

measure has caused a complaining member.³⁹ If, as the Appellate Body suggested, the evidence does not support the view that the Byrd Amendment has resulted in the filing of more petitions than would have been the case without it, it is hard to see how the measure would have caused a complainant any compensable loss. It will be interesting to see how the complainants try to surmount this difficult problem.

MARK L. MOVSESIAN
Hofstra Law School

Arbitration—NAFTA Chapter 11—relationship of arbitral tribunals to domestic courts—court judgments as measures—denial of justice—requirement of judicial finality—requirement of continuous nationality—lack of retrospective effect

LOEWEN GROUP, INC. V. UNITED STATES. ICSID Case No. ARB(AF)/98/3. 42 ILM 811 (2003).
At <<http://www.state.gov/documents/organization/22094.pdf>>.
NAFTA Chapter 11 Arbitral Tribunal, June 26, 2003.

MONDEV INTERNATIONAL LTD. V. UNITED STATES. ICSID Case No. ARB(AF)/99/2. 42 ILM 85 (2003). At <<http://www.state.gov/documents/organization/14442.pdf>>.
NAFTA Chapter 11 Arbitral Tribunal, October 11, 2002.

In two recent awards, *Loewen Group, Inc. v. United States* and *Mondev International Ltd. v. United States*, arbitral tribunals rejected claims that U.S. court decisions violated Chapter 11 of the North American Free Trade Agreement (NAFTA).¹ These awards not only articulate standards for “denial of justice” claims under NAFTA, but also address difficult questions regarding the relationship between Chapter 11 tribunals and domestic courts.

Loewen Group, Inc. v. United States

The claim in *Loewen*² grew out of a business dispute between Jeremiah O’Keefe, the owner of a funeral home in Mississippi, and the Loewen Group, Inc. (LG), a Canadian chain of funeral homes that was expanding its operations in the United States. After attempts to reach a settlement failed, O’Keefe’s contract, tort, and state-law antitrust claims went to trial before a Mississippi jury, which awarded O’Keefe \$500 million dollars in damages, including \$75 million for emotional distress and \$400 million in punitive damages. Mississippi law requires a 125% bond to stay execution of a judgment pending appeal. When the Mississippi Supreme Court refused to reduce the required bond, LG settled the case for \$175 million. LG and its owner, Raymond Loewen, then brought claims against the United States under NAFTA Chapter 11, arguing that the trial court violated Article 1102 (national treatment) and Article 1105 (minimum standard of treatment) by allowing prejudicial comments about nationality, racial attitudes, and economic class, that the \$500 million verdict and the bond requirement were denials of justice in violation of Article 1105, and that the end result was an expropriation under Article 1110.

³⁹ Understanding on Rules and Procedures Governing the Settlement of Disputes, Apr. 15, 1994, Art. 22.4, MARRAKESH AGREEMENT ESTABLISHING THE WORLD TRADE ORGANIZATION, Annex 2, in THE LEGAL TEXTS, *supra* note 1, at 354.

¹ North American Free Trade Agreement, Dec. 17, 1992, Can.-Mex.-U.S., 32 ILM 289 & 605 (1993) [hereinafter NAFTA].

² *Loewen Group, Inc. v. United States*, ICSID Case No. ARB(AF)/98/3 (NAFTA Ch. 11 Arb. Trib. June 26, 2003), 42 ILM 811, at <<http://www.state.gov/documents/organization/22094.pdf>> [hereinafter *Loewen award* (merits)]. Publicly released documents on all NAFTA disputes are available online at <<http://www.naftalaw.org>>.

After the arbitral tribunal was constituted,³ the United States raised preliminary objections to its competence on the ground that the Mississippi judgments were not “measures adopted or maintained by a Party.”⁴ In its award on jurisdiction,⁵ the tribunal rejected the United States’ argument that judicial acts in litigation between private parties are not “measures.” It noted that Article 201 defines “measure” broadly to include “any law, regulation, procedure, requirement or practice,” that other provisions of NAFTA indicate that judicial decisions may be measures, and that general principals of state responsibility make states responsible for the acts of their courts. The tribunal found no basis in NAFTA or in international law for excluding court judgments in private disputes.⁶

The United States further argued that the Mississippi judgments were not “adopted or maintained by a Party,” because “State responsibility only arises when there is final action by the State’s judicial system as a whole.”⁷ Apparently in order to avoid the argument that Article 1121 of NAFTA waives the procedural-exhaustion requirement of the local remedies rule,⁸ the United States characterized the rule of judicial finality as a substantive requirement of denial of justice claims.⁹ The tribunal expressed skepticism, stating that “the rule of judicial finality is no different from the local remedies rule. Its purpose is to ensure that the State where the violation occurred should have an opportunity to redress it by its own means, within the framework of its own domestic legal system.”¹⁰ In the end, however, the tribunal decided to consider the argument later—at the hearing on the merits.¹¹ LG subsequently filed for bankruptcy, from which it emerged as a U.S. corporation, with its Chapter 11 claims assigned to a new Canadian subsidiary.

In its award on the merits, the tribunal concluded “that the conduct of the trial by the trial judge was so flawed that it constituted a miscarriage of justice amounting to a manifest injustice as that expression is understood in international law.”¹² The tribunal faulted the trial judge for allowing several different kinds of prejudicial behavior: repeated references to LG’s nationality,¹³ suggestions that LG did business only with white people,¹⁴ and appeals to class-based prejudice.¹⁵ The tribunal also faulted the irregular manner in which the trial judge accepted the jury’s initial verdict on compensatory damages but directed it to reconsider the question of punitive damages.¹⁶

The tribunal focused on NAFTA Article 1105(1) because LG had not provided sufficient evidence of how U.S. investors were treated to allow an evaluation of LG’s Article 1102 claim

³ The tribunal initially comprised Sir Anthony Mason (president), Judge Abner J. Mikva, and L. Yves Fortier. After the award on jurisdiction but prior to the award on the merits, Fortier resigned from the tribunal and was replaced by Lord Mustill.

⁴ NAFTA, *supra* note 1, Art. 1101(1).

⁵ *Loewen Group, Inc. v. United States, Competence and Jurisdiction*, ICSID Case No. ARB(AF)/98/3 (NAFTA Ch. 11 Arb. Trib. Jan. 5, 2001), at <<http://www.state.gov/documents/organization/3921.pdf>> [hereinafter *Loewen award (jurisdiction)*].

⁶ *Id.*, paras. 39–54.

⁷ *Id.*, para. 61.

⁸ *See infra* notes 59–62 and accompanying text.

⁹ *Loewen award (jurisdiction)*, *supra* note 5, para. 61.

¹⁰ *Id.*, para. 71.

¹¹ *Id.*, para. 74.

¹² *Loewen award (merits)*, *supra* note 2, para. 54.

¹³ *Id.*, paras. 56–64.

¹⁴ *Id.*, paras. 65–67.

¹⁵ *Id.*, paras. 68–70. The tribunal excused LG’s failures to object to such comments, reasoning that “[i]n a jury trial, . . . counsel are naturally reluctant to create the impression, by continuously objecting, that they are seeking to suppress relevant evidence or that they are relying on technicalities,” *id.*, para. 73, and found that LG had preserved its claims by requesting a jury instruction addressing nationality, racial, and class bias, *id.*, paras. 84–87.

¹⁶ *Id.*, paras. 88–114, 122.

(national treatment) and because its Article 1110 claim (expropriation) was simply duplicative.¹⁷ Article 1105(1) provides: “Each party shall accord to investments of investors of another party treatment in accordance with international law, including fair and equitable treatment and full protection and security.”¹⁸ Although LG did not establish that the judge or jury was actually biased against it,¹⁹ the tribunal concluded that “bad faith or malicious intention” was not required.²⁰ “Manifest injustice in the sense of a lack of due process leading to an outcome which offends a sense of judicial propriety is enough”²¹ In this case, the tribunal said that “the whole trial and its resultant verdict were clearly improper and discreditable and cannot be squared with minimum standards of international law and fair and equitable treatment.”²²

Nevertheless, the tribunal rejected LG’s Article 1105 claim because LG had failed to pursue its domestic remedies. This conclusion required “qualification” of the tribunal’s statement in the award on jurisdiction that “the rule of judicial finality is no different from the local remedies rule.”²³ Upon reflection, the tribunal concluded that the rules were distinct²⁴ and that whatever impact Article 1121 might have on the local remedies rule with respect to nonjudicial measures, “it says nothing expressly about the requirement that, in the context of a judicial violation of international law, the judicial process be continued to the highest level.”²⁵ The tribunal continued:

¹⁷ *Id.*, paras. 140–41.

¹⁸ NAFTA, *supra* note 1, Art. 1105(1). On July 31, 2001, the NAFTA Free Trade Commission, comprising representatives from the three NAFTA parties, issued an interpretation of Article 1105(1), limiting “international law” to customary international law and stating that “fair and equitable treatment” and “full protection and security” were not meant to go beyond the protections of customary international law:

B. Minimum Standard of Treatment in Accordance with International Law

1. 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.
2. The 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.
3. A determination that there has been a breach of another provision of the NAFTA, or of a separate international agreement, does not establish that there has been a breach of Article 1105(1).

Free Trade Commission Clarifications Related to NAFTA Chapter 11 (July 31, 2001), at <<http://www.ustr.gov/regions/whemisphere/nafta-chapter11.PDF>>. Although claimants had argued that the interpretation amounted to an unauthorized amendment of Chapter 11, they did not press the argument. The tribunal concluded that the interpretation was binding on it under NAFTA Article 1131(2). Loewen award (merits), *supra* note 2, paras. 124–28; compare *Pope & Talbot, Inc. v. Canada, Damages*, para. 47 (NAFTA Ch. 11 Arb. Trib. May 31, 2002), 41 ILM 1347, 1356 (2002) (“were the Tribunal required to make a determination whether the Commission’s action is an interpretation or an amendment, it would choose the latter”).

¹⁹ Loewen award (merits), *supra* note 2, para. 138.

²⁰ *Id.*, para. 132.

²¹ *Id.* The tribunal also quoted with approval two other formulations of a standard for denial of justice: (1) the formulation of the *Mondev* tribunal, *id.* para. 133, *see infra* note 47 and accompanying text; and (2) a phrase from the *ELSI* case on which the tribunal in *Pope & Talbot*, para. 63, 41 ILM at 1358, had relied. *See* Loewen award (merits), *supra* note 2, para. 131 (quoting *Elettronica Sicula S.p.A. (ELSI) (U.S. v. Italy)*, 1989 ICJ REP. 15, 76 (July 20) (“It is a wilful disregard of due process of law, an act which shocks, or at least surprises, a sense of juridical propriety.”)).

²² Loewen award (merits), *supra* note 2, para. 137.

²³ *Id.*, paras. 158–59; *see supra* note 10 and accompanying text.

²⁴ Loewen award (merits), *supra* note 2, paras. 142–56.

²⁵ *Id.*, para. 161. As a condition precedent to submitting a claim, Article 1121 requires the investor and the enterprise to

waive their right to initiate or continue before any administrative tribunal or court under the law of any Party, or other dispute settlement procedures, any proceedings with respect to the measure of the disputing Party that is alleged to be a breach . . . , except for proceedings for injunctive, declaratory or other extraordinary relief, not involving the payment of damages, before an administrative tribunal or court under the law of the disputing Party.

NAFTA, *supra* note 1, Arts. 1121(1)(b) & 1121(2)(b). LG argued that Article 1121 “requires an arbitral claimant to waive its local remedies, not exhaust them.” Loewen award (merits), *supra* note 2, para. 145.

If Article 1121 were to have that effect, it would encourage resort to NAFTA tribunals rather than resort to the appellate courts and review processes of the host State, an outcome which would seem surprising, having regard to the sophisticated legal systems of the NAFTA Parties. . . . Further, it is unlikely that the Parties to NAFTA would have wished to encourage recourse to NAFTA arbitration at the expense of domestic appeal or review when, in the general run of cases, domestic appeal or review would offer more wide-ranging review as they are not confined to breaches of international law.²⁶

The rule of judicial finality imposes “an obligation to exhaust remedies which are effective and adequate and are reasonably available to the complainant in the circumstances in which it is situated.”²⁷ Although the bond requirement meant that appeal to the Mississippi Supreme Court was not “a reasonably available remedy,”²⁸ LG also had the alternative of filing a petition for certiorari with the U.S. Supreme Court challenging the bond requirement as a due process violation and seeking a stay. “[T]he central difficulty in Loewen’s case,” the tribunal concluded, was that “Loewen failed to present evidence disclosing its reasons for entering into the settlement agreement in preference to pursuing other options, in particular the Supreme Court option”²⁹

The tribunal further reasoned that LG’s reorganization in bankruptcy as a U.S. corporation deprived the tribunal of jurisdiction.³⁰ NAFTA Chapter 11 applies only to measures of one NAFTA party relating to investors of *another* NAFTA party or their investments.³¹ Under customary international law, “there must be continuous national identity from the date of the events giving rise to the claim, which date is known as the *dies a quo*, through the date of the resolution of the claim, which date is known as the *dies ad quem*.”³² Although some treaties have altered the requirement of continuous nationality, “such specific provisions in other treaties and agreements only hinder [LG]’s contentions, since NAFTA has no such specific provision.”³³ LG’s attempt to satisfy the continuous nationality requirement by assigning its claims to a new Canadian subsidiary with no other assets was unavailing. “All of the benefits of any award would clearly inure to the American corporation. Such a naked entity as Nafcanco, even with its catchy name, cannot qualify as a continuing national for the purposes of this proceeding.”³⁴

Finally, the tribunal offered a word of explanation for why it had declined to correct what it saw as a clear miscarriage of justice. Emphasizing the limits of Chapter 11 review, the tribunal stated:

As we have sought to make clear, we find nothing in NAFTA to justify the exercise by this Tribunal of an appellate function parallel to that which belongs to the courts of the host nation. In the last resort, a failure by that nation to provide adequate means of remedy may amount to an international wrong but only in the last resort. . . . Too great a readiness to step from outside into the domestic arena, attributing the shape of an international wrong to what is really a local error (however serious), will damage both the integrity of the domestic judicial system and the viability of NAFTA itself.³⁵

²⁶ Loewen award (merits), *supra* note 2, para. 162.

²⁷ *Id.*, para. 168.

²⁸ *Id.*, para. 208. The tribunal concluded that the refusals of the trial judge and the Mississippi Supreme Court to reduce the bond were not themselves violations of Article 1105. *Id.*, paras. 189, 197.

²⁹ *Id.*, para. 215.

³⁰ This holding would seem to render the rest of the award unnecessary, but the tribunal explained: “As our consideration of the merits of the case was well advanced when Respondent filed this motion to dismiss [for lack of jurisdiction] and as we reached the conclusion that Claimants’ NAFTA claims should be dismissed on the merits, we include in this Award our reasons for this conclusion.” *Id.*, para. 2.

³¹ NAFTA, *supra* note 1, Art. 1101(1).

³² Loewen award (merits), *supra* note 2, para. 225.

³³ *Id.*, para. 229.

³⁴ *Id.*, para. 237.

³⁵ *Id.*, para. 242.

Mondev International v. United States

The claim in *Mondev*³⁶ arose out of a real estate development contract concluded in 1978 between the City of Boston (City), the Boston Redevelopment Authority (BRA), and Lafayette Place Associates (LPA), a limited partnership owned by the Canadian company Mondev International Ltd. One provision of this contract gave LPA the option to purchase a piece of land known as the Hayward Parcel by January 1, 1989, at a price calculated by a formula in the contract. The City, believing the option price to be too low in light of the intervening surge in real estate prices, allegedly tried to frustrate exercise of the option. LPA had leased its rights in the project to Campeau, another Canadian developer, which notified the City in December 1988 that it wished to buy the parcel. Campeau never made a formal tender of payment, however, and LPA terminated the lease after Campeau defaulted on its obligations. Subsequently, Manufacturers Hanover Trust foreclosed on both LPA's and Campeau's interests in the project.

In March 1992, LPA brought suit in Massachusetts state court against the City for breach of contract and against BRA for intentional interference with contractual relations. The jury found for LPA on both claims, but the trial judge set aside the tort judgment on the ground that BRA was immune from liability for intentional torts under a Massachusetts statute. On appeal, the Massachusetts Supreme Judicial Court (SJC) affirmed BRA's tort immunity and reversed the judgment against the City for breach of contract. In a unanimous opinion authored by Justice Charles Fried, the SJC held that LPA could not claim that the City was in breach, because LPA had not formally tendered its own performance under the option.³⁷ The U.S. Supreme Court denied LPA's petition for certiorari.³⁸

Mondev then brought a claim against the United States under Chapter 11 of NAFTA, alleging violations of Articles 1102 (national treatment), 1105 (minimum standard of treatment), and 1110 (expropriation). The Chapter 11 tribunal dismissed Mondev's claims in their entirety.³⁹

The tribunal concluded that only Mondev's Article 1105 claims were properly before it because the alleged expropriation in violation of Article 1110 and the alleged discrimination in violation of Article 1102 had both occurred prior to NAFTA's entry into force on January 1, 1994, and NAFTA is not retrospective.⁴⁰

The tribunal accepted the clarifications of Article 1105(1) issued by the NAFTA Free Trade Commission (FTC) as legitimate.⁴¹ The tribunal further noted, however, that customary international law evolves, and concluded that the phrase "customary international law" in the FTC's interpretation "refers to customary international law as it stood no earlier than the time at which NAFTA came into force."⁴² The tribunal therefore rejected the suggestion that the minimum standard be limited to the standard articulated by the Mexican Claims Commission in the *Neer* case—that "the treatment of an alien . . . should amount to an outrage, to bad faith, to wilful 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."⁴³

³⁶ *Mondev Int'l Ltd. v. United States*, ICSID Case No. ARB(AF)/99/2 (NAFTA Ch. 11 Arb. Trib. Oct. 11, 2002), 42 ILM 85 (2003), at <<http://www.state.gov/documents/organization/14442.pdf>> [hereinafter *Mondev award (merits)*].

³⁷ *Lafayette Place Assoc. v. Boston Redevelopment Authority*, 694 N.E.2d 820 (Mass. 1998).

³⁸ *Lafayette Place Assoc. v. City of Boston*, 525 U.S. 1177 (1999).

³⁹ The tribunal consisted of Sir Ninian Stephan (president), James Crawford, and Judge Stephen Schwebel.

⁴⁰ *Mondev award (merits)*, *supra* note 36, paras. 57–75. Alternatively, the tribunal suggested that these claims would have been barred by the three-year statute of limitations. See NAFTA, *supra* note 1, Art. 1116(2) ("An investor may not make a claim if more than three years have elapsed from the date on which the investor first acquired, or should have first acquired, knowledge of the alleged breach and knowledge that the investor has incurred loss or damage."); see also *id.*, Art. 1117(2). The tribunal said it would not have accepted Mondev's argument that it could not have had "knowledge of . . . loss or damage" prior to the court decisions denying it relief. *Mondev award (merits)*, *supra* note 36, para. 87.

⁴¹ *Mondev award (merits)*, *supra* note 36, paras. 121–22; see *supra* note 18.

⁴² *Mondev award (merits)*, *supra* note 36, para. 125.

⁴³ *Neer (U.S.A.) v. United Mexican States*, 4 R.I.A.A. 60 (U.S.–Mexico Gen'l Claims Comm'n) (1926); see *Mondev award (merits)*, *supra* note 36, paras. 114–17, 125.

The tribunal then turned to consider the specific standard for denial of justice claims, emphasizing “the importance of the specific context in which an Article 1105(1) claim is made.”⁴⁴

It is one thing to deal with unremedied acts of the local constabulary and another to second-guess the reasoned decisions of the highest courts of a State. Under NAFTA, parties have the option to seek local remedies. If they do so and lose on the merits, it is not the function of NAFTA tribunals to act as courts of appeal.⁴⁵

Building on the *ELSI* case’s description of arbitrary conduct as that which displays “a wilful disregard of due process of law, . . . which shocks, or at least surprises, a sense of judicial propriety,”⁴⁶ the tribunal articulated the following standard for denial of justice:

The test is not whether a particular result is surprising, but whether the shock or surprise occasioned to an impartial tribunal leads, on reflection, to justified concerns as to the judicial propriety of the outcome, bearing in mind on the one hand that international tribunals are not courts of appeal, and on the other hand that Chapter 11 of NAFTA (like other treaties for the protection of investments) is intended to provide a real measure of protection. In the end the question is whether, at an international level and having regard to generally accepted standards of the administration of justice, a tribunal can conclude in the light of all the available facts that the impugned decision was clearly improper and discreditable, with the result that the investment has been subjected to unfair and inequitable treatment.⁴⁷

Applying this standard to *Mondev*’s claim, the tribunal found no denial of justice. The SJC’s dismissal of LPA’s contract claim against the City based on LPA’s failure to tender its own performance was simply an application of existing Massachusetts law, or at most the development of Massachusetts law “within the limits of common law adjudication. There is nothing here to shock or surprise even a delicate judicial sensibility.”⁴⁸ Turning to the SJC’s decision that BRA was statutorily immune from tort liability, the tribunal reasoned that, “within broad limits, the extent to which a State decides to immunize regulatory authorities from suit for interference with contractual relations is a matter for the competent organs of the State to decide,”⁴⁹ that there were legitimate reasons why a legislature might wish to so immunize a redevelopment agency, and that there was thus no breach of Article 1105 in this case.⁵⁰

* * * *

Both the *Loewen* and the *Mondev* tribunals repeatedly emphasized that it was not their function to serve as courts of appeal from domestic decisions,⁵¹ but because of differences in the cases, each tribunal interpreted that principle in a different way. The *Loewen* tribunal required that a Chapter 11 claimant wishing to challenge a judicial decision first exhaust its domestic remedies; the concern was that a failure to require exhaustion “would encourage

⁴⁴ *Mondev* award (merits), *supra* note 36, para. 126.

⁴⁵ *Id.*

⁴⁶ *Elettronica Sicula S.p.A. (ELSI) (U.S. v. Italy)*, 1989 ICJ REP. 15, 76 (July 20).

⁴⁷ *Mondev* award (merits), *supra* note 36, para. 127. The tribunal conceded that “[t]his is admittedly a somewhat open-ended standard, but it may be that in practice no more precise formula can be offered to cover the range of possibilities.” *Id.*

⁴⁸ *Id.*, para. 133. After examining *Mondev*’s claims that the Massachusetts Supreme Judicial Court should have remanded the contract claim and considered whether its allegedly new rule should have been applied retrospectively, the tribunal concluded that these questions were matters of local practice and did not constitute denials of justice. *Id.*, paras. 135–38.

⁴⁹ *Id.*, para. 154.

⁵⁰ *Id.*, paras. 153–54.

⁵¹ See *supra* notes 26, 35, 45, 47 and accompanying text; see also *Loewen* award (merits), *supra* note 2, para. 51 (“The Tribunal cannot under the guise of a NAFTA claim entertain what is in substance an appeal from a domestic judgment.”); *id.*, para. 134 (“A NAFTA claim cannot be converted into an appeal against the decisions of municipal courts.”); *Mondev* award (merits), *supra* note 36, para. 136 (“On the approach adopted by *Mondev*, NAFTA tribunals would turn into courts of appeal, which is not their role.”).

resort to NAFTA tribunals rather than resort to the appellate courts and review processes of the host State.⁵² By contrast, the *Mondev* tribunal adopted a deferential “clearly improper and discreditable” standard for reviewing domestic decisions,⁵³ reasoning that “[i]t is one thing to deal with unremedied acts of the local constabulary and another to second-guess the reasoned decisions of the highest courts of a State.”⁵⁴ These two strategies to avoid acting as courts of appeal are in tension, however, for if one requires exhaustion of domestic remedies *and* applies a deferential standard of review to those domestic decisions, the result may be to insulate violations of Chapter 11 from effective review by international tribunals.

As a matter of policy, there is much to be said for requiring exhaustion of domestic remedies before allowing an investor to bring claims before a Chapter 11 tribunal. From the state’s point of view, an exhaustion requirement “afford[s] the State the opportunity of redressing through its legal system the inchoate breach of international law occasioned by the lower court decision.”⁵⁵ From the investor’s point of view, “domestic appeal or review would offer more wide-ranging review as they are not confined to breaches of international law.”⁵⁶ One might also add that domestic court review is more determinate (because domestic law tends to be better developed), more accountable (because domestic courts are less insulated from review), and more legitimate (legitimacy being a function of both accountability and determinacy) than review by Chapter 11 tribunals.⁵⁷ And although the *Loewen* tribunal limited its exhaustion requirement to judicial decisions, the same factors argue in favor of requiring exhaustion of domestic remedies with respect to other measures alleged to violate Chapter 11.⁵⁸

As desirable as an exhaustion requirement may be in theory, however, the *Loewen* award is in considerable tension with the text of NAFTA and the decisions of other Chapter 11 tribunals. Customary international law requires the exhaustion of local remedies before bringing an international claim,⁵⁹ but this rule may be waived by international agreement.⁶⁰ NAFTA Article 1121 establishes that, as a condition precedent to bringing a Chapter 11 claim, the

⁵² *Loewen* award (merits), *supra* note 2, para. 162.

⁵³ *Mondev* award (merits), *supra* note 36, para. 127.

⁵⁴ *Id.*, para. 126.

⁵⁵ *Loewen* award (merits), *supra* note 2, para. 156.

⁵⁶ *Id.*, para. 162. LG could, for example, have challenged the punitive damages award as excessive under Mississippi law, *see* Miss. Code Ann. §11-1-65 (2001), *Andrew Jackson Life Ins. Co. v. Williams*, 566 So. 2d 1172 (Miss. 1990), and under the Due Process Clause of the U.S. Constitution, *see State Farm Mut. Auto. Ins. Co. v. Campbell*, 538 U.S. 408 (2003), *BMW of N. Am., Inc. v. Gore*, 517 U.S. 559 (1996), *TXO Prod. Corp. v. Alliance Res. Corp.*, 509 U.S. 443 (1993).

Domestic appeals could be made more effective in redressing Chapter 11 violations if U.S. and Canadian implementing legislation were changed to make NAFTA enforceable in domestic court. *See* 19 U.S.C.A. §3312(c)(2) (“No person other than the United States . . . may challenge, in any action brought under any provision of law, any action or inaction by any department, agency, or other instrumentality of the United States, any State, or any political subdivision of a State on the ground that such action or inaction is inconsistent with the [NAFTA].”); North American Free Trade Agreement Implementation Act, ch. 44, 1993 S.C. 1924–25 (Can.) (“Subject to Section B of Chapter Eleven of the Agreement, no person has any cause of action and no proceedings of any kind shall be taken, without the consent of the Attorney General of Canada, to enforce or determine any right or obligation that is claimed or arises solely under or by virtue of the Agreement.”). Investors may raise Chapter 11 claims in Mexican courts but are subsequently precluded from raising the same claims before a NAFTA tribunal. *See* NAFTA, Annex 1120.1(a) (“an investor of another Party may not allege that Mexico has breached an obligation under [NAFTA] . . . both in an arbitration under this Section and in proceedings before a Mexican court or administrative tribunal”).

⁵⁷ William S. Dodge, *Loewen v. United States: Trials and Errors Under NAFTA Chapter Eleven*, 52 DEPAUL L. REV. 563, 570–71 (2002) (published before the *Loewen* tribunal’s award on the merits); *see also* Charles H. Brower II, *Structure, Legitimacy, and NAFTA’s Investment Chapter*, 36 VAND. J. TRANSNAT’L L. 37 (2003) (discussing legitimacy of Chapter 11 review).

⁵⁸ Dodge, *supra* note 57, at 575–77. This discussion assumes that domestic courts provide adequate remedies. U.S. and Canadian courts certainly do, and the same is probably true of Mexican courts. Customary international law excuses a claimant from exhausting local remedies when doing so would be futile. *See* C. F. AMERASINGHE, *LOCAL REMEDIES IN INTERNATIONAL LAW* 193–94 (1990).

⁵⁹ *Interhandel (Switz. v. U.S.)*, 1959 ICJ REP. 5, 27 (Mar. 21) (“The rule that local remedies must be exhausted before international proceedings may be instituted is a well-established rule of customary international law.”); *see generally* AMERASINGHE, *supra* note 58.

⁶⁰ *Elettronica Sicula S.p.A. (ELSI) (United States v. Italy)*, 1989 ICJ REP. 15, 42 (July 20) (expressing “no doubt that the parties to a treaty can therein either agree that the local remedies rule shall not apply to claims based on alleged breaches of that treaty”); *see* AMERASINGHE, *supra* note 58, at 251–75.

claimant waive its “right to initiate or continue before any administrative tribunal or court” any proceedings with respect to the measure alleged to breach NAFTA, “except for proceedings for injunctive, declaratory or other extraordinary relief, not involving the payment of damages.”⁶¹ Other NAFTA tribunals have unanimously concluded that Article 1121 waives the local remedies rule for Chapter 11 claims.⁶² Of course, the awards cited did not involve challenges to domestic court decisions, and the *Loewen* tribunal distinguished its substantive rule of judicial finality from the procedural requirements of the local remedies rule.⁶³ But *Loewen* does squarely conflict on this point with *Mondev*, which did involve a challenge to a domestic court decision. The *Mondev* tribunal assumed that an investor claiming denial of justice was *not* required to exhaust domestic remedies:

[U]nder the system of Chapter 11, it will be a matter for the investor to decide whether to commence arbitration immediately, with the concomitant requirement under Article 1121 of a waiver of any further recourse to any local remedies in the host State, or whether initially to claim damages with respect to the measure before the local courts. . . . Thus under NAFTA it is not true that the denial of justice rule and the exhaustion of local remedies rule “are interlocking and inseparable.”⁶⁴

Indeed, the *Mondev* tribunal justified its deferential standard of review, at least in part, on the ground that the investor had *chosen* to appeal through the Massachusetts courts: “Under NAFTA, parties have the option to seek local remedies. If they do so and lose on the merits, it is not the function of NAFTA tribunals to act as courts of appeal.”⁶⁵

The *Mondev* tribunal’s alternative strategy to avoid functioning as a court of appeal was to adopt a deferential standard for denial of justice claims. It is noteworthy that *Mondev* supported this approach with a quotation from the Chapter 11 award in *Azinian v. Mexico*: “The possibility of holding a State internationally liable for judicial decisions does not, however, entitle a claimant to seek international review of the national court decisions as though the international jurisdiction seised has plenary appellate jurisdiction. This is not true generally, and it is not true for NAFTA.”⁶⁶ In *Azinian* the investors had appealed a city council decision annulling their concession contract to the Mexican courts, and lost. The Chapter 11 tribunal suggested that Mexican court decisions should be given *res judicata* effect, thereby foreclosing the investors’ expropriation claims unless the Mexican decisions themselves constituted a denial of justice.⁶⁷ The *Mondev-Azinian* approach of denying an investor two bites at the apple seems premised on the notion that if the investor chooses to pursue its claims in domestic court, it should have to live with the result absent an extraordinary miscarriage of justice.

⁶¹ NAFTA, *supra* note 1, Arts. 1121(1)(b), 1121(2)(b).

⁶² See *Feldman v. Mexico*, ICSID Case No. ARB(AF)/99/1, para. 73 (NAFTA Ch. 11 Arb. Trib. Dec. 16, 2002), 42 ILM 625, 639 (2003) (“Article 1121(2)(b) and (3) substitutes itself as a qualified and special rule on the relationship between domestic and international judicial proceedings, and a departure from the general rule of customary international law on the exhaustion of local remedies.”); *Waste Management, Inc. v. Mexico*, Mexico’s Preliminary Objection Concerning the Previous Proceedings, ICSID Case No. ARB(AF)/00/3, para. 30 (NAFTA Ch. 11 Arb. Trib. June 26, 2002), 41 ILM 1315, 1321 (2002) (“In common with almost all investment treaties, there is no requirement of exhaustion of local remedies.”); *Metalclad Corp. v. Mexico*, ICSID Case No. ARB(AF)/97/1, para. 97 n.4 (NAFTA Ch. 11 Arb. Trib. Aug. 30, 2000), 40 ILM 36, 49 n.4 (2001) (“Mexico does not insist that local remedies must be exhausted. Mexico’s position is correct in light of NAFTA Article 1121(2)(b) . . .”); see also William S. Dodge, *National Courts and International Arbitration: Exhaustion of Remedies and Res Judicata Under Chapter Eleven of NAFTA*, 23 HASTINGS INT’L & COMP. L. REV. 357, 373–76 (2000) (arguing that Article 1121 waives the local remedies rule).

⁶³ See *supra* notes 24–25 and accompanying text.

⁶⁴ *Mondev* award (merits), *supra* note 36, para. 96 (quoting C. EAGLETON, THE RESPONSIBILITY OF STATES IN INTERNATIONAL LAW 113 (1928)).

⁶⁵ *Id.*, para. 126.

⁶⁶ *Id.* (quoting *Azinian v. Mexico*, ICSID Case No. ARB(AF)/97/2, para. 99 (NAFTA Ch. 11 Arb. Trib. Nov. 1, 1999), 39 ILM 537, 552 (2000)).

⁶⁷ *Azinian v. Mexico*, paras. 96–100, 39 ILM at 551–52. The rule in customary international law is that the decisions of domestic courts do not bind international tribunals as *res judicata*. See, e.g., *Amco Asia Corp. v. Republic of Indonesia* (Nov. 20, 1984), 1 ICSID REP. 413, 460 (1993) (“an international tribunal is not bound to follow the result of a national court”). For further discussion, see Dodge, *supra* note 62, at 365–370, 376–83.

The *Mondev-Azinian* deference to domestic court decisions is open to criticism, however—whether exhaustion is required or not. Without an exhaustion requirement, such deference will “encourage resort to NAFTA tribunals rather than resort to the appellate courts and review processes of the host State.”⁶⁸ Indeed, this dynamic is likely to be strongest for those investors with the weakest claims. “An investor that doubts its chances of success in a domestic appeal may nevertheless be willing to gamble on getting a sympathetic Chapter 11 tribunal whose decision will be largely insulated from review.”⁶⁹ But with an exhaustion requirement, one of the principal justifications for deference disappears, for one cannot fault an investor for taking two bites at the apple if it was forced to take the first bite.⁷⁰ Moreover, if an investor is required to exhaust its remedies in domestic court and if arbitral tribunals then defer to the decisions of those courts, investors may be denied the “real measure of protection”⁷¹ that Chapter 11 is intended to provide.

At present, the problem is not grave. *Mondev*’s “clearly improper and discreditable” standard,⁷² while deferential, plainly allows more meaningful review than the “outrage” standard of the *Neercase* that the *Mondev* tribunal rejected.⁷³ *Loewen*’s exhaustion requirement applies only to judicial decisions and not to other measures alleged to breach Chapter 11.⁷⁴ Given the different directions in which these two awards point, however, it is apparent that the relationship between domestic courts and NAFTA Chapter 11 tribunals still needs to be worked out. My own view is that investors should be required to exhaust their remedies in domestic courts before bringing Chapter 11 claims, but that NAFTA tribunals should not be bound to follow those results.⁷⁵ These rules are, of course, the ones that customary international law has developed to mediate between national courts and international tribunals.⁷⁶ The NAFTA parties may have been unwise to abandon them so hastily.

WILLIAM S. DODGE

University of California, Hastings College of the Law

Headquarters agreements of international organizations—privileges and immunities of international civil servants—income taxation in France of retirement pensions of former UNESCO officials

UNESCO-FRANCE ARBITRATION. Award. 107 REVUE GÉNÉRALE DE DROIT INTERNATIONAL PUBLIC 221 (2003).

Arbitral tribunal, January 14, 2003.

In an effort to overcome a conflict that had resisted a negotiated solution for nearly a decade, France and the UN Educational, Scientific and Cultural Organization (UNESCO) agreed in

⁶⁸ *Loewen* award (merits), *supra* note 2, para. 162; *see also* *Azinian v. Mexico*, para. 86, 39 ILM at 550 (“it would be unfortunate if potential claimants under NAFTA were dissuaded from seeking relief under domestic law from national courts, because such actions might have the salutary effect of resolving the dispute without resorting to investor-state arbitration under NAFTA”).

⁶⁹ Dodge, *supra* note 57, at 575.

⁷⁰ *See supra* notes 65–67 and accompanying text.

⁷¹ *Mondev* award (merits), *supra* note 36, paras. 119, 127.

⁷² *Id.*, para. 127.

⁷³ *See supra* note 43 and accompanying text. The *Loewen* tribunal’s standard—“[m]anifest injustice in the sense of a lack of due process leading to an outcome which offends a sense of judicial propriety”—seems substantively identical to *Mondev*’s. Moreover, the *Loewen* tribunal both quoted and applied *Mondev*’s standard. *See supra* notes 21–22 and accompanying text.

⁷⁴ *See supra* notes 23–26 and accompanying text.

⁷⁵ *See* Dodge, *supra* note 57.

⁷⁶ *See, e.g., Interhandel (Switz. v. U.S.)*, 1959 ICJ REP. 5, 27 (Mar. 21) (“The rule that local remedies must be exhausted before international proceedings may be instituted is a well-established rule of customary international law.”); *Amco Asia Corp. v. Republic of Indonesia* (Nov. 20, 1984), 1 ICSID REP. 413, 460 (1993) (“an international tribunal is not bound to follow the result of a national court”); *see generally* Dodge, *supra* note 62, at 360–70.