IN THE ARBITRATION UNDER CHAPTER ELEVEN
OF THE NORTH AMERICAN FREE TRADE AGREEMENT
AND THE ICSID ARBITRATION (ADDITIONAL FACILITY) RULES

BETWEEN

ADF GROUP INC.

Claimant/Investor

-and-

UNITED STATES OF AMERICA

Respondent/Party

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

SECOND SUBMISSION OF CANADA

PURSUANT TO *NAFTA* ARTICLE 1128

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Introduction

1. This submission provides Canada's observations on certain questions of interpretation of NAFTA arising from the May 31, 2002 Award in *Pope & Talbot, Inc.* v. *Government of Canada*.

2. To the extent this submission does not address certain aspects of the *Pope & Talbot* Award, Canada's silence should not be taken to constitute concurrence with the positions advanced in that decision. Canada takes no position on how the interpretations it submits apply to the facts of this case.

A. PRELIMINARY OBSERVATIONS

3. In its earlier Award of April 10, 2001 (the "Merits Award"), the *Pope & Talbot* Tribunal concluded that the phrase "fair and equitable treatment" is "to be understood and applied independently and autonomously" from the minimum standard of treatment under customary international law.[1] As a result, the Tribunal determined whether Canada treated the investment fairly, "without any threshold limitation that the conduct complained of be "egregious", "outrageous", "shocking," or "otherwise extraordinary."[2] The Tribunal termed this approach "the additive interpretation to Article 1105".[3]

4. The Free Trade Commission (FTC) Interpretation squarely rejects the *Pope & Talbot* Tribunal's "additive" interpretation of Article 1105. The FTC Interpretation confirms that, "Article 1105(1) prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to investments of investors of another Party", and that "[t]he concepts of "fair and equitable treatment" and "full protection and security" do not require treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens."

5. In its Award on Damages, the *Pope & Talbot* Tribunal suggested that the FTC Interpretation is an "amendment", and that in any event, the minimum standard of treatment under customary international law is no longer limited to "egregious" conduct.

6. Canada agrees with the submissions of the United States to this Tribunal[4] addressing the *Pope & Talbot* Award. NAFTA Chapter Eleven awards have "no binding force except

between the disputing parties and in respect of the particular case".[5] Moreover, many of the opinions in the *Pope & Talbot* Award are *obiter dicta*. The persuasiveness of the *Pope & Talbot* Award for other Chapter Eleven tribunals therefore depends on the quality of the Tribunal's reasoning. In Canada's view and for the reasons set out below, this Tribunal should accord little or no weight to the opinions in the *Pope & Talbot* Award.

7. Canada respectfully submits the observations below to the effect that:

- Chapter Eleven Tribunals have no authority to review FTC interpretations;
- The FTC Interpretation is not an "amendment"; and
- The *Pope & Talbot* Tribunal incorrectly interpreted the threshold for establishing a breach of the minimum standard of treatment.

B. ARTICLE 1105

Authority to Review FTC Interpretations

8. Nothing in the NAFTA grants Chapter Eleven tribunals the authority to review interpretations issued by the Commission. Article 1131(2) is unequivocal:

> …[a]n interpretation by the Commission of a provision of this Agreement shall be binding on a Tribunal established under this Section.

9. Despite the clear wording of Article 1131(2), the *Pope & Talbot* Tribunal determined that a Chapter Eleven tribunal should question whether it is bound by a Note of Interpretation. In its view:

> …[i]f a question is raised whether, in issuing an interpretation, the Commission has acted in accordance with Article 2001, an arbitral tribunal has a duty to consider and decide that question and not simply to accept that whatever the Commission has stated to be an interpretation is one for the purposes of Article 1131(2).[6]

10. The Tribunal's analysis reflects a misunderstanding of the respective roles of Chapter Eleven tribunals and of the Free Trade Commission. It is the Parties to the NAFTA acting collectively as the Commission, and not an *ad hoc* tribunal established under a chapter of NAFTA, that is the final authority with respect to the interpretation of the Agreement.

11. The FTC is vested with the prime and final authority as the interpreter of the NAFTA. Article 2001(2) unambiguously states that the "Commission shall (a) supervise the implementation of the Agreement; (b) oversee its further elaboration; [and] (c) resolve disputes that may arise regarding its implementation and application." Acting in their plenary capacity as the Commission, the Parties act as the guardians of the Agreement.

12. By contrast, a tribunal established under Section B of Chapter Eleven is established on an *ad hoc* basis for the sole purpose of arbitrating a particular investment dispute. The jurisdiction of a Chapter Eleven Tribunal is confined to the subject matter set out in Articles 1116 and 1117. That is the full extent of its jurisdiction *ratione materiae*. Nowhere is there any suggestion that Chapter Eleven tribunals should adjudicate an interpretation by the Commission, even where it is contested by an investor.

13. The *Pope & Talbot* Tribunal ignored the relevant context of the word "interpretation" in Article 1131(2), which includes 1131(2) itself, Article 1132(2), and Article 2001.

14. Article 1131(2) provides that interpretations by the Commission "shall be binding" on Chapter Eleven tribunals. In order to give full effect to term "binding", the term "interpretation" cannot be understood to mean an "interpretation with which a tribunal agrees".

15. Article 1132(1), entitled "Interpretation of Annexes", provides that a tribunal must request the interpretation of the Commission on the scope of Annexes I through IV where an issue arises concerning the interpretation of these Annexes. Article 1132(2) states that "[f]urther to Article 1131(2), a Commission interpretation submitted under paragraph 1 shall be binding on the Tribunal", and then goes on to state that "If the Commission fails to submit an interpretation within 60 days, the Tribunal shall decide the issue." Thus, Article 1132(2) makes it clear that where the Commission *does* submit an interpretation on an issue, a tribunal is *not* entitled to decide the issue.

16. Article 2001(2)(c) states that the Commission shall "resolve" disputes that may arise regarding the interpretation of the Agreement. If the Commission's interpretations are subject to review by Chapter Eleven tribunals, then the Commission will be rendered

incapable of "resolving" disputes over the interpretation of the Agreement. Moreover, Article 2001(3)(c) states that the Commission has unlimited power to take "such other action in the exercise of its functions as the Parties may agree".

17. The Tribunal also ignored the purpose of Article 1131(2), which is to ensure that NAFTA Chapter Eleven is applied in a consistent and uniform manner and that the Parties could clarify matters where necessary. That purpose would be undermined if each *ad hoc* Chapter Eleven tribunal could assess and decide whether to reject or accept an interpretation issued by the Commission.

The FTC Interpretation Is Not An "Amendment"

18. Having asserted jurisdiction to review whether an FTC Interpretation is an interpretation for the purposes of Article 1131(2), the Tribunal 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."[7] The Tribunal arrived at this conclusion despite noting that the word "customary" was not included in any of the various drafts of Article 1105 which Canada provided at the request of the Tribunal.

19. After asserting, without any evidence or explanation, that the Article 1105 drafts submitted by Canada were "mutually agreed negotiating texts", the Tribunal proceeded to make the following observations concerning those drafts. The Tribunal noted that "nowhere in the over forty negotiating texts submitted does the word "customary" appear in qualification of "international law" in what eventually became Article 1105; that the first 18 drafts contained the "additive" formulation of the Model U.S. BIT of 1987; and that the final formulation of Article 1105 appeared for the first time in the nineteenth draft. The Tribunal then stated that "[t]he foregoing represents the entirety of what the Tribunal gleaned from the documents provided."[8]

20. The Tribunal found that none of the drafts showed, as had been suggested, that the Parties had considered but rejected a version of Article 1105 expressly referring to "customary" international law. However, the Tribunal still arrives at the inexplicable conclusion that it would characterize the FTC Interpretation as an "amendment" on the basis of those drafts

21. The Tribunal's analysis is fundamentally flawed in at least three other respects.

22. First, the FTC Interpretation is entirely consistent with Article 31 of the *Vienna Convention*, which requires a treaty interpreter to interpret the terms of a treaty in accordance with, among other things, the ordinary meaning of the terms, the context in which the terms appear, and any unilateral instrument made by one of the parties in connection with the conclusion of the treaty within the meaning of Article 31(2)(b) of the *Vienna Convention*.

23. The FTC Interpretation is consistent with the ordinary meaning of the terms of Article 1105. In its Merits Award, the Tribunal recognized that its "additive" interpretation was inconsistent with the ordinary meaning of Article 1105, which provides that "fair and equitable treatment" is "included within international law."[9]

24. The FTC Interpretation is also consistent with the context in which the phrases "fair and equitable treatment" and "international law" appear. The Tribunal admitted that its "additive interpretation" was inconsistent with the "facially sound" contextual interpretation of Article 1105 adopted by the *S.D. Myers* Tribunal. That Tribunal had concluded that:

> Article 1105(1) expresses an overall concept. The words of the article must be read as a whole. The phrases … *fair and equitable treatment* … and … *full protection and security* … cannot be read in isolation. They must be read in conjunction with the introductory phrase … *treatment in accordance with international law.*
>
> The Tribunal considers that a breach of Article 1105 occurs only when it is shown that an investor has been treated in such an unjust or arbitrary manner that the treatment rises to the level that is unacceptable from the international perspective. That determination must be made in the light of the high measure of deference that international law generally extends to the right of domestic authorities to regulate matters within their own borders.[10]

25. The FTC Interpretation is also consistent with the Canadian *Statement of Implementation, North American Free Trade Agreement*[11], a unilateral instrument made by Canada in connection with the conclusion of the NAFTA and therefore a relevant instrument for interpreting the Agreement under Article 31(2)(b) of the *Vienna Convention*. The *Statement of Implementation* set out Canada's view that Article 1105 "provides for a minimum absolute standard of treatment, based on long-standing principles of customary international law".

26. Second, in support of its conclusion that it was "beyond argument" that Article 1105 is "ambiguous", the Tribunal claimed that the interpretation of Article 1105 "has proved to be particularly difficult for various tribunals and, indeed, for the NAFTA Parties themselves", that the Tribunal itself had "grappled with the stark inconsistencies between the provisions of BITs and corresponding commitments in Article 1105" and that "the NAFTA Parties themselves found it necessary to promulgate the Interpretation."[12] The Tribunal notes that "[h]ad the NAFTA Parties not perceived an ambiguity, no interpretation [of Article 1105] would have been necessary."[13]

27. The *Pope & Talbot* Tribunal is the only Chapter Eleven tribunal to adopt the "additive" interpretation of Article 1105. The Parties have consistently expressed the view that Article 1105 incorporates nothing more than the minimum standard of treatment under customary international law. There is no basis under Article 31 of the *Vienna Convention* for taking into consideration any real or perceived "inconsistencies between the provisions of BITs and corresponding commitments in Article 1105". Finally, in finding that FTC interpretations constitute evidence of "ambiguity", the Tribunal turns Article 1131(2) on its head. Following the Tribunal's reasoning, FTC interpretations, rather than clarifying the meaning of a provision in the Agreement, create "ambiguity" that Chapter Eleven tribunals must resolve by recourse to *travaux preparatoires.*

28. Third, and in any event, the Tribunal's suggestion that the FTC Interpretation should be characterized as an "amendment" is irreconcilable with the Tribunal's finding that it is "beyond argument" that Article 1105 is "ambiguous": the conclusion that the FTC Interpretation is an "amendment" rests on the premise that the meaning of Article 1105 is actually perfectly clear.

29. At several places in its Award, the Tribunal seemed to imply that the FTC Interpretation was an "amendment" because Article 38 of the Statute of the International Court of Justice provides that "international law" includes more than "customary" international law.[14] Thus, the Tribunal seems to conclude that the phrase "international law" in Article 1105 includes not only customary international law, but also 'international conventions' under Article 38(1)(a) of the Statute. This interpretation of the phrase "international law" suggests that the

NAFTA Parties intended that all of the obligations contained in the NAFTA, an international convention under Article 38(1)(a) of the Statute, would be encompassed under Article 1105. This interpretation also deprives Articles 1116 and 1117 of any effect, as these provisions limit the scope of investor-State dispute settlement to the obligations found in Section A of Chapter Eleven. Canada respectfully submits that this interpretation is obviously incorrect.

The *Pope & Talbot* Tribunal Incorrectly Interpreted The Threshold For Establishing A Breach Of The Minimum Standard Of Treatment

30. One of the issues in the *Pope & Talbot* arbitration was what threshold should be applied to establish a breach of the minimum standard of treatment in the case of a verification review of a foreign investment initiated by the government. Canada contended that the appropriate threshold is best captured in the classic formulation of the *Neer* case decided by the Mexico-U.S. General Claims Commission. In *Neer*, the Commission held that treatment, in order to meet the threshold, "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 recognize its insufficiency". In other words, only very seriously wrongful conduct meets the threshold for establishing a breach of the minimum standard.

31. The Tribunal suggested that the *Neer* decision no longer reflects the appropriate threshold for establishing a breach of the customary international law minimum standard of treatment. The Tribunal concluded that "[t]hose standards have evolved since 1926, and, were the issue necessary for the Tribunal's decision here, it would propose a formulation more in keeping with the present practice of states." The Tribunal's analysis is based on several errors.

32. First, the Tribunal claimed that "Canada considers that the principles of customary international law were frozen in amber at the time of the *Neer* decision", and that this "static conception of international law" is inconsistent with Canada's "admission" that the minimum standard of treatment evolves over time.

33. Canada's position has never been that the customary international law regarding the treatment of aliens was "frozen in amber at the time of the *Neer* decision". Obviously, what is shocking or egregious in the year 2002 may differ from that which was considered

shocking or egregious in 1926. Canada's position has always been that customary international law can evolve over time, but that the threshold for finding violation of the minimum standard of treatment is still high. The Tribunal mischaracterized Canada's position.

34. Second, the Tribunal relied on the Commentary to the OECD *Draft Convention on the Protection of Foreign Property* to support its claim that the minimum standard of treatment has moved away from the *Neer* formulation. In fact, the Commentary does not support this view. The Commentary simply states that the fair and equitable treatment standard "conforms … to the 'minimum standard' which forms part of customary international law."[15]

35. Third, the Tribunal notes that the *Neer* decision did not concern the "fair and equitable treatment" standard, and that the *Neer* formulation is therefore inapplicable to that standard. This reasoning is circular in that it depends on the premise that the "fair and equitable treatment" standard is "additive" to the minimum standard of treatment under customary international law.

36. Fourth, the Tribunal notes that more than 1800 BITS have been negotiated, and then concludes that "applying the ordinary rules for determining the content of custom in international law, one must conclude that the practice of states is now represented by those treaties." The Tribunal's analysis ignores elementary principles of public international law.

37. Customary international law is established through consistent and widespread state practice based on a sense of legal obligation. The Tribunal's own Awards indicate that BITs reveal no consistent practice. The Tribunal repeatedly emphasizes the "stark inconsistencies" between the provisions of BITs and the corresponding commitments in Article 1105, and among the corresponding provisions of BITs themselves.

38. The Tribunal also ignores the *opinio juris* requirement for establishing a new rule of customary international law. In fact, the Tribunal's Awards implicitly indicate that there is no such *opinio juris*. The Tribunal makes frequent reference to the fact that Canada's belief, "confirmed internationally in its proposals in the FTAA negotiations"[16], is that the *Neer* standard still represents the applicable standard. Clearly, Canada has not considered itself

bound by the "customary" norm the Tribunal purports to find in bilateral investment treaties.

39. Finally, the decision of the Chamber of the International Court of Justice in the *ELSI* case offers no support for the Tribunal's conclusion that the threshold for finding a breach of the minimum standard is merely one of "surprise". The *ELSI* decision did not address the minimum standard of treatment under customary international law. The Chamber's analysis was focused on Article I of the Supplementary Agreement to the 1948 FCN Treaty between Italy and the United States. That provision referred to "arbitrary" measures, and made no reference to "fair and equitable treatment" or the "minimum standard of treatment". Thus, the Chamber's analysis of the term "arbitrary" cannot be seen as a "move away from the *Neer* formulation".

40. In addition, the Chamber did not find that the threshold for characterizing a measure as "arbitrary" was one of mere "surprise". Rather, the Chamber held that "arbitrariness is not something so much opposed to a rule of law, as something opposed to the rule of law." The Court found that arbitrariness should be defined generally as "a wilful disregard of due process of law, an act which shocks, or at least surprises a sense of juridical propriety."[17]

41. The underlying facts in the ELSI case confirm that the threshold for classifying a measure as "arbitrary" under international law is high. In that case, the facts were as follows: the legal basis of the measure was justified only in theory; the measure was incapable of achieving its purported objectives; the measure did not achieve its purported objectives; the measure was in part designed to give the public the impression that the government authority was confronting a problem "in one way or another", rather than prescribing a measure which could have been responsive to the problem; the measure was not simply unlawful but "a typical case of excess of power"; the measure was pursued without regard to relevant treaty obligations; and the authority transgressed the terms of his own order.[18] Notwithstanding these facts, the Chamber found that the measure at issue was not "arbitrary".

All of which is respectfully submitted,

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July 19, 2002

[1] F.A. Mann, "British Treaties for the Promotion and Protection of Investments" 52 B.Y.I.L. (1981) 241, at p. 244, cited by the *Pope & Talbot* Tribunal at footnote 105 of the Merits Award.
[2] See Merits Award, para. 118.
[3] See Merits Award, para. 117.
[4] 'Post-hearing Submission of Respondent United States of America on Article 1105(1) and *Pope & Talbot*', dated June 27, 2002.
[5] Article 1136(1).
[6] At para. 23.
[7] See the Award, para. 47.
[8] At para. 46.
[9] See Merits Award, para. 110.
[10] See Merits Award, at footnote 99.
[11] Canada Gazette, Part I, January 1, 1994.
[12] At para. 25.
[13] At footnote 9.
[14] At paras. 20 and 46.
[15] See OECD, "Council Resolution of 12 October 1967 on the Draft Convention on the Protection of Foreign Property", I.L.M., vo. 7, at page 120 (cited at para. 60 of the Award).
[16] At para. 57. See also footnote 36 of the Award.
[17] *Elettronica Sicula S.P.A. (ELSI)* (U.S. v. Italy), 1989 I.C.J. 15 at 76.
[18] Id., at 113-14.