THE INTERNATIONAL CENTRE FOR SETTLEMENT OF INVESTMENT DISPUTES

The Mexican Experience

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I. INTRODUCTION

The purpose of this comment is to provide a summary about Mexico's recent experience with investment arbitration and share an opinion about the same. For this purpose I shall give a general explanation regarding the International Centre for the Settlement of Investment Disputes ("ICSID") and then summarize the cases in which Mexico has acted as defendant, which have been brought under ICSID's Additional Facility.

II. ICSID

A. Background[1]

After World War II the World Bank[2] was created with the purpose of encouraging and financing projects, particularly in developing countries.

Almost immediately the founders of this institution realized that the resources of the World Bank would be insufficient to reach the ambitious goals of financing infrastructure and development projects in developing countries. Thus the importance of private resources in the pursuit of the above-mentioned objectives became evident. Foreign investments became a very important matter in the future association between wealthy

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1 From the sources consulted for the preparation of this study the following are of particular interest: several articles of Aron Broches (*See, in general*, Aron Broches, SELECTED ESSAYS. WORLD BANK, ICSID, AND OTHER SUBJECTS OF PUBLIC AND PRIVATE INTRENATIONAL LAW, Martinus Nijhoff Publishers, The Hague, 1995); likewise, the discussion found at INVESTISSEMENTS ETRANGERS ET ARBITRAGE ENTRE ETATS ET PERSONNES PRIVEES. La Convention B.I.R.D. du 18 Mars 1965, Centre de Recherche sur le Droit des Marchés et des Investissements Internationaux de la Faculté de Droit et des Sciences Économiques de Dijon, Ed. Pedone, Paris, 1969; as well as the *travaux preparatoires* of the ICSID convention.

2 The International Bank for Reconstruction and Development (the "World Bank") is not only a bank that facilitates funds, but an institution engaged in economic development.

and poor countries in order to achieve worldwide development and substituting the financial deficiencies which the World Bank would necessarily face.

In the context of fostering international investment, one of the obstacles that appeared was the fact that many countries that needed the resources the most to finance development programs presented an unfavorable investment environment since the "political risk"[3] existing in these countries constituted an almost unsurmountable obstacle to convince private investors to invest in them. This was especially true once the investment opportunities offered by other markets were taken into consideration. After all, how could an investor justify an investment made in a high-risk market when there were other possibilities for investment that offered a similar or higher rate of return at a lower risk?

Faced with these circumstances, the architects of the international financial system came up with the following solution. If an impartial forum with a reliable remedy could be offered to foreign investors in countries with a high political risk, so that any dispute that could arise with regards to their investment could be solved by reputable organs in a fair way, the political risk would be reduced and investing in the respective countries would become financially justified. Hence, the investment needed for development would ensue.

As a result ICSID was created by means of the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (the "ICSID Convention"), which entered into force on October 14, 1966, and has its offices in the World Bank, Washington, D.C.

The purpose of ICSID is to facilitate the submission of investment disputes to conciliation[4] or arbitration,[5] between the Contracting States of the ICSID Convention and nationals of other Contracting States.

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[3] For financial purposes, this term (also known as "country risk analysis") implies much more than that the stability of the political system of a country. It comprises every factor that may have an influence on the political environment and the economic market, and thus may be relevant for purposes of investment, such as: the legal framework; compliance with laws; social and political factors; the existence of language, ethnic and religious differences that may diminish the stability of a country; extreme nationalist or xenophobic movements that could give rise to preferences in treatment to nationals vis-à-vis foreigners; unfavorable social conditions (including social polarization); social unrest; violence; the existence of "guerrillas"; the force and organization of radical groups; foreign debt; international reserves; economic growth; exports; etc. (see Steven Husted and Michael Melvin, INTERNATIONAL ECONOMICS, Ed. Addison Wesley, U.S.A. Fourth Ed., 1998, pgs. 527-531.)

[4] The conciliation procedure is governed by Articles 28 to 35 of the ICSID Convention as well as by the Rules of Procedure for Conciliation Proceedings ("Conciliation Rules").

[5] See Article 1(2) of the ICSID Convention. The arbitration procedure is ruled by Articles 36 to 55 of the ICSID Convention as well as by the Rules of Procedure for Arbitration Proceedings ("Arbitration Rules").

B. The Legal Nature of ICSID Arbitration

ICSID arbitration has some special characteristics. Generally, there are three basic types of arbitration:

1. **Public Arbitration**: An arbitration is considered public when the parties are sovereign. For example, the arbitration of Isla de la Pasion or Clipperton between Mexico and France of 1909.[6]

2. **Private Arbitration**: An arbitration is considered private when the parties involved are private entities. An example of this type of arbitration is that followed between two corporations carried out in accordance with the Rules of Arbitration of the International Court of Arbitration, International Chamber of Commerce.

3. **Mixed Arbitration**: An arbitration is mixed when it relates to a dispute between a state and a private entity. It is within this category that we find ICSID arbitration.

C. Jurisdictional Requirements

ICSID is a *sui generis* institution that has a restricted scope of "jurisdiction."[7] That is, three requirements must be met so that ICSID jurisdiction may exist: (1) consent, (2) the *ratione personae* requirement and (3) the *ratione materiae* requirement.

1. Consent

Both parties must agree to ICSID jurisdiction. Being a Contracting State to the ICSID Convention does not fulfill the consent requirement. Consent to arbitration must be given to the specific dispute. Likewise, being a Contracting State to the ICSID Convention does not impose any obligation to submit any particular dispute to arbitration. Nevertheless, once consent has been granted, it cannot be withdrawn unilaterally.

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[6] This arbitration was agreed to by the Treaty between Mexico and France to Submit to Arbitration the Property of *Isla de la Pasión* of March 2, 1909. Other examples are the arbitration of the *Fondo Piadoso de las Californias* (formally known as the case of Tadeus Amat and Joseph Alemany against Mexico, resolved by a Commission established to settle disputes between Mexico and the United States of America, pursuant to a Convention dated July 4, 1868) and the *Chamizal* case (followed pursuant to the Treaty for the settlement of the Chamizal Case between Mexico and the United States of America dated June 24, 1910).

[7] I employ the word "jurisdiction" since it is the term that the ICSID Convention (Article 25) has given to the admissibility requirements for the Secretary – General to accept a case. Nevertheless, strictly speaking, since ICSID itself does not solve the disputes submitted to its supervision, but rather the arbitrators appointed for this purpose, the appropriate term is not "jurisdiction," as this refers to the capacity of solving disputes by applying general laws to a particular dispute.

In this context, it is important to mention an exception or, rather, a redefinition of this concept. Traditionally, the paradigm that the source and *sine qua non* condition for an arbitration procedure is the existence of a valid arbitration agreement, in which the respective parties have consented to submit any dispute to arbitration, has prevailed. This assumed the existence of a contractual relationship, either through an arbitration clause or an independent arbitration agreement.

Recently, this paradigm has been relaxed. As a result of the manner in which several laws have been drafted with the purpose of attracting foreign investment, what an experienced practitioner and author[8] has baptized as "arbitration without privity," has surged. These types of arbitrations have occurred as a result of a promise made by a State to foreign investors to settle through arbitration any dispute that could arise as a result of their investment. These promises have been provided for in two bodies of law:

a). Foreign Investment Laws: an example of this is the case *SPP v. Egypt*[9] in which jurisdiction was grounded on the Egyptian Foreign Investment Law of 1974.

b). Investments Treaties: as an example, the case *AAPL v. Sri Lanka*[10] may be quoted, where claimant, a Hong Kong company, claimed ICSID jurisdiction on the ICSID Bilateral Investment Treaty between the United Kingdom and Sri Lanka.

Having explained the consent requirement, it is necessary to note that consent by itself is not enough to secure ICSID jurisdiction, the subjective and objective requirements must also be present.

2. *Ratione Personae* Requirement

The subjective or *ratione personae* requirement involves the need of one of the parties in the arbitration to be a Contracting State of the ICSID Convention[11] and the other a national (private entity) of another ICSID Convention Contracting State.

With regards to the requirement of nationality of the investor, a positive and negative requirement is involved. The positive requirement is that the investor must have the

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8 Jan Paulsson, ARBITRATION WITHOUT PRIVITY, 10 ICSID Review - Foreign Investment Law Journal, at 232 (1995). Also see W. Lawrence Craig, William W. Park, and Jan Paulsson, INTERNATIONAL CHAMBER OF COMMERCE ARBITRATION, Third Edition, 2000, Oceana Publications, Inc., pgs. 663 – 670.

9 ICSID Case No. ARB/84/3.

10 ICSID Case No. ARB/87/3.

11 Or a subdivision or agency of the Contracting State acting with the State's approval.

nationality of a Contracting State of the ICSID Convention. The negative requirement is that the investor cannot have the nationality of the State with which it has a dispute.[12]

From a legal standpoint, in my opinion, this is the most amazing feature of the ICSID Convention: the capacity of a private entity to proceed directly against a State in an international forum, without the need for intervention from their government. Moreover, the ICSID Convention provides that when an investor and a State have agreed to submit their disputes to ICSID arbitration, the State of the investor may not grant diplomatic protection or file any international claim in connection with this dispute, unless the host state breaches the award.

3. *Ratione Materiae* Requirement

The *ratione materiae* or objective requirement includes two conditions:

a). The dispute or controversy must be of a "legal nature."
During the drafting of the ICSID Convention it was stressed that only legal disputes could be contested before ICSID. Disputes of a political, economic, financial or commercial nature were excluded from ICSID's jurisdiction. Therefore, disputes involving commercial risks are not within the scope of ICSID's jurisdiction. Likewise, by referring to legal disputes it was assumed that conflicts of interest were excluded.

b). The dispute must result directly from an "investment."
From the travaux preparatoires it can be observed that, although this requirement was stressed, it was never defined. This was not an oversight but an intentional lacunae resulting from the divergence of opinion found in economic literature with regards to this concept, as well as the definitions given in that respect by several foreign investment laws. Therefore, it was deemed convenient to leave the term undefined so that the arbitrators could analyze it having all the circumstances of the case at their disposal. Likewise, they considered that arriving at an acceptable definition of the term "investment" came second after the essential requirement of the consent of the parties.[13]

D. Applicable Procedural Law

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[12] An exception to this is where a legal entity that has the nationality of the State party to the dispute may be considered as a foreign investor when the parties have so agreed, as a result of it being subject to foreign control (Article 25(2)(b) of the ICSID Convention).

[13] In this context it is interesting to note that in *Fedax N.V. v. Republic of Venezuela* (Case No. ARB/96/3, Award dated March 9, 1998) the arbitral tribunal characterized promissory notes – that had even been circulated! – as an "investment" and, therefore, this requirement for ICSID jurisdiction was satisfied. A review of the tribunal's reasoning is suggested which is, from a legal and financial standpoint, both sophisticated and interesting.

Much could be said about the ICSID procedure; nevertheless, for the purposes of this study I will limit myself to mentioning two basic principles, which are frequently ignored by domestic courts that review ICSID awards:

a). All aspects of the arbitral procedure are thoroughly covered in the ICSID Convention.[14] The ICSID Convention constitutes the *lex arbitri.*[15]

b). The ICSID Convention isolates an ICSID award from domestic remedies. The only available remedies are those provided in the ICSID Convention.[16]

E. Applicable Substantive Law

In the ICSID Rules of Arbitration, as in all modern arbitration rules, the principle of party autonomy governs.[17] That is, the arbitral tribunal will resolve the dispute pursuant to the legal provisions agreed to by the parties.

In the absence of an agreement between the parties, the arbitral tribunal will apply the law of the Contracting State involved in the dispute (including its choice of law provisions) and the applicable international law.[18]

This is another of the outstanding qualities of the ICSID mechanism. Under Article 42 of the ICSID Convention, the arbitral tribunal must apply the substantive law of the Contracting State, as well as international law. This means that the domestic law may be overridden if the arbitral tribunal concludes that the domestic law is incompatible with, violates or does not meet "minimum international law standards."[19] In other words, international law may be *corrective* of local law! The impact and importance of this provision has been the subject of much discussion.[20]

F. Remedies

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14 Articles 37-40 of the ICSID Convention.

15 See Article 44 of the ICSID Convention.

16 Articles 51-53 of the ICSID Convention.

17 Ibrahim F.I. Shihata and Antonio R, Parra. APPLICABLE SUBSTANTIVE LAW IN DISPUTES BETWEEN STATES AND PRIVATE FOREIGN PARTIES: THE CASE OF ARBITRATION UNDER THE ICSID CONVENTION, ICSID Review – Foreign Investment Law Journal, Vol. 9, No. 2, 1994, at 189.

18 Article 42 of the ICSID Convention.

19 Whatever they may be. As the reader has surely reflected when reading the above, international law is very abstract in this area – as in many others – and thus a successful argument will probably be determined by the ability and international legal training of the attorneys involved.

20 Ibrahim F.I. Shihata and Antonio R. Parra. *Ob. Cit*. at 192. Also see Christopher H. Schreuer, COMMENTARY ON THE ICSID CONVENTION. ICSID Review – Foreign Investment Law Journal, Vol. 12, No. 2, 1997 at 398; and Christopher H. Schreuer, THE ICSID CONVENTION: A COMMENTARY, INTERNATIONAL CENTRE FOR SETTLEMENT OF INVESTMENT DISPUTES, Cambridge University Press, Cambridge, 2001, at 627.

There is no possibility for an appeal under the ICSID procedure. Nevertheless, there are three remedies that may be used against an ICSID award:

1. **Interpretation:** This involves a request to determine the meaning or scope of an award. If possible, it is preferable that this proceeding be submitted before the same tribunal that issued the award. Should this be impossible, a new tribunal will be established pursuant to the ICSID Convention.[21]

2. **Revision:** This relates to a request based on the discovery of new information which may affect the award. This information must have been unknown to the tribunal and to the applicant, and the applicant's ignorance of it must not result from the applicant's negligence.[22]

3. **Annulment:** The annulment of an award may be requested in the following circumstances:[23]

    a). The tribunal was not properly constituted;
    b). The tribunal manifestly exceeded its powers;
    c). There was corruption on the part of a member of the tribunal;
    d). There has been a serious departure from a fundamental rule of procedure; or
    e). The award has failed to state the reasons on which it is based.

In cases where the annulment is requested, the application shall be filed before an *ad hoc* Committee formed by three members selected by the Chairman of the Administrative Council, and not before the tribunal that issued the original award. The *ad hoc* Committee may nullify the award in whole or in part.

Should the Contracting State breach its obligations under the award, two legal consequences ensue:

1. The right to request diplomatic protection will be regained (which until then had been suspended pursuant to Article 27 of the ICSID Convention);

2. Proceedings may be commenced against the breaching State before the International Court of Justice.[24]

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[21] Article 50 of the ICSID Convention.

[22] Article 51 of the ICSID Convention.

[23] Article 52 of the ICSID Convention.

[24] Article 64 of the ICSID Convention.

Until any of the above-mentioned remedies are exercised, the award has *res judicata* status and, pursuant to Article 54 of the ICSID Convention, shall be granted full faith and credit treatment by the rest of the Contracting States. The foregoing to the extent tat the referred provision requires that the Contracting States of the ICSID Convention grant the same treatment to an ICSID award as that afforded to a final judgment of a domestic court.

The above-mentioned obligation is particularly important if we consider that under general international law no obligation exists to recognize or enforce foreign judgments and arbitration awards,[25] as the recognition and enforcement is subject to the domestic law of the State where *exequatur* is requested, unless relevant treaties ratified by the State in question exist which provide otherwise.

III. THE ADDITIONAL FACILITY

After the creation of ICSID, the Secretariat received multiple queries as to the possibility of rendering its services with respect to disputes involving Contracting States and nationals of other *non*–Contracting States of the ICSID Convention which, because of the strict jurisdictional requirements, lacked ICSID standing.

As a result of the above, on September 27, 1978, the Administrative Council of ICSID approved the rules of the Additional Facility of ICSID by virtue of which the ICSID Secretariat could administer proceedings that originally escaped ICSID jurisdiction.

Under the Additional Facility there are three kinds of proceedings that may be administered which would otherwise not meet the ICSID jurisdiction requirements:

1. **Absence of the *Ratione Personae* Requirement**: when one of the parties is not a Contracting State or a national of a Contracting State.

2. **Absence of the *Ratione Materiae* Requirement**: when the dispute does not arise directly from an "investment." In this case the Secretary–General of ICSID may grant his approval only if the transaction that originated the dispute contains certain features that distinguish it from an ordinary international commercial transaction. This is to prevent ICSID from becoming an international commercial arbitration forum.

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[25] There have been several attempts to rectify such deficiency of international law through different international conventions in matters of execution of foreign arbitration awards, such as the Geneva Convention of 1927, the 1958 (New York) Convention on the Recognition and Enforcement of Foreign Arbitral Awards, the European Convention of International Arbitration (Geneva, 1961), Inter–American Convention on International Commercial Arbitration (Panama, 1975) and the Montevideo Convention of 1979. With regard to judgments, the most successful effort has been the Brussels Convention. A world judgment convention is still an ongoing effort.

3. Fact-Finding Proceedings: proceedings that seek to solely determine facts but not to settle a dispute.

The purpose of including fact-finding proceedings in the Additional Facility was to address the need felt in private and public circles for these kind of proceedings in pre–controversy situations. This is useful since it gives the parties an impartial analysis of the facts (not the law), which in some cases may prevent a different understanding of the facts from becoming a legal dispute.

The reason for this was to promote the use of the ICSID Convention as much as possible. An important requirement to bear in mind regarding the use of the Additional Facility is that access to it is subject to approval by the Secretary–General.[26]

Consequences of Conducting Proceedings under the Additional Facility

It is important to mention that a proceeding conducted in accordance with the Additional Facility has a legal consequence of great relevance: none of the provisions of the ICSID Convention apply to the procedure in question.[27] Due to this, the arbitration proceedings and awards will not be insulated from domestic law and the enforcement of the award will be governed by the law of the forum (*lex arbitri*), including the applicable international conventions.

IV. CASES IN WHICH MEXICO HAS BEEN A PARTY

At the time of preparation of this review, Mexico had been part of seven[28] arbitral proceedings before ICSID (through the Additional Facility), of which only three have concluded. A brief summary of the concluded cases shall be made in order to comment on their impact on our subject.

1. ***Robert Azinian v. United Mexican States***[29]

The Claimants, Robert Azinian, Kenneth Davitian and Ellen Baca initiated a procedure pursuant to Chapter XI of the North America Free Trade Agreement ("NAFTA") as shareholders of Desechos Sólidos de Naucalpan, S.A. de C.V. ("Desona") which was a

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26 Article 4 of the Additional Facility Rules.

27 Article 3 of the Additional Facility Rules.

28 *Robert Azinian and others v. United Mexican States* (ICSID Case No. ARB(AF)/97/2); *Metalclad Corporation v. United Mexican States* (ICSID Case No. ARB(AF)/97/1); *Waste Management, Inc. v. United Mexican States* (ICSID Case No. ARB(AF)/98/2); *Marvin Roy Feldman Karpa v. United Mexican States* (ICSID Case No. ARB(AF)/99/1); *Técnicas Medioambientales Tecmed, S.A v. United Mexican States* (ICSID Case No. ARB(AF)/00/2); *Waste Management, Inc. v. United Mexican States* (ICSID Case No. ARB(AF)/00/3) registered on September 27, 2000; and *Adams et al v. United Mexican States*, February 16, 2001.

29 ICSID case No. ARB(AF)/97/2. Award dated November 1, 1999.

contract for waste collection in Naucalpan de Juarez, a county outside Mexico City. In short, the city council revoked the contract basing its decision on a series of "irregularities" detected in regard to the fulfillment of the contract. However, after domestic proceedings were followed, it was found that of the twenty - seven alleged irregularities, only nine were proved. Having lost this case, as well as an *amparo* (constitutional suit) against the decision to cancel the contract, Claimants proceeded to bring a claim under NAFTA on March 17, 1997.

Given the purpose of this comment I will not elaborate on the details of the award. What is relevant is the conclusion and some of the reasoning in the award. The outcome was conclusive: Mexico prevailed on every issue. The reasons were not only that Claimants did not prove their case, but also that the behavior of the Mexican authorities, both the city council and the courts, was considered appropriate, even when assessed against the (high) requirements of the applicable international law.

2. ***Metalclad Corporation v. United Mexican States***[30]

This case involved a dispute resulting from the claimant's investment in the state of San Luis Potosí, Mexico.

The claimant, Metalclad Corporation ("Metalclad," a corporation formed under the laws of Delaware, U.S.A.) was the majority shareholder of Ecosistemas Nacionales, S.A. de C.V. (**"**ECONSA"), which acquired Confinamiento Técnico de Residuos Industriales, S.A. de C.V. ("COTERIN"), a Mexican corporation, with the purpose of developing and operating a hazardous waste facility in Valle de la Pedrera, located at Guadalcazar, San Luis Potosí.

COTERIN obtained permits to build and operate a hazardous waste facility in La Pedrera, Guadalcazar. The county (*Municipio*) ordered the suspension of activities due to the lack of a construction permit which the county alleged was within its jurisdiction to grant and was hence additional to the federal permits already obtained. Metalclad claimed that it had been assured by the Mexican federal authorities that all the required permits had been secured and that the permit in question would be granted automatically upon application. Following this advice, Metalclad reinitiated construction work, requesting the relevant permit from the county. Shortly thereafter it obtained an additional (federal) permit for this purpose from the National Ecology Institute.

On December 5, 1995, more than a year after the application had been made and with the construction almost finished, the permit was formally denied. The reason given was Metalclad's commencement of the construction work prior to securing the county construction permit.

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[30] ICSID Case No. ARB(AF)/97/1. Award dated August 30, 2000.

The arbitral tribunal held that the conduct of the Mexican authorities breached NAFTA in two respects:

i). Failure to Accord Investments of Investors Treatment in Accordance with International Law, including Fair and Equitable Treatment: The Tribunal held that the acts and omissions of Mexican authorities constituted a breach of Mexico's duty to accord investments of investors treatment in accordance with international law, including fair and equitable treatment further to NAFTA Article 1105(1).

The Tribunal's analysis factored in the concept of transparency found in NAFTA Article 102(1). The Tribunal believed that such concept includes the obligation of making clear and of easy reference all the requirements an investor must fulfill in order to successfully initiate, complete and operate an investment. No doubts should exist and, where existing, they should be clarified by the Host State in order to guarantee security to the foreign investor so that it may continue with the investment.

The Tribunal considered that the facts resulted in Mexico's failure to comply with the duty of securing a transparent and predictable framework for Metalclad's investment.

In the Tribunal's opinion the circumstances of the case displayed, on the one hand, the lack of a clear rule with regards to the requirements (or the absence thereof) for obtaining a municipal construction permit, and, on the other hand, the lack of an organized process *vis-à-vis* an investor who may expect to be treated in a fair and equitable manner pursuant to NAFTA. The county's conduct after the denial of the construction permit, coupled with the substantive and procedural deficiencies,[31] forced the conclusion that the county's denial of the construction permit was not appropriate, particularly because the competence of the county did not include hazardous residues, such authority being limited to federal authorities.

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31 The tribunal found that certain circumstances aggravated the case. One being that Metalclad was never notified of the municipal meeting whereby the decision to deny the construction permit was taken, nor did it have the opportunity to present its case. Also, the manner and term in which the permit was denied –thirteen months after having been requested and when the construction was almost finished– was also deemed inappropriate. Finally, none of the grounds for denying the construction permit were within the authority of the county. Therefore, the Tribunal found that the permit had been unjustly denied and its grounds were unrelated to the construction or material aspects of the same, including defects.

32 NAFTA Article 102(1).

33 The tribunal found that certain circumstances aggravated the case: Metalclad was never notified of the municipal meeting where the decision to deny the construction permit was taken, nor did it

ii). Expropriation:[34] NAFTA sets forth that neither of the parties may, directly or indirectly, expropriate an investment or take similar measures[35] except: (a) for a public purpose; (b) on a non-discriminatory basis; (c) in accordance with due process of law and Article 1105(1); and (d) upon payment of compensation.

Although not strictly necessary for its conclusion, the tribunal found that Mexico indirectly expropriated Metalclad's investment without paying any compensation. The manner in which an ecological decree was implemented, permanently proscribed Metalclad's use of its investment and constituted a measure tantamount to expropriation, hence breaching provisions of Article 1110 of NAFTA.

In holding Mexico liable for breach of NAFTA commitments, the Arbitration Tribunal awarded Metalclad US$16,685,000.00 which was the assessment of Metalclad's damages.[36]

The Setting Aside Decision: Mexico brought a suit before the Supreme Court of British Columbia (the "BC Court")[37] requesting that the award be set aside. Mexico claimed that the Arbitration Tribunal committed two acts in excess of jurisdiction: (i) it used NAFTA's transparency provisions as a basis for finding a breach of Article 1105; and (ii) the Tribunal went beyond the transparency provisions in NAFTA and created new transparency obligations.[38]

Hence, the question before the BC Court was whether the award contained decisions which were beyond the scope of the arbitral submission, i.e. what is commonly known in arbitration argot as an *ultra-petita* award. The BC Court found the award´s scope did exceed the submission to arbitration (which was limited to the bounds of Chapter XI of

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have the opportunity to present its case. Also, the manner and circumstances in which the permit was denied – thirteen months after having been requested and when the construction was almost finished – was also deemed inappropriate. Finally, none of the grounds upon which the construction permit denial were based were within the authority of the county; therefore, the tribunal found that the permit had been unjustly denied and the grounds for denial were unrelated to the material aspects or possible defects of the construction.

34 NAFTA Article 1110.

35 The term "measure" is defined in Article 201(1) NAFTA and includes any law, regulation, process, requirement or practice.

36 The foregoing notwithstanding Metalclad´s claim that it invested approximately US$20.5 million, exclusive of interest. The Arbitration Tribunal rejected three aspects of the claimed expenses: (1) the costs incurred prior to the acquisition of COTERIN; (2) costs related to the development of other Metalclad projects in Mexico which had been "bundled" into the project; and (3) certain remediation of the site.

37 Since the place of arbitration was Vancouver, B.C.

38 Para. 66, BC Court Decision.

NAFTA) and hence partially set aside the same,[39] insofar as it included interest due prior to the date when the Ecological Decree was issued (September 20, 1997).

The above finding of excess of authority was premised on the following rationale. In solving the controversy the Tribunal is constrained to the submission agreement. The submission agreement in the dispute is circumscribed to violations of obligations found in NAFTA Chapter XI. To the extent that no "transparency" obligations exist in NAFTA Chapter XI, the awards decision, to the extent it relies in an alleged "transparency" duty, should be set aside for excess of jurisdiction.[40]

The outcome of testing the three main legal findings in the Metalclad decision against such rationale was as follows.[41] The first, the Article 1105 "fair and equitable treatment" obligation, failed the test to the extent it relied in the "transparency" obligation. The second (pre-ecological decree) finding that Mexico had taken measures tantamount to expropriation in violation of NAFTA Article 1110, also failed the test since the Tribunal partially relied on the concept of transparency to conclude that there had been an expropriation within the meaning of Article 1110. Finally, the finding that the Ecological Decree amounted to an expropriation passed muster insofar as it stood on its own and was not infected by the *transparency malaise* nor was premised on the finding of breach of Article 1105.[42]

As a final note, on October 26, 2001 a settlement was reached whereby Mexico agreed to discontinue challenging the award in Canada.

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39 Para. 134, BC Court Decision.

40 Under §34 of the International Commercial Arbitration Act (R.S.B.C. 1996, c.233) which is the Canadian version of UNCITRAL's Model Law for International Commercial Arbitration which provides, that "an arbitral award may be set aside by the Supreme Court only if … the party making the application furnishes proof that … the arbitral award deals with a dispute not contemplated by or not falling within the terms of the submission to arbitration, or it contains decisions on matters beyond the scope of the submission to arbitration …".

41 The first finding was the governing finding. However, to the extent the first had been set aside the secondary findings became the governing findings. Despite fact that Mexico was successful in establishing that two of the findings of the Tribunal involved decisions on mattes beyond the scope of the submission, Metalclad "carried the day" in resisting Mexico's application to have the award set aside in its entirety (Para. 137 of the B.C Court Decision).

42 Paras. 94 and 105, BC Court Decision. Other arguments were put forward by Mexico: (i) Metalclad´s improper acts (which included a corruption claim and an excess damage claim); and (ii) failure to address all questions. The first was not established before the court and the second was found not to merit an annulment to the extent that the Tribunal adequately dealt with all issues before it and the failure to deal with all arguments is not a sufficiently good reason to merit annulment since the Tribunal is not required to answer all but only the dispositive arguments made in connection with the questions which the Tribunal must decide (Paras. 122, 130 and 131, BC Court Decision).

3. ***Waste Management, Inc. v. United Mexican States***[43]

This case involved a dispute between Waste Management, Inc. ("Waste Management") acting on its own behalf and on behalf of ACAVERDE, S.A. de C.V., against Mexico as a result of an alleged breach of Articles 1105 and 1110 of NAFTA by Banco Nacional de Obras y Servicios Públicos, S.N.C. (BANOBRAS), the State of Guerrero and the City Council of Acapulco de Juárez.

I shall not discuss the facts of this case since the tribunal's ruling concerned only the issue of jurisdiction. Therefore, the substance of the case that gave rise to the dispute was not dealt with in the award.

The tribunal held that insofar as claimants had not withdrawn their domestically initiated claims, the requirement of a waiver to the right to initiate or continue domestic remedies provided by Article 1121(2)(b) of NAFTA had not been complied with and, therefore, the tribunal lacked jurisdiction.[44]

A subsequent claim has been brought before an ICSID Additional Facility Tribunal and is currently being heard.[45] No final award has been issued.

Having canvassed the ICSID mechanism as well as some of the cases Mexico has been a party to under this system, I have a comment to share.

V. MEXICO'S FAILURE TO ADHERE TO THE ICSID CONVENTION

It is unfortunate that Mexico has failed to become a Contracting State of the ICSID Convention. As a result all the procedures referred to in this article have been conducted under the auspices of the Additional Facility. As described in Section III, the legal consequence of this is that the procedures carried out are not isolated from the law of the place of arbitration. This result, although it has thus far not created any problems, is regrettable since one of the virtues (and purposes) of these types of procedures is to

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43 ICSID case No. ARB(AF)/98/2. Award on Jurisdiction dated June 2, 2000.

44 In this context, it is interesting to draw the reader's attention to the dissenting opinion of Mr. Keith Highet who, put simply, considered that domestic remedies were not incompatible with the NAFTA Chapter XI procedure provided they did not refer to the same legal grounds/theory. My summarized description does not do justice to Mr. Highet's sophisticated and interesting legal argument and, whether or not one shares his views, the fact remains that (together with the *Azinian* case and *Ethyl Corporation v. The Government of Canada (Award on Jurisdiction)* (June 24, 1998) – also a case involving NAFTA Chapter XI) it assists in the construction of a theoretical and practical basis for the cases that must be understood as comprised under the investment protection provisions of this treaty. Needless to say, this is a subject of great importance to arbitration experts and practitioners.

45 *Waste Management, Inc. v. United Mexican States* (ICSID Case No. ARB(AF)/00/3) registered on September 27, 2000.

prevent the use (and abuse) of domestic remedies that delay or obstruct the arbitral process.

When questioning authorities as to the reason for Mexico's failure to become a Contracting State of ICSID, one is confronted with the following abstract answer: that this is being carefully considered. This answer is meaningless and therefore one must speculate about the real reasons for the reluctance to be part of this international institution. I can only think of three:

1. Mexico's experience with international arbitration;
2. The desire to not pursue a case that involves Mexico's interests in international fora; and
3. Article 42 of the ICSID Convention.

1. Mexico's Experience with International Arbitration

Some argue that Mexico's not too positive experience with arbitration as a dispute resolution mechanism explains its reluctance of relying on this method.[46]

In reply I would say that the past does not necessarily equal the future. As it may be observed from certain recent cases, Mexico can be successful in international arbitration, but for this it is imperative that Mexican authorities act impeccably.

Moreover, it is contradictory to think that in a global society, where the number of international investments is exponentially increasing and countries (particularly developing) compete to attract international investment, a country of Mexico's importance can ignore or fear the most important dispute settlement mechanism.

2. The Desire To Not Pursue Cases that Involve Mexico's Interests in the International Fora

This is not a sufficiently good motive for not becoming a Contracting State of the ICSID Convention. Rather, it seems more like the result of insufficient thought.

By including the use of ICSID's Additional Facility in all of the investment treaties Mexico has thus far entered into[47] and then failing to formally adhere to the ICSID

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[46] See Luis G. Zorrilla, LOS CASOS DE MEXICO EN EL ARBITRAJE INTERNACIONAL, Ed. Porrúa, S.A., Mexico, Second Edition, 1981.

[47] The investment provisions have been included by way or free trade agreements and bilateral investment treaties. For instance, NAFTA Chapter XI, the Agreement for the Reciprocal Promotion and Protection of Investments between the United Mexican States and the Kingdom of Spain (published in the Daily Official Gazette on March 19, 1997); the Agreement between the United Mexican States and the Confederation of Switzerland for the Reciprocal Promotion and Protection of Investments (published in the Daily Official Gazette on August 20, 1998); the Agreement between the Government of the United Mexican States and the Government of the Republic of Argentina for the Reciprocal Promotion and Protection of Investments (published in

Convention, the following contradictory situation is provoked: on the one hand, there *is* arbitration for foreign investors; but, on the other, it is an arbitration which potential has been diminished through the partial use (and waste – in my opinion) of an instrument that presents the benefits of ICSID.

If the reason for the non-adherence to the ICSID Convention is the desire to not pursue disputes that are sensitive to Mexico's interests in an international forum, then why accept arbitration in other international investment instruments?

As a result of the above, the *status quo* is that foreign investors *do* have access to arbitration to settle any problems arising from their investment, but the chosen arbitration procedure has less than all the resources/potential it could otherwise have and which are offered by ICSID. This situation is inexplicably contradictory. What is sauce for the goose is also sauce for the gander. The differentiation is unwarranted and most probably the result of either incomplete consideration of leaving behind unsolved loose-ends.

One could argue that a little arbitration is better than no arbitration. I disagree. Either you choose a method with all its envisaged weaponry, or you stick with with what you already have. Anything less is mediocre.

Moreover, the international financial and legal community is sophisticated enough to realize that the current situation is not as attractive as it could be and that other markets offer better opportunities. Potential investors will take this into account when assessing the benefits of investing in Mexico as compared to in other markets.

3. Section 42 of the ICSID Convention

Another reason that may explain Mexico's reluctance to adhere to the ICSID Convention is Article 42. As mentioned in Section II.E, this provision establishes an impressive

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the Daily Official Gazette on August 28, 1998); and the Agreement for the Reciprocal Promotion and Protection of Investments between the United Mexican States and the Kingdom of the Netherlands (executed in Mexico City on May 13, 1998 and published in the Daily Official Gazette on July 10, 2000). To date, the free trade agreements Mexico has become a party to total ten and the investment treaties (BIT´s) total fifteen. For an excellent review of the same I refer the reader to Dr. Jose Luis Siqueiros' article: AN OVERVIEW OF ARBITRATION MECHANISMS BETWEEN STATES AND INVESTORS, Journal of World Investment, June 2001, Vol. 2, No. 2.

[48] For instance, NAFTA Chapter XI, the Agreement for the Reciprocal Promotion and Protection of Investments between the United Mexican States and the Kingdom of Spain (published in the Daily Official Gazette on March 19, 1997); the Agreement between the United Mexican States and the Confederation of Switzerland for the Reciprocal Promotion and Protection of Investments (published in the Daily Official Gazette on August 20, 1998); the Agreement between the Government of the United Mexican States and the Government of the Republic of Argentina for the Reciprocal Promotion and Protection of Investments (published in the Daily Official Gazette on August 28, 1998); and the Agreement for the Reciprocal Promotion and Protection of Investments between the United Mexican States and the Kingdom of the Netherlands (executed in Mexico City on May 13, 1998 and published in the Daily Official Gazette on July 10, 2000).

device: it makes international law corrective of domestic law in foreign investment matters. One can easily imagine the kind of arguments that can be made to defend the non-adherence to this convention, as a result of this provision. For instance, the (often abused) sovereignty argument .

However, the preceding arguments would overlook the fact that international law of foreign investment has already filtered into Mexican law and in a way that has the same effect as Article 42 of the ICSID Convention. Article 1105 of NAFTA provides that the host state (in this case Mexico, Canada or the United States of America) must grant the investments of another party "treatment in accordance with international law, including fair and equitable treatment and full protection and security." This is also known as the "minimum standard of treatment."

The result of this provision is that international law *is* binding on Mexico in an arbitral procedure involving another NAFTA host state, under Chapter XI of NAFTA. Should this establish a higher protection threshold than the treatment afforded by the state to the respective investor or investment, *international law shall prevail!*[49]

Thus, it is obvious that there is no valid reason to justify Article 42 as an obstacle for the adherence by Mexico to the ICSID Convention.

VI. A GROWING *LEGE FERENDA*

Having made the preceding practical considerations, a brief comment regarding the significance that investment treaties, ICSID and the cited cases have had in the legal and political debate that has historically surrounded the subject of international foreign investment law in Mexico is warranted.

Within the cornucopia of international regulation it is hard to find another area where the lack of consensus about what international law *is* and *should be* is so acute.[50]

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[49] The escape valve to this overarching comment is that international law in matters of foreign investment is diffuse, ambiguous and controversial.

[50] This comment coincides with the view expressed by the U.S. Supreme Court of Justice in the case *Banco Nacional de Cuba v. Sabbatino* ((376 U.S. 398 (1964)) where Justice Harlan noted that *"There are few if any issues in international law today on which opinion seems to be so divided as the limitations on the state's power to expropriate the alien's property"*. For a discussion in this subject see M. Sornarajah, THE INTERNATIONAL LAW ON FOREIGN INVESTMENT, Grotius Publications, Cambridge University Press, 1994. It is advisable not to loose sight of the fact that because of the noted lack of consensus in this field the literature on this subject may frequently display renowned authors saying exactly the opposite to other author's views. For instance see OPPENHEIM'S INTERNATIONAL LAW, edited now by Sir Robert Jennings QC and Sir Arthur Watts KCMG QC, Ninth Edition, Vol. 1, PEACE, pgs. 911 to 927. Likewise, Ian Brownlie, PRINCIPLES OF PUBLIC INTERNATIONAL LAW, Oxford University Press, Fifth Edition, pgs. 460 to 510; and Peter Malanczuk, AKEHURST'S MODERN INTRODUCTION TO INTERNATIONAL LAW, 7th ed., Routledge, London – New York, pgs. 435 to 439. Having said this, I must mention that the international law of foreign investment has been clarified up to a certain point by the Iran-U.S. Claims Tribunal. For a magnificent analysis see Charles N. Brower and Jason D. Brueschke, THE

An ideological and political confrontation has traditionally existed between, on the one hand, rich capital–exporting countries and, on the other, developing capital–importing countries.[51] Briefly stated, wealthy countries tend to support transnational [52] companies in their search for business in any part of the world, urging that the property and contract rights they acquire as a result of this activity be protected. On the other hand, developing countries, to a certain extent in response to the legacy of colonial economic domination, perceive the expansion of transnational companies as a neo-colonial incursion that in the long run risks their sovereignty and welfare.[53]

The division and lack of understanding between these two extremes has been so intense that to date no multilateral treaty regulating foreign investment has been achieved[54] and the creation of one has been qualified as a political impossibility[55] (suffice it to recall the experience[56] of the Multilateral Agreement on Investment).

IRAN–U.S. CLAIMS TRIBUNAL, Clarendon Press, Oxford 1996; and Allahyar Mouri, THE INTERNATIONAL LAW OF EXPROPRIATION AS REFLECTED IN THE WORK OF THE IRAN-U.S. CLAIMS TRIBUNAL, Martinus Nijhoff, Dordrecht.

51 The expressed division is frequently not obvious. A capital exporting country may –at the same time– be a capital importer. A clear example is the United States of America which is one of biggest private capital exporting economies and one of the most important receivers of international flows. (See Edward M. Graham and Paul R. Krugman, FOREIGN DIRECT INVESTMENT IN THE UNITED STATES, Institute for International Economics, Washington, DC, (1989). Having said this, it is useful to mention that the United States of America, as of 1989, had become a net/aggregate debtor with regards to the balance between the position of its assets and liabilities in international capital flows and has remained so since then. In 1999 it had a negative balance higher than US$1.9 Trillion Dollars, more than 20% of its GNP. (The Economist – November 18th 2000, at 123). Compare this with the total amount of global foreign capital flow that in 1999 rose to US$865 billion, which meant a 27% increase from 1998. (Source: United Nations Conference of Trade and Development – UNCTAD and OECD) (The Economist, November 11, 2000, at 131).

52 Or "multinational," depending on the definition preferred.

53 Stephen Zamora, ECONOMIC RELATIONS AND DEVELOPMENT, in UNITED NATIONS LEGAL ORDER. Vol. 1, Edited by Oscar Schachter and Christopher C. Joyner, American Society of International Law, Grotius Publications, Cambridge University Press, Cambridge, 1995, at 431.

54 This statement merits a qualification. Even though no multilateral understanding on this subject exists, thousands of Bilateral Investment Treaties (or "BIT's") exist which regulate foreign investments. Although BIT's do not encompass a complete framework concerning investor – Host State relations, they do include obligations upon the State vis-à-vis the investor with regards to its investment, such as the duty not to expropriate but for public purpose reasons and upon payment of compensation, treatment standards (minimum, national and most favored nation), etc. (see, in general, Rudolf Dolzer and Margrete Stevens, BILATERAL INVESTMENT TREATIES, International Centre for Settlement of Investment Disputes, Martinus Nijhoff Publishers, The Hague, 1995). Likewise, several Codes of Conduct have been elaborated which have certain legal effects (which I shall not discuss). See "Guidelines on the Treatment of Foreign Direct Investment" prepared by the World Bank. ICSID Review –Foreign Investment Law Journal, Vol. 7, no. 2, 1992, at 295.

55 "*La conclusion des conventions multilaterales à vocation universelle ayant pour objet la protection des investissements internationaux est une impossibilité politique…*" (emphasis in original). D. Carreau; P. Juillard & T. Flory, Droit International Economique (1978) pgs. 78-79. Cited by Stephen Zamora in ECONOMIC RELATIONS AND DEVELOPMENT, in UNITED NATIONS

It is against this background that the importance and impact of the above-mentioned cases must be assessed.

I consider that such cases give content to the general rules of international foreign investment law and, therefore, are a highly plausible step in the development and progress efforts of this prickly subject. In other words, the result of these cases is the slow but progressive crystallization and ripening of international law in matters of foreign investment, that begin to have a "binding"[57] effect on Mexico and whose content has, from the inception[58] of international investment, been aggressively disputed.[59]

VII. FINAL COMMENT

The cases that have thus far been brought against Mexico demonstrate the quality of the justice granted to foreign investors in the country.[60] These cases teach that Mexico has no reason to fear arbitration and that it may prevail[61] in cases against foreign investors with great financial resources.[62]

LEGAL ORDER. Vol. 1, Edited by Oscar Shachter and Christopher C. Joyner, American Society of International Law, Grotius Publications, Cambridge University Press, Cambridge, 1995, at 431.

56 Multilateral Agreement on Investment. For an interesting paper in this matter, confere Peter T. Muchlinski. THE RISE AND FALL OF THE MULTILATERAL AGREEMENT ON INVESTMENT: WHERE NOW?, The International Lawyer, Fall 2000, Vol. 34, No. 3, at 1033.

57 This observation must be understood within the premise that even though such decisions lack legal force for future cases, they are useful as an authoritative/persuasive source that assist in the developing of an understanding of what the law should be. That is, an *opinio iuris communis*.

58 Foreign investments can be traced back more than 400 years. During the European colonial expansion in America and then Africa and Asia there was an expansion in foreign investment by groups or enterprises directed to developing economic activities outside their country of origin. (See Otis Rodner S., James, LA INVERSION INTERNATIONAL EN PAISES EN DESARROLLO, Ed. Arte, Caracas, Venezuela, 1993, at 58).

59 The "precedent value" of these cases may be observed in, for instance, the opinion prepared by dissenting arbitrator in *Waste Management* wherein the *Ethil* and *Azinian* cases were analyzed. Likewise, the *Metalclad* award analyzed another international case which facts were similar to the one at bar: *Biloune, et al v. Ghana Investment Centre, et al* (95 I.L.R. 183, 207-10 (1993)).

60 In this context, and to allow the reader to discount the opinion expressed in the manner it considers convenient, the author confesses to have a professional and personal relationship with two of the arbitrators who have acted in cases in which Mexico has been involved in the context of ICSID's Additional Facility: Dr. José Luis Siqueiros P. and Mr. Eduardo Siqueiros T.

61 Of course, assuming Mexico has a strong case.

62 In this regard, another comment is warranted. It would be in Mexico's best interest to be represented by specialists on the subject instead of using internal officials. Even though to date they have done a fine job, the improvisation (and distraction) of existing human resources cannot be compared with the outsourcing of professional services from experts who are frequently involved in such cases. This practice is followed even by some of the poorest countries in the world. For example, the author had the opportunity to take part in the defense of an African country (Ethiopia) against Canadian constructing companies. Needless to say, the foregoing does

Likewise, even in cases where Mexico has lost, the situation can be used in Mexico's favor by voluntarily complying with the award and hence "sending the message" to the international community that Mexico honors its commitments and therefore has a good investment climate. By doing so, all losses may be seen as aiding Mexico's reputation as a jurisdiction favorable to investment.

An additional benefit is that disputes which previously remained unaddressed will be resolved. This serves to purge frustrations and negative comments which harmed Mexico's image in the eyes of potential investors. In the medium and long run this attracts more foreign investment than a thousand promises, and it also forces authorities to be careful and to avoid acting arbitrarily.

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not compromise the duty of confidentiality to the extent that no other information is being provided.