentioned the availability of an MFN claim for a higher level of treatment at footnote 54 of its Damages Award.

[50] Although in other cases where the breach of a specific non-NAFTA treaty norm is used as the basis for a claim, the two approaches would differ, as concluding the FTC Interpretation was of no practical effect would permit claims based on relevant investment protection clauses in other treaties, as opposed to just custom (which would require more evidence than one treaty provision to be proved as binding customary law).

[51] Investor's Reply Memorial, at para 222 et. s..

[52] Of course, the fact that the United States has taken a reservation, in Annex IV of the NAFTA, from providing MFN treatment under Article 1103 "for treatment accorded under all bilateral or multilateral international agreements in force or signed prior to the date of entry into force of this Agreement" is demonstrative of its clear intention to be bound to offer NAFTA investors any more favourable treatment that it agreed to provide to other investors from other countries under any BITs signed after the NAFTA came into force.

60. Article II(3)(a) of the Albania-US BIT requires "fair and equitable treatment and full protection and security," ***in addition to*** whatever obligations the U.S. would owe under "international law" generally. Article II(3) provides as follows:

> (a) Each Party shall at all times accord to covered investments fair and equitable treatment and full protection and security, and shall in no case accord treatment less favorable than that required by international law.
>
> (b) Neither Party shall in any way impair by unreasonable and discriminatory measures the management, conduct, operation and sale or other disposition of covered investments.

Whereas Article II(2)(b) of the Estonia-US BIT similarly – but perhaps slightly more expansively – states:

> (b) Neither Party shall in any way impair by arbitrary or discriminatory measures the management, operation, maintenance, use, enjoyment, acquisition, expansion, or disposal of investments. For purpose of dispute resolution under Articles VI and VII, a measure may be arbitrary or discriminatory notwithstanding the fact that a Party has had or has exercised the opportunity to review such measure in the courts or administrative tribunals of a Party.

61. As noted by renown internationalist commentators such as Sir Robert Jennings and former senior officials of the U.S. State Department such as Professor Vandevelde, the intended effect of such language, as argued by counsel for ADF and un-contradicted by US counsel during the oral hearing, was to "ratchet up" the minimum standard owed by states through continued practice and through the evolving jurisprudence of mixed international claims.[53]

62. This Tribunal can conclude that these BITs, along with numerous other BITs, along with free trade agreements and international economic cooperation agreements entered into by the NAFTA Parties provide evidence that the customary international law standard of treatment has evolved from protection against the most outrageous or egregious international delinquencies to require that states act fairly and equitably; provide full protection and security; avoid acting in an unreasonable, arbitrary or discriminatory manner; and at all times to act in perfect good faith. Or this Tribunal can conclude, based upon the approach adopted in the Maffezini case, and approved by the Pope Tribunal's with its Merits and Damages Awards, that these factors are required under the MFN principle under Article 1103. It does not matter. The results are the same.

63. As demonstrated by the Pope Tribunal, if this Tribunal adopts the customary international law approach to Article 1105(1), as modified by the FTC Interpretation, a critical factor in accessing the context of the contemporary customary international law standard is the vast array of BITs. Of particular importance, are the numerous BITs and free trade agreements negotiated by the NAFTA Parties and, in particular, the BITs and free trade

[53] Investor's Reply Memorial, at para's 216 and 25-226.

agreement negotiated by the United States. These BITs are clear evidence of state practice favoring transnational investment flows by creating a stable, predictable, fair, non-discriminatory and non-arbitrary investment environment.

64. In addition, if this Tribunal adopts the FTC's customary international law standard, it can have recourse to various international tribunals to understand what kinds of factors can be relevant within the context of various fact based scenarios (in contrast to the more abstract language of other BITs). Treatment in accordance with the rule of law, as opposed to treatment in accordance with the arbitrary whim of an unrestrained bureaucrat is one such factor.

65. As the International Court of Justice stated in the *ELSI* case:

> Arbitrariness is not so much something that is opposed to a rule of law, as something opposed to the rule of law… It is a willful disregard of due process of law, an act which shocks, or at least surprises a sense of judicial propriety." [54]

66. The Pope Tribunal noted that in *ELSI*, the ICJ "has moved away from the *Neer* formulation".

67. The WTO Appellate Body has also considered the question of what constitutes "arbitrary or unjustified discrimination" in application of a measure under GATT Article XX. The Appellate Body found that a regulatory certification scheme was not transparent, did not provide for sufficient notice or comment by affected states or their citizens, and lacked a formal legal procedure for review or appeal. The Appellate Body concluded that these procedural flaws were inconsistent with the spirit, if not the letter, of GATT Article X:3. It further determined that if a regulatory measure is applied too rigidly or inflexibly, it may constitute "arbitrary discrimination". [55] The Appellate Body has also concluded that where alternative means for a state to exercise its sovereign regulatory discretion exists that does not have a discriminatory result, it is obligated to choose such means in order to act consistently with its GATT obligations.[56]

68. In the *Behring Fur Seal Arbitration*,[57] a tribunal was asked to determine whether the US had a right to complain about the state-sanctioned hunting of pelagic seals by British fishermen in the waters off the American Pribilof Islands. The Tribunal held that it is a violation of customary international law for a state to act in a discriminatory manner against a foreign national with intent to injure or harm the national or his/her business interests and concluded that the U.S. therefore had a right of complaint against the United Kingdom[58].

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[54] *Case Concerning Elettroncia Sicula S.p.A (ELSI)* [1989] I.C.J. Rep.15.
[55] *US - Import Prohibition of Certain Shrimp and Shrimp Products*, WT/DS58/AB/R, October 12, 1998 at para's. 177-183.
[56] *United States – Standards for Reformulated and Conventional Gasoline*, WT/DS2/9, 20 May 1996, at pp. 22-25.
[57] *Behring Fur Seal Arbitration*, G.B./U.S., (1893) 1 Int.Arb. 755.
[58] Along with the Permanent Court of Arbitration's decision in *North Atlantic Coast Fisheries Case* (1910), the *Behring Fur Seal Arbitration* represents the bedrock of the principle of good faith for state responsibility in international law. See:.*North Atlantic Coast Fisheries Case* (1910), 1 H.C.R., 141 at 169.

69. In a communication issued by the UN Human Rights Commission in 1995, it was determined that a membership allocation scheme for seats in the legislative press gallery impinged upon the claimant's right to have access to information because the Commission determined that the "operation and application" of the scheme "must be shown as necessary and proportionate to the [legislative] goal in question and not arbitrary."[59]

70. In a very recent bilateral investment case, a Dutch investor was coerced into complying with a discriminatory direction from a Czech regulatory body which ultimately precipitated a loss of control of its investment. The actions of the Czech Republic were found to violate the standards of "fair and equitable treatment" by the majority of a tribunal that included former Chief Justice of the ICJ, Stephen Schwebel.[60] The Majority commented as follows:

> The Media Council breached its obligation of fair and equitable treatment by evisceration of the arrangements in reliance upon with the foreign investor was induced to invest… [para. 611]
>
> On the face of it, the Media Council's actions and inactions in 1996 and 1999 (…) were unreasonable as the clear intention of the 1996 actions was to deprive the foreign investor of the exclusive use of the Licence under the MOA and the clear intention of the 1999 actions and inactions was collude with the foreign investor's Czech business partner to deprive the foreign investor of its investment. The behaviour of the Media Council also smacks of discrimination against the foreign investor. para. 612
>
> The Media Council's actions in 1996 and its actions and inactions in 1999 were targeted to remove the security and legal protection of the Claimant's investment in the Czech Republic. The Media Council's (possible) motivation to regain control of the operation of the broadcasting after the Media Law had been amended as of January 1, 1996 is irrelevant. The host State is obligated to ensure that neither by amendment of its laws nor by actions of its administrative bodies is the agreed and approved security and protection of the foreign investor's investment withdrawn or devalued. (…)_[para. 613]

71. Finally, and most importantly, the Majority concluded the following about how these various standards together breached the exact formulation which has been proffered by the FTC for interpretation of the text of Article 1105(1):

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[59] United Nations, Human Rights Committee, Communication No. 633/1995: Canada 05/05/99, CCPR/C/65/D/633/1995 at para.13.6.

[60] *Re: CME Czech Republic B.V. (The Netherlands) and the Czech Republic*, UNCITRAL Tribunal, 13 December 2001, at para's. 504-516. It should also be noted that another tribunal, operating under a US/Czech BIT and reviewing the mostly the same facts, came to a different conclusion than the majority in the CME case. This other tribunal did not deny that questions of arbitrariness and effective discrimination lay behind the BIT's "minimum standard" provision, only that there was not enough to establish a breach in that particular case. The Investor respectfully submits that after reviewing both awards, this Tribunal will find the reasoning of the Tribunal which included Judge Schwebel far more persuasive. See: *Lauder and the Czech Republic*, UNCTRIAL Arbitration, Spetember 2001. Both awards can be found at the following URL: http://www.mfcr.cz/scripts/hpe/default.asp.

> The Media Council's actions as described above are not compatible with the principles of international law, which the Arbitral Tribunal is charged with applying. On the contrary, the intentional undermining of the Claimant's investment's protection, the expropriation of the value of that investment, its unfair and inequitable treatment, the Media Council's unreasonable actions, the destruction of the Claimant's investment security and protection, are together a violation of the principles of international law assuring the alien and his investment treatment that does not fall below the standards of customary international law. [para. 614]

72. In the *Metalclad* Award, a tribunal chaired by Sir Eli Lauterpacht, accorded a meaning to the "fair and equitable" standard of treatment that also went far beyond the approach advocated by the U.S.. The tribunal made a number of findings that Mexico breached the fair and equitable treatment standard, starting with the simple fact that there appeared to be "no clear rule" as to whether a municipal permit was ever required under Mexican law. It further determined that there was no established practice or procedure governing permit applications at any rate. The *Metalclad* Tribunal concluded that these omissions amounted "to a failure on the part of Mexico to ensure the transparency required by NAFTA."[61]

73. The *Metalclad* Tribunal also set out a series of examples of government conduct that breached the customary international law standard of "fair and equitable treatment". First, it concluded that *Metalclad* was led by federal officials to believe that it did not require the municipal construction permit first required, and later refused, by local officials. It further concluded that *Metalclad* relied upon the advice it received from federal officials, to its detriment. Regardless of whether the advice that *Metalclad* received was correct, the tribunal appears to have concluded that a failure to address such detrimental reliance constituted a breach of fair and equitable treatment under international law.[62] The tribunal further appeared to conclude that the near total lack of transparency that characterised the long, confusing and painful process that *Metalclad* was forced to endure in order to run its business made *Metalclad's* detrimental reliance particularly critical and damaging. The tribunal further concluded that the municipality's decision to deny *Metalclad's* permit was based upon irrelevant and/or improper considerations, and that it was denied without the provision of satisfactory reasons for decision.[63]

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[61] *Metalclad* Award, at para. 88. In making these findings, however, the tribunal did not repeat the interpretative analysis it employed earlier in its award -- that because "transparency" is a fundamental principle of the NAFTA, which must inform the objectives that must be employed in interpreting its provisions, gross failures to regulate in a transparent manner could be seen as failure to accord "fair and equitable treatment" in accordance with "international law," as required under NAFTA art. 1105(1). In fact, the tribunal never fully explained whether it saw the "fair and equitable treatment" standard as: (1) being additional to whatever treatment is required under "international law", (2) being an example of the kind of standard that must be followed in international law, or (3) whether the words "fair and equitable treatment" are essentially superfluous terms that recall no more than the customary international law governing the treatment of aliens. Given the wording of the tribunal's primary finding, however, it would appear that it chose the second of these formulations: that fair and equitable treatment is one of the international law standards that must be respected under NAFTA art. 1105. See *Metalclad* Award, ibid., at para. 74.

[62] *Metalclad* Award, at para's. 88-89.

[63] *Metalclad* Award, at para's. 92-93. The tribunal noted that "the construction permit was denied without any consideration of, or specific reference to, construction aspects or flaws of the physical facility."

74. And finally, in an award involving a BIT between the United Kingdom and Egypt, a tribunal has recently concluded that the standards of "fair and equitable treatment" and "full protection and security" were breached when a regulator failed to act in a manner that would prevent the arbitrary seizure of its property by a local third party. [64]

75. This growing body of case law and BITs clearly demonstrate that no international tribunal has adopted the "egregious" or "outrageous" test found in the *Neer* case, or the "watertight compartments" approach provisions now advocated by the US. The US has cited no authority for its position – other than an FTC Interpretation which is open not only to attack for being an improper exercise of the FTC's authority under the NAFTA, [65] but also open to multiple interpretations itself and of marginal effect given the existence of the MFN obligation.

Application to the Facts of this Case

76. As indicated in paragraphs 249 to 250 of the Investor's Memorial and paragraphs 248 to 264 of the Investor's Reply, the Investor asserts that the US has abused its discretion to administer the Buy America program and that this practice results in effective discrimination against foreign investors such as ADF. The U.S. action is not consistent with the customary international law principles of state responsibility and it is neither reserved nor exempted under the NAFTA.

77. The Investor alleges that the U.S. has violated its Article 1105 obligations by failing to provide a transparent legal environment which operated fairly and equitably and which guaranteed full protection and security. Not only does the legislative scheme fail to provide the necessary Article 1105 protection, it creates an environment where absolute administrative discretion and the arbitrary and capricious exercise of power replaces the rule of law. The U.S. has indeed exercised such discretion to the considerable detriment of the investor and its investment.

78. The legislative scheme created to apply the Buy America measures is not an exercise in law making, where legislators make rules to be applied by administrative officials and where discretionary power is given only in measured doses. Rather, the legislative scheme is an elaborate camouflage to allow for the unchecked exercise of arbitrary administrative power to impose unforeseen or unreasonable conditions that target foreign competitors, at the cost of foreigners in general and foreign investors in particular.

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[64] *Wena Hotels Ltd.* v. *Arab Republic of Egypt*, ICSID Arbitration, Final Award, Case No. ARB/98/4, 8 December 2000. Request for Annulment denied: Case No. ARB/98/4, 5 February 2002.

[65] This is so because with the FTC statement, the three NAFTA Parties appear to have manifestly ignored their collective obligation to interpret the provisions of the NAFTA in accordance with its objectives and the applicable rules of international law under Article 101(2) and their obligation to "ensure that all necessary measures are taken in order to give effect to the provisions of the Agreement".

79. Recall that the original rule enacted by Congress called for U.S. preferences on "steel, iron and manufactured products", distinguishing between "steel and iron" on the one had as "materials" and " manufactured products" on the other hand[66].

80. Recall also that when regulations implementing the law were drafted, the drafters dropped all references to "manufactured products" and enacted the regulations which, on their face, only applied to "steel and iron". However, by administrative feat, the bureaucrats broadened the meaning of steel – the output of steel mills – to cover steel manufactured articles.[67] Thus, not content with ignoring the statute's reference to "all manufactured articles" the administrative officials ignored the plain meaning of "steel" to interpret it as meaning "steel and steel manufactured products".

81. The foregoing is arbitrary in the extreme, with the "law" as applied being a bureaucratic concoction that bears little resemblance to the supposedly governing terms of the statute. This Tribunal should also recall that operating in this fashion was the only way that the administrative officials could effectively impose a 100% origin rule on a manufactured product. Had the officials respected Congressional intent, they would likely have chosen an origin rule that would allow some foreign contact rather than a 100% rule.

82. The regulations were enacted in a way that ignored congressional intent (as set out in the law) and customary international law, in order to facilitate the targeted application of a protectionist measure.

83. Further evidence of the arbitrary nature of the application of the powers of the Federal Highway officials is seen in their ability to simply ignore relevant case law. U.S. courts have held that if foreign steel is fabricated in the U.S. it remains U.S.-origin steel, and if U.S. steel is fabricated in a foreign country it remains foreign origin steel. Despite the strength of those cases, and the similarity of legislation being applied, the officials of the FHWA felt sufficiently free of constraints to simply ignore them.

84. In the application of Buy America, the FHWA has been allowed to act outside the boundaries of the normal restraints on administrative action. This arbitrator and non-transparent state of affairs has been permitted because, in applying Buy America, the FHWA hurts only the interests of foreigners and foreign investors.

85. The continued application by FHWA of Buy America policies in an arbitrary, unchecked manner with the express goal of discriminating against foreigners and foreign investors is a violation of the minimum standard of treatment under Article 1105(1). While FHWA may have achieved effective immunity from the application of the rule of law in the United States, the U.S. State has no such immunity from its obligations under international law (customary or otherwise).

86. The U.S. has also violated its Article 1105(1) obligation by failing to perform its NAFTA obligations in good faith. This Tribunal will recall that on several occasions, the U.S. admitted that had the Springfield Interchange Project been a federal procurement, it

[66] Investor's Memorial, paras 47 to 51.
[67] Investor's Memorial, paras 52 to 86.

would not have applied the Buy America provisions in question. That is because under Chapter Ten of NAFTA, the U.S. government has promised its NAFTA partners that (with certain specific exceptions) it would not apply domestic preference requirements[68].

87. It has also been demonstrated, and not denied by the U.S. that the State of Virginia does not have its own domestic preference requirements and that the Buy America requirements were applied in Springfield as a condition imposed on the receipt of Federal funds.

88. The international law principle of good faith is enshrined in the *pacta sunt servanda* rule which can be found in Article 26 of the *Vienna Convention on the Law of Treaties*. It requires that any right enjoyed by, or obligation owed by, a state must be executed in perfect good faith. It is a violation of the good faith requirement for the Federal government to do indirectly, through the Virginia government, what it has promised not to do directly.

89. The principle of good faith performance has clearly attained the status of customary international law and is subsumed in the Article 1105(1) obligations undertaken by the U.S. in respect of investors and their investments. The proposition that good faith in the performance of treaty obligations is customary international law is axiomatic. In *United States: Standards for Reformulated and Conventional Gasoline*, the Appellate Board held that Article 31 of the Vienna Convention, which contains an obligation to interpret a treaty in good faith, "has attained the status of a rule of customary or general international law".[69] If the obligation to interpret a treaty in good faith has attained the status of customary international law, how much more so is the obligation to perform treaty obligations in good faith.

90. The International Court of Justice has put it this way:

> One of the basic obligations governing the creation and performance of legal obligation, whatever their source, is the principle of good faith. Trust and confidence are inherent in international co-operation, in particular in an age when this co-operation in many fields is becoming increasingly essential. Just as the very rule of *pacta sunt servanda* in the law of treaties is based on good faith, so also is the binding character of an international obligation assumed by unilateral declaration.[70]

91. In its Merits Award, the ICSID Tribunal in *AMCO Asia v. Indonesia* determined that the obligation of good faith, as expressed in the *pacta sunt servanda* rule was a principle of international law upon which an investor could found its claim. It therefore concluded that, as a matter of good faith in respect of treaty obligations, the investor was entitled: "to realize the investment, to operate it with a reasonable expectation to make profit and to have the benefit of the incentives provided by law".[71]

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[68] Transcript, Apr. 16, 2002 at p. 387 (Statement of Ms Menaker).
[69] *United States – Standards for Reformulated and Conventional Gasoline*, AB-1996-1, WT/DS2/AB/R, 21 April, 1996 at p. 17.
[70] *Nuclear Test Case (Australia v. France)* (1974) ICJ Rep. 253 at 268.
[71] *AMCO Asia v. Indonesia*, 1 ICSID Reports 377 at p. 493.

92. In *the Anglo-Norwegian Fisheries Case*, the ICJ has gone so far as to state:

> The principle of good faith requires that every right be exercised honestly and loyally. Any fictitious exercise of a right for the purpose of evading either a rule of law or a contractual obligation will not be tolerated. Such an exercise constitutes an abuse of the right, prohibited by law.

93. The conundrum faced by the United States was put into stark relief by the gymnastics of logic that its argument required in order to justify the Federal action. The crux of the U.S. presentation in respect of this issue was that the grant of funds to Virginia was not a Federal procurement and therefore not subject to the promise to refrain from the imposition of domestic preference requirements. However, according to the U.S., conditions attached to that funding constituted procurement.

94. The difficulty could not be clearer because procurement is defined in NAFTA Article 1001(5) to specifically exclude "any form of government assistance, including grants". However, if the Federal grant to the State of Virginia did not constitute procurement, which is admitted by the U.S.[72], those grants would be subject to Chapter Eleven provisions and, in particular, to the prohibition in Article 1106 on attaching performance requirements in connection with the "establishment, acquisition, expansion, management, conduct or operation of an investment".

95. Hence, the U.S. position that, while the grant is not procurement, the conditions imposed within the grant are procurement. But, not all conditions within the grant constitute procurement, some are not procurement.[73] The U.S. then argues that, even though the grant is not procurement, some (but not all) conditions imposed on the grant are procurement. Those "procurement" conditions are Federal conditions (and presumably Federal procurement conditions) but somehow the U.S. is still performing its obligation not to impose domestic preferences in Federal procurement.

96. The U.S. arguments in this respect are disingenuous: While funding state procurement, it escapes its treaty obligations but the conditions attached to the funding – Federal conditions – escape Chapter Eleven discipline because those federal conditions are procurement – but not federal procurement. Simply put, the Buy America program is not good faith performance of the NAFTA obligations undertaken by the U.S. and, in asserting its convoluted argument respecting its interpretation of the relevant terms in NAFTA, the U.S. is putting forward an interpretation which falls far short of a good faith interpretation of the treaty.

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[72] See Transcript, Apr. 16, 2002, at 390 (Statement of Ms. Menaker) ("That funding changed hands between the Federal and State governments does nothing to change this result. That funding was not procurement").

[73] The U.S. has admitted that at least some of the conditions placed on the receipt of funding are not procurement. See Transcript Apr. 16, 2002 (Statement of Mr. Legum discussing conditions imposing State law requirements for purchasing alcoholic beverages) ("Is that measure procurement? No. We would not suggest that it is").

D. Conclusion

97. The Pope Tribunal's Damages Award is useful in demonstrating to this Tribunal that the claims of the US regarding the interpretation and application of Article 1105(1) are completely unfounded. This Tribunal can accept the FTC Interpretation of Article 1105 and conclude that the "fair and equitable treatment and full protection and security" standard refers to the customary international law minimum standard of treatment and easily conclude that the US has committed an abuse of discretion under that standard. It could also conclude that the FTC Interpretation is not valid,

98. The Tribunal could also conclude that the FTC Interpretation freezes the minimum standard owed to investors "in amber" based solely upon the test adopted by a majority of the *Neer* tribunal, and then conclude that the Investor is nonetheless owed a far better level of treatment by virtue of Article 1103 and the protection offered to investors under BITs concluded between the US and countries such as Albania and Estonia. The bottom line is that the manner in which federal US officials acted – in order to harm the business of the Investor and other foreigners in a similar position – was not in conformity with the US' obligations under Article 1105(1). The work of the Pope Tribunal merely brings this fact into sharper focus.

E. Relief Sought

99. The Investor maintains its plea for all of the relief sought in its memorial and reply memorial.

The whole of which is respectfully submitted
Montreal, July 11, 2002

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