Metalclad Corporation v. The United Mexican States

(ICSID Case No. ARB(AF)/97/1)

Submission of the Government of the United States of America

1. Pursuant to NAFTA Article 1128, the United States Government makes this submission to address certain questions of interpretation of the NAFTA arising in the case brought by Metalclad Corporation against the United Mexican States.

2. The United States wishes to comment on specific issues that have arisen during the course of the Metalclad arbitration. However, we must emphasize that our lack of comment on other issues does not indicate that the United States agrees with other positions expressed by the parties to the arbitration. No inference should be drawn from our failure to comment on a particular point.

NAFTA Coverage of Actions of Local Governments, Including Municipalities

3. One question that was addressed in oral argument was whether, as a general rule, the actions of local governments, including municipalities, are subject to the NAFTA standards. The United States believes that there is no general exclusion from the NAFTA standards for local government action. At the hearing, an argument that local government actions are generally not subject to these standards was made based on Article 105 of the NAFTA, which does not use the term "local governments" in describing the extent of the obligations set forth in the Agreement. According to this argument, the NAFTA Parties deliberately excluded the term "local governments" from Article 105 to signal a departure from otherwise applicable customary international law, which provides that a State is liable for the acts of all its political subdivisions, including local governments. Again under this line of argument, Article 201(2) ("unless otherwise specified, a reference to a state or province includes local governments of that state or province") means that it is only when state or provincial governments are specifically mentioned in a particular obligation that the obligation covers local governments' acts.

4. However, the United States believes that there is no such general exclusion from NAFTA standards for the actions of local governments. Rather, the U.S. intended, and we believe the Parties intended, that, except where specific exception was made, the actions of local governments would be subject to the NAFTA standards. We made this clear in our Statement of Administrative Action submitted to the U.S. Congress with the text of the Agreement and proposed implementing legislation. In that Statement, the U.S. Government explains that NAFTA Article 105 "makes clear that state, provincial and local governments must, as a general rule, conform to the same obligations as those

applicable to the three countries' federal governments, subject to the same exceptions." U.S. Statement of Administrative Action 4, in Message from The President of the United States Transmitting North American Free Trade Agreement, Text of Agreement, Implementing Bill, Statement of Administrative Action and Required Supporting Statements, H.R. Doc. No. 103-159, Vol. 1 (1993) (attached).

5. The Canadian Statement on Implementation expresses a view that mirrors the United States' understanding that local government measures are generally subject to the NAFTA standards. Its description of Article 1101 explains that Chapter 11's section A (which sets forth the substantive obligations of the Parties) "covers measures by a Party (i.e., any level of government in Canada)." Canada Gazette, Pt. 1, at 148, Jan. 1, 1994 (attached).

6. Moreover, the ordinary meaning of the provisions at issue is in line with the United States' position. Article 105 provides that "[t]he Parties shall ensure that all necessary measures are taken in order to give effect to the provisions of this Agreement, including their observance, except as otherwise provided in this Agreement, by state and provincial governments." Article 201(2), part of the NAFTA Chapter entitled "General Definitions," plainly defines any reference to a state or province to include the local governments of that state or province. Absent any treaty language to the contrary, the natural meaning of these provisions, taken together, is that Article 105's reference to states and provinces includes a reference to their local governments.

7. The context of these provisions further supports the United States' view. Other provisions in the NAFTA, both in Chapter 11 and elsewhere in the Agreement, make clear that local government measures, including municipal measures, are subject to the NAFTA standards. For example, Article 1108(1)(a)(iii) specifically exempts existing local government measures from the reach of Articles 1102, 1103, 1106 and 1107. If the argument proposed at the hearing were correct, no exemption would be necessary because these articles would not address the actions of local governments at all. Other chapters have similar exclusions reinforcing this point. See, e.g., Article 1206(1)(a)(iii); Article 1409(1)(a)(iii).

8. In sum, contemporaneous statements of the Parties' intent, together with the ordinary meaning of the relevant provisions taken in their context, establish that the actions of local governments, including municipalities, are subject to the NAFTA standards.

The Meaning of "Measure Tantamount to Expropriation"

9. With respect to the Tribunal's question as to the meaning of the term "tantamount to expropriation" in NAFTA Article 1110(1), we do not believe that

the Tribunal need address the question, as doing so is not required to resolve the issues in the case. We urge the Tribunal to limit its rulings to matters that are necessary to the resolution of the claim and that have been fully briefed and argued by the parties to the dispute. However, to respond to the Tribunal's request, it is the position of the United States that the phrase "take a measure tantamount to . . . expropriation" explains what the phrase "indirectly . . . expropriate" means; it does not assert or imply the existence of an additional type of action that may give rise to liability beyond those types encompassed in the customary international law categories of "direct" and "indirect" nationalization or expropriation. We believe that this conclusion is consistent with the positions taken by both the disputants in this case.

10. The United States Government believes that it was the intent of the Parties that Article 1110(1) reflect customary international law as to the categories of expropriation. The United States Government reflected that position in its Statement of Administrative Action, transmitted to the Senate during the process of concluding the NAFTA. See Statement of Administrative Action 140 (attached). Neither of the other Parties has ever expressed a view contrary to this United States public statement of intent. The customary international law of expropriation recognizes only two categories of expropriation: direct expropriation, such as the compelled transfer of title to the property in question; and indirect expropriation, i.e., expropriation that occurs through a measure or series of measures even where there is no formal transfer of title or outright seizure. To conform to these rules of customary international law, Article 1110(1) must be read to provide that expropriation may only be either direct, on one hand, or indirect through "a measure tantamount to nationalization or expropriation of such an investment," on the other.

11. The context in which the phrase "tantamount to expropriation" is found confirms that it was not intended to create a new category of expropriation. If Article 1110 had been meant to create a wholly new, third category of expropriation, thereby departing radically from customary international law, the Parties would surely have included language providing guidance on what circumstances, other than either direct or indirect expropriation, were meant to be covered. Instead, there are no standards for determining when such a new category would be applicable. It is extremely unlikely that the Parties would have exposed themselves to potentially significant liability for an entirely new category of expropriation without such guidance. As they did not provide the necessary standards, the only reasonable conclusion is that the Parties did not intend an expansion of the two categories of expropriation currently recognized under customary international law.

12. Furthermore, a separate meaning for the term "take a measure tantamount to . . . expropriation" is not required or even supported by the fact that the phrase is redundant in light of the provision's previous reference to

"indirect[] expropriat[ion]." In fact, its redundancy mirrors the construction of another passage in Article 1110. Article 1110(1) addresses the circumstances under which Parties may "nationalize or expropriate," even though the term "nationalize" is redundant since it is a type of expropriation. See, e.g., State Responsibility, [1959] 2 Y.B. Int'l L. Comm'n 1, 13, U.N. Doc. A/CN.4/119 (labeling "the practice . . . of carrying out acts of expropriation on a wide scale and impersonally" as a "type or form of expropriation . . . commonly referred to as 'nationalization'") (attached); B.A. Wortley, Expropriation in Public International Law 36 (1977) ("Nationalization differs in its scope and extent rather than in its juridical nature from other types of expropriation.") (emphasis added) (attached). As the term "nationalize" is but a subset of the broader term "expropriate," similarly, the phrase "take a measure tantamount to expropriation" is simply an elaboration of what "indirectly . . . expropriate" means, notwithstanding the presence in both instances of the disjunctive "or." The similar repetition of other concepts in the terms of Article 1110(1) suggests that this redundancy results, not from an intent to create a new category of expropriation, but rather from an abundance of caution taken to ensure that the two categories of expropriation, direct and indirect, that are recognized under customary international law would be covered. Thus, while perhaps not artful, these redundant usages in Article 1110(1) do not reflect a deviation from customary international law.

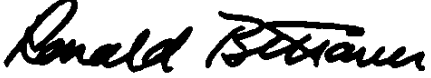
13. The preparatory work of the NAFTA confirms this conclusion. The NAFTA's expropriation provision was modeled on the expropriation provision of the bilateral investment treaties ("BITs") that the United States had concluded with many countries. All of the forty-five BITs signed by the United States contain similar language on expropriation, although their exact phrasing has varied over time. See, e.g., U.S. Bilateral Investment Treaties (BITs), at http://www.state.gov/www/issues/economic/7treaty.html (providing several BIT texts); Investment Treaties in the Western Hemisphere, at http://www.sice.oas.org/bitse.stm (same); Trade & Related Agreements, at http://www.mac.doc.gov/tcc/treaty.htm (same). Despite the variations in expression, the scope of protection provided by the BITs has remained the same, and all of these different formulations have been understood to incorporate the customary international law definition of expropriation, not to expand upon it. See, e.g., State Department, Description of the United States Model Bilateral Investment Treaty (BIT): Hearing Before the Senate Comm. on Foreign Relations, 102d Cong., 2d Sess. 61, 63 (1992) ("Article III incorporates into the Treaty the highest international law standards for expropriation and compensation.") (attached). Article 1110(1) should likewise be recognized as a further effort to capture that customary international law concept of "expropriation," not as an unprecedented departure from the BITs.

14. Thus, Article 1110 addresses measures that directly expropriate and measures tantamount to expropriation that thereby indirectly expropriate. This is the only possible interpretation of the terms of the provision consistent with the Parties' intent and the ordinary meaning of the terms in light of the provision's context, as confirmed by reference to the preparatory work. Therefore, NAFTA claimants may not seek damages under Article 1110 for actions beyond those contemplated in the customary international law concepts of direct and indirect expropriation.

Denial of Justice Issues

15. Finally, the United States notes that, during closing arguments, the President of the Tribunal asked counsel for Mexico a hypothetical question regarding whether a denial of justice occasioned by a federal court would be directly redressable by a NAFTA Tribunal. This issue need not be addressed in this case, as Metalclad has not alleged a denial of justice by the Mexican courts at any level. Again, the United States urges the Tribunal to limit its rulings to matters necessary to the resolution of the claim and that have been fully briefed and argued by the parties to the dispute.

Respectfully submitted,



Ronald J. Bettauer
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U.S. Department of State
November 9, 1999

103d Congress, 1st Session - - - - - - - House Document 103-159, Vol. 1

# NORTH AMERICAN FREE TRADE AGREEMENT, TEXTS OF AGREEMENT, IMPLEMENTING BILL, STATEMENT OF ADMINISTRATIVE ACTION, AND REQUIRED SUPPORTING STATEMENTS

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## MESSAGE

FROM

# THE PRESIDENT OF THE UNITED STATES

TRANSMITTING

NORTH AMERICAN FREE TRADE AGREEMENT, TEXTS OF AGREEMENT, IMPLEMENTING BILL, STATEMENT OF ADMINISTRATIVE ACTION AND REQUIRED SUPPORTING STATEMENTS

NOVEMBER 4, 1993.—Message and accompanying papers referred to the Committees on Ways and Means, Agriculture, Banking, Finance and Urban Affairs, Energy and Commerce, Foreign Affairs, Government Operations, the Judiciary, and Public Works and Transportation and ordered to be printed

# THE NORTH AMERICAN FREE TRADE AGREEMENT IMPLEMENTATION ACT

## STATEMENT OF ADMINISTRATIVE ACTION

This Statement of Administrative Action is submitted to the Congress in compliance with section 1103 of the Omnibus Trade and Competitiveness Act of 1988 ("1988 Act") and accompanies the implementing bill for the North American Free Trade Agreement ("NAFTA" or "Agreement"). The bill approves and makes statutory changes required or appropriate to implement the Agreement, which the President signed on December 17, 1992, on behalf of the United States under the authority of section 1102 of the 1988 Act.

This Statement describes significant administrative actions proposed to implement the NAFTA. In addition, incorporated into this Statement are two other statements required under section 1103: (1) an explanation of how the implementing bill and proposed administrative action will change or affect existing law; and (2) a statement setting forth the reasons why the implementing bill and proposed administrative action are necessary or appropriate to carry out the Agreement.

For ease of reference, this Statement generally follows the organization of the NAFTA, with the exception of grouping the general provisions of the Agreement (*i.e.*, Chapters One, Two and Twenty-Two of the Agreement) at the beginning of the discussion.

For each chapter of the NAFTA, the Statement first briefly summarizes the most important provisions of the Agreement. Next, the Statement describes the pertinent provisions of the implementing bill, explaining how the bill changes or affects existing law and stating why those provisions are required or appropriate to implement the NAFTA. Finally, the Statement describes the administrative action proposed to implement the particular chapter of the NAFTA, explaining how the proposed action changes existing administrative practice and stating why the changes are required or appropriate to implement the Agreement.

The Statement addresses certain provisions of Title V as well as Title VI of the implementing bill -- which make various changes in U.S. law that are appropriate (rather than required) to implement the NAFTA -- following the discussion of NAFTA Chapter Twenty-One.

It should be noted that this Statement does not, for the most part, discuss those many instances in which U.S. law or administrative practice will remain unchanged under the NAFTA. In many cases, U.S. laws and regulations are already in conformity with the obligations imposed by the Agreement. In other cases, U.S. laws and regulations are "grandfathered" (*i.e.*, exempted) from the obligations of the NAFTA. In addition, some provisions of the NAFTA impose obligations only on Canada or Mexico.

In a few instances where there have been frequent questions from the public or the Congress, the Statement notes examples of specific statutes, regulations or practices that do *not* have to be changed as a result of the Agreement. Because this Statement is designed to describe *changes* in U.S. laws and regulations proposed to implement the NAFTA, however, the Statement concentrates on those changes and generally does not attempt to enumerate instances in which no change in existing law or practice will be required.

Although the implementing bill is voluminous, a careful reading of this Statement makes clear that the NAFTA requires comparatively few significant changes in U.S. law or regulation. Much of the bulk of the legislation is taken up with amendments or additions to U.S. law -- such as Title VI, the "Customs Modernization Act," -- that the Administration, working with the Congress, considered to be desirable, rather than necessary, to implement the NAFTA. Other parts of the bill -- such those establishing NAFTA's "rules of origin" for goods -- set out certain parts of the NAFTA itself. Still other bill provisions, simply extend to Mexico treatment currently enjoyed by Canada under the United States - Canada Free-Trade Agreement Implementation Act of 1988.

Finally, references in this Statement to particular sections of U.S. statutes are based on those statutes in effect as of the date this Statement was submitted to the Congress.

# CHAPTERS ONE, TWO AND TWENTY-TWO: GENERAL PROVISIONS

## A. SUMMARY OF NAFTA PROVISIONS

Chapters One, Two and Twenty-Two set out provisions that, for the most part, have general application to the rest of the Agreement. Chapter One makes clear that the NAFTA establishes a free-trade area in accordance with Article XXIV of the General Agreement on Tariffs and Trade ("GATT"). The chapter also sets out the general objectives of the Agreement, including the liberalization of trade in goods and services, removal of barriers to investment, the protection and enforcement of intellectual property rights, and the establishment of a framework for further trilateral, regional and multilateral cooperation to expand and enhance the benefits of the Agreement.

### 1. Relationship to Other Agreements

Articles 103 and 104 describe the relationship between the NAFTA and other international agreements.

Article 103 makes clear that the United States, Canada and Mexico retain their respective rights and obligations under the GATT and other preexisting agreements to which all three countries are parties, but that the provisions of the NAFTA prevail over inconsistent provisions of other agreements to the extent of the inconsistency, unless otherwise specified in the NAFTA. The North American Agreement on Environment Cooperation and the North American Agreement on Labor Cooperation, signed on September 14, 1993, are not covered by Article 103 because they were concluded after the NAFTA and will enter into effect immediately after the NAFTA. The Administration does not consider that there are any inconsistencies between the supplemental labor and environmental agreements and the NAFTA.

It should be noted that nothing in the NAFTA will affect native American treaty rights.

Article 104 states that the trade obligations of certain international environmental agreements prevail over the NAFTA's provisions to the extent of any inconsistency between them. Article 104 lists three multilateral environmental agreements with trade provisions – the Washington convention on trade in endangered species, the Montreal protocol on ozone-depleting substances and the Basel convention on the transborder movement of hazardous waste.

In addition, Annex 104.1 lists two bilateral agreements with trade provisions to which the United States is a party. These are an agreement with Canada on cross-border movement of hazardous waste and the La Paz agreement with Mexico on protecting the environment in

the border area, which includes an annex on cross-border movement of hazardous waste. The Administration does not consider that agreements listed in Article 104, or Annex 104.1, are necessarily inconsistent with the NAFTA in whole or in part, but listing these agreements removes doubt in the unlikely event that an inconsistency were found.

The NAFTA governments may agree in writing to add to the list of agreements included in Article 104 or to include amendments of the three multilateral agreements listed above. The Administration views this modification procedure as an ongoing process to respond to changes in international environmental and conservation law and to provide greater clarity regarding the NAFTA's relationship to other environmental and conservation agreements. To this end, the Administration has obtained commitments from Mexico and Canada to add to the list of agreements specified in Article 104, when the NAFTA enters into effect, the *Convention Between the United States of America and the United Mexican States for the Protection of Migratory Birds and Game Mammals* and the U.S.-Canada *Convention on the Protection of Migratory Birds*. The Administration intends to pursue further discussions with Mexico and Canada concerning the addition of other agreements.

By virtue of Article 2005(3), in any dispute between NAFTA countries concerning a governmental action that the defending government claims is subject to Article 104, that government may insist that the dispute be resolved exclusively under the NAFTA, in which case the complaining government will not have recourse to dispute settlement procedures under the GATT. The Administration does not foresee any conflict between the requirements of the NAFTA and the trade obligations imposed by the environmental agreements mentioned above or other agreements that are not currently included in Article 104.

2. Application to States and Provinces

NAFTA Article 105 is virtually identical to Article 103 of the United States - Canada Free-Trade Agreement ("CFTA") and builds on language in GATT Article XXIV:12. It makes clear that state, provincial and local governments must, as a general rule, conform to the same obligations as those applicable to the three countries' federal governments, subject to the same exceptions.

Some provisions of the NAFTA, however, either do not apply to states or localities or impose reduced levels of obligation for state and local measures. For example, Article 902 requires the three governments only to "seek, through appropriate measures," state and provincial government observance of NAFTA's rules regarding standards-related activities. Chapter Ten, which covers government purchases, imposes no obligations on state, provincial or local governments. Articles 1108, 1206 and 1409 exempt all existing measures at the local level in respect of certain investment and services provisions of the NAFTA and provide a mechanism for "grandfathering" state and provincial laws.

Chapter Ten also applies to several government-controlled enterprises not subject to the GATT Code -- the Tennessee Valley Authority, the St. Lawrence Seaway Development Corporation and the five power marketing administrations of the Department of Energy. These entities currently follow procedures similar to those in the FAR and thus will not need to change current procurement procedures.

Within thirty days of passage by the Congress of the NAFTA implementing bill, the Administration will provide to each state a status report of USTR efforts to include state governments in a new GATT Code. This report will include an assessment of the reciprocal concessions the United States will obtain from other countries in such an agreement and the likely schedule for concluding the agreement.

The Administration will also provide states with the names and phone numbers of the particular U.S. Government officials with expertise on the obligations of the GATT Code and NAFTA Chapter Ten. These officials will be available to answer questions regarding implementation by state governments of a GATT agreement and initiation of consultations regarding state participation in a future expansion of the coverage of Chapter Ten.

# CHAPTER ELEVEN: INVESTMENT

## A. SUMMARY OF NAFTA PROVISIONS

Chapter Eleven comprises two parts. Part A sets out each government's obligations with respect to investors from other NAFTA countries and their investments in its territory. Part B affords investors the right to seek compensation through international arbitration for a violation of the provisions of Part A or of certain provisions of Chapter Fifteen, governing the behavior of government monopolies and state enterprises.

### 1. Section A - Investment

#### a. Scope and Coverage

Part A provides four basic protections to "investors of other Parties": non-discriminatory treatment; freedom from "performance requirements;" free transfer of funds related to an investment; and expropriation only in conformity with international law.

"Investment" is broadly defined in Article 1139, and both existing and future investments are covered. "Investor of a Party" is defined to encompass both firms (including branches) established in a NAFTA country, without distinction as to nationality of ownership, and NAFTA-country nationals. The chapter applies where such firms or nationals make or seek to make investments in another NAFTA country.

The chapter applies to all governmental measures relating to investment, with the exception of measures governing financial services, which are treated in Chapter Fourteen. Under Article 1112, in the event of any inconsistency between Chapter Eleven and another chapter, the other chapter will prevail.

#### b. Non-discrimination and Minimum Treatment Standards

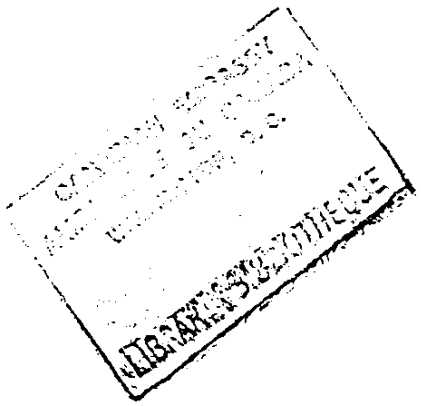
Articles 1102 and 1103 set out the basic non-discrimination rules of "national treatment" and "most-favored-nation treatment." These rules require, respectively, each government to treat NAFTA investors and their investments:

- no less favorably than its own investors and their investments, and
- no less favorably than investors of other countries and their investments.

Article 1102 makes clear that the "national treatment" rule prohibits governments from imposing local equity requirements or requiring an investor from another NAFTA country, by reason of its nationality, to sell an investment. Furthermore, Article

Extract
Canada Gazette, Part I
January 1, 1994

Extrait
Gazette du Canada, Partie I
Le 1er janvier 1994



# NORTH AMERICAN FREE TRADE AGREEMENT

# ACCORD DE LIBRE-ÉCHANGE NORD-AMÉRICAIN

## Department of External Affairs

## Ministère des Affaires extérieures

Canadian Statement on Implementation

Énoncé canadien des mesures de mise en œuvre de l'ALENA

also important in protecting Canadian investments in Mexico.

Canada will be able to maintain all existing restrictions on sensitive sectors in the Canadian economy such as air and maritime transportation, telecommunications, social services and cultural industries. Furthermore, Canada's ability to review major takeovers remains unaffected (apart from the extension of the FTA-based higher Investment Canada review thresholds to Mexico). Canada has further agreed to subject disputes raised by foreign investors to international arbitration elaborating on Canada's own practice of including such provisions in recent foreign investment protection agreements. This section provides the rules for the treatment of investors and their investments by the governments of the three Parties. Generally, it sets out the rules for the treatment of investments owned by investors of another Party, although the provisions on performance requirements and environmental measures apply to all investments (that is, including domestic investments and investments from non-NAFTA countries).

Article 1101 states that section A covers measures by a Party (i.e., any level of government in Canada) that affect:

—investors of another Party (i.e., the Mexican or American parent company or individual Mexican or American investor);

—investments of investors of another Party (i.e., the subsidiary company or asset located in Canada); and

—for purposes of the provisions on performance requirements and environmental measures, all investments (i.e., all investments in Canada).

The section does not apply to any measure to the extent it is covered by chapter fourteen relating to financial services. Article 1101 affirms the right of a Party to perform functions (such as law enforcement) and to provide services (such as social welfare and health). The article also affirms the right of Mexico to perform exclusively the economic activities set out in annex III, which lists those sectors reserved to the state in the Mexican Constitution. To the extent that Mexico permits foreign investment in these sectors (e.g., in the form of a service contract or joint production arrangement), the protections of the investment chapter apply to that investment. Additional exceptions to particular obligations are set out in separate articles (e.g., article 1108 provides that subsidies are not subject to the national treatment obligation).

Article 1102 sets out the basic obligation of national treatment for investors and their investments with respect to establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition. National treatment means that Canada will treat US and Mexican investors and their investments as favourably as it treats

l'Accord canado-américain, englobe les transports terrestres et ferroviaires, de même que les services aériens spécialisés; elle garantira en outre une meilleure protection des investissements canadiens au Mexique.

Le Canada pourra reconduire toutes les contraintes qu'il impose actuellement dans certains secteurs névralgiques de son économie, comme les transports aériens et maritimes, les télécommunications, les services sociaux et le domaine culturel. Il conservera également son droit de regard sur les prises de contrôle de grande envergure, à cette exception près qu'il devra consentir au Mexique les avantages découlant du relèvement des seuils d'examen d'Investissement Canada à la suite de l'adoption de l'Accord canado-américain. Il a en outre convenu de soumettre les réclamations d'investisseurs étrangers à un tribunal d'arbitrage international, agissant ainsi en conformité de la pratique établie dans ses plus récentes ententes à ce sujet. La section susmentionnée de l'Accord fixe les règles du traitement qu'accordera chaque pays signataire aux investisseurs originaires des autres Parties et à leurs investissements, mais stipule clairement que les passages visant les prescriptions de résultats et les mesures environnementales s'appliqueront également aux investissements intérieurs et à ceux qui proviennent d'autres pays.

Aux termes de l'article 1101, la section A vise toute mesure prise par une Partie (c'est-à-dire, pour le Canada, tout palier gouvernemental) et agissant sur :

— les investisseurs d'une autre Partie (soit les sociétés-mères ou particuliers mexicains ou américains);

— les investissements effectués par les investisseurs d'une autre Partie (filiales ou éléments d'actif situés au Canada); et

— pour les fins des dispositions concernant les prescriptions de résultats et les mesures environnementales, tous les investissements effectués au Canada.

Les mesures visées par le chapitre 14 (Services financiers) échappent à la portée de la section A. L'article 1101 confirme le droit de chaque Partie d'exercer des fonctions (par exemple l'exécution des lois) et d'assurer des services comme la sécurité sociale et les services de santé. Il confère également au Mexique l'exercice exclusif des activités économiques énumérées à l'annexe III, soit celles qui relèvent du domaine public en vertu de la constitution mexicaine. Par contre, les investissements qu'autorisent les autorités mexicaines dans ces secteurs (par marché de services, entente de partage de production ou autrement) sont assujettis aux dispositions de l'ALENA. Certains articles instaurent des dérogations supplémentaires; l'article 1108, entre autres, prévoit que l'obligation du traitement national ne s'applique pas aux subventions.

L'article 1102 précise l'obligation fondamentale des gouvernements, qui est d'accorder le traitement national aux investisseurs et aux investissements dans l'établissement, l'acquisition, l'expansion, la gestion, la direction, l'exploitation, la vente ou autre aliénation de ceux-ci. L'expression «traitement national» signifie que le Canada accordera aux

# YEARBOOK OF THE INTERNATIONAL LAW COMMISSION

# 1959

*Volume I*

*Summary records of the eleventh session*

*20 April - 26 June 1959*



UNITED NATIONS
New York, 1959

# INTERNATIONAL LAW COMMISSION

## DOCUMENTS OF THE ELEVENTH SESSION, INCLUDING THE REPORT OF THE COMMISSION TO THE GENERAL ASSEMBLY

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## STATE RESPONSIBILITY

## [Agenda item 4]

### DOCUMENT A/CN.4/119

**International responsibility. Fourth report by F. V. García Amador, Special Rapporteur**

RESPONSIBILITY OF THE STATE FOR INJURIES CAUSED IN ITS TERRITORY TO THE PERSON OR PROPERTY OF ALIENS —MEASURES AFFECTING ACQUIRED RIGHTS

[*Original text: Spanish*]
[*26 February 1959*]

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municipal law of States, principles which, at that time, were remarkably uniform. For the same reason, must not the profound transformation which has taken place during the last forty years in the social function of private ownership and in the character of expropriation also have fundamental consequences?

48. Before the First World War, expropriation was normally directed against individual property. But thereafter, various States began to generalize the practice—which was resumed and intensified after the Second World War—of carrying out acts of expropriation on a wide scale and impersonally. This type or form of expropriation is commonly referred to as "nationalization".[58] In contrast with individual or personal acts of expropriation, nationalization measures reflect changes brought about in the State's socio-economic structure (land reforms, socialization of industry or of some of its sectors, exclusion of private capital from certain branches of the national economy); or, looked at from another angle, nationalization measures constitute the instruments through which those changes in the former liberal economy are introduced. Although measures of this category are sometimes prescribed in the State's constitution, as a general rule they are adopted, and are always applied, pursuant to special statutory provisions which lay down the conditions and procedures for carrying the nationalization into effect.[59] There are also other differences, including some fairly marked ones, between nationalization and expropriation pure and simple, but any attempt to point them out would show that many of the characteristic features of the former can also be found, and in fact, often are found, in the latter.[60] In brief, therefore, except in the matter of compensation, where important distinctions can be noted, the two juridical institutions are, at least from the point of view of international law, substantially the same.

## II. Other international aspects of expropriation

49. Of all the questions raised by expropriation, compensation is undoubtedly that of the greatest interest to international law and will therefore be considered in a separate section of the present chapter. This section will refer to other aspects of the institution, in order to show the extent to which they, too, are of interest in the international context. First, however, it is necessary to consider the notion of "unlawful" expropriation, which has been explicitly recognized in practice, in order to contrast it with the notion of "arbitrary" expropriation, and to analyse the special problems created by acts of expropriation involving the non-observance of contracts or concession agreements.

### 12. "Unlawful" expropriation and "arbitrary" expropriation

50. The first step must be to agree on the meaning of the term "unlawful". According to a generally accepted principle, an expropriation is not necessarily "unlawful" even when the action imputable to the State is contrary to international law. Unlike other acts and omissions of this nature which are qualified with the same adjective or the adjective "wrongful", an expropriation can only be termed "unlawful" in cases where the State is expressly forbidden to take such action under a treaty or international convention. By analogy, acts of expropriation which do not satisfy the requirements of form or substance stipulated in an international instrument are deemed to fall within the same category. This qualification, which stems from the idea that expropriation is intrinsically lawful both from the municipal and international points of view, has been confirmed in the decisions of the Permanent Court of International Justice and of other judicial bodies. The Permanent Court, for example, in the case concerning certain German interests in Polish Upper Silesia (1926 and 1928), held that expropriation was only "unlawful" in the two instances stated above.[61] Other aspects of this question will be referred to again, but, for the present, the point to stress is that the "unlawful" character of an expropriation assimilates it, so far as the existence and imputability of international responsibility are concerned, to other acts or omissions which render the State responsible directly and immediately. In other words, in the event of an "unlawful" expropriation, responsibility comes into play and becomes imputable merely by reason of the State's act being done, even though the measure of expropriation might be fully consistent with the conditions or requirements (municipal or international) to which the exercise of the right would have been subject in the absence of a treaty.[62]

51. Once this basis is established, and having regard also to the points developed in the preceding chapter (section 5), it is not difficult to determine what is meant by "arbitrary" expropriation. This second category covers measures of expropriation which are not in conformity with the international conditions and limitations to which the exercise of the right of expropria-

[58] For a summary account of the "nationalization" measures taken before 1917 and during the period between the two world wars, see Friedman, *Expropriation in International Law* (1953), p. 12 *et seq.* As regards land reform and the nationalization of the oil industry in Mexico, see Kunz, "The Mexican Expropriations", *New York University Law School Pamphlets* (1940), Series 5, No. 1. On the Romanian land reform, see Deák, *The Hungarian-Rumanian Land Dispute* (1928), *passim*. On nationalization measures taken since 1945, see Doman, "Post-war Nationalization of Foreign Property in Europe", *Columbia Law Review* (1948), vol. 48, p. 1140 *et seq.*

[59] As regards constitutional provisions which envisage "nationalization", see K. Katzarov, "Rapport sur la nationalisation", paper prepared for the *International Law Association, New York Conference, 1-7 September 1958*, p. 11.

[60] As regards the various definitions which have been formulated of "nationalization", see, in particular, Foighel, *Nationalization, A Study of the Protection of Alien Property in International Law* (1957), pp. 13-20; Perroux, *Les nationalisations* (1945). With regard to the special aspects of the post-war nationalization measures, as well as the problems which they raise from the domestic point of view, see Scammel, "Nationalisation in Legal Perspective", *Current Legal Problems* (1952), vol. 5, pp. 30-54.

[61] Publications of the Permanent Court of International Justice, *Collection of Judgments*, series A, No. 7 (Merits), pp. 21 and 22; cf. *ibid.*, series A, No. 17, Judgment 13 (Indemnities), pp. 46 and 47.

[62] When instead of a treaty a contract or concession agreement with the alien individual concerned prohibits expropriation, the position is, as will be shown in the next section, different.

# EXPROPRIATION IN PUBLIC INTERNATIONAL LAW

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view assumes that a sovereign State can bind itself in the future by treaty to respect property rights, but that it can otherwise disregard claims to property. Yet treaties are not the sole basis of international law. A treaty or a contract may underline a duty, or make it easier to prove a breach, but obligations in international law can exist without treaties to support them.

## IV. Nationalization with Adequate Compensation: its Analogy with Expropriation and Requisition

The word 'nationalization' is not a term of art, but it usually signifies expropriation in pursuance of some national political programme intended to create out of existing enterprises, or to strengthen, a nationally controlled industry. Nationalization differs in its scope and extent rather than in its juridical nature from other types of expropriation.

There is a growing literature on the subject of nationalization in international law. In addition, there has recently been a full discussion of the problem at the Third Conference of the International Academy for Comparative Law in 1950, by the Institut de Droit International in 1952,[1] and by the International Bar Association at its Fifth Conference in 1954.[2] The problem is not a new one; it has arisen quite often in this century as has been shown, for example, in connection with the nationalization of insurance in Italy and Uruguay in 1911, the Bolshevik Revolution in Russia with its wholesale confiscatory nationalizations in 1918, and by seizures by way of nationalization of industries in Spain, Mexico and Germany and more recently in Eastern Europe.

The far-reaching governmental control exercised in belligerent countries over their economies during the Second World War prepared the way for, and even rendered essential for national economic survival, measures of nationalization, that is, of permanent national control, of vital industries. Many of these industries had already been in receipt of Government subsidies, or subject to extensive Government control, even before the War.

An Australian statesman, desirous of 'protecting Australia against nationalization or socialization of private enterprise', after taking the 'highest legal advice' did not find it possible to give a satisfactory definition of nationalization or of socialization.[3] Indeed, no definition of nationalization can be completely comprehensive. A distinction between nation-

1 See *Annuaire de l'institut de droit international*, vol. XLIV (ii) (1952), p. 251.
2 See record of the conference entitled *International Aspects of Nationalization* (1954).
3 Mr Menzies, as reported in *The Times*, 11 March 1954.

alization and socialization has been attempted by Friedman,[1] that is, between the 'reorganisation of certain forms of property within a given sector of economy' and the securing 'of the benefits of technical reorganisation to new social classes which are acceding to power'. This distinction seems to be without much value in international law, save so far as the term 'socialization' seems to refer more directly to communist or fascist theory than does the term 'nationalization'. For our purposes, however, when a nationalization or a socialization of an industry can be assimilated either to classical expropriation or to requisition, it may be treated as displaying the same juridical characteristics.

The subject of nationalization—and this term will be used to include socialization—is, however, so important that it requires a separate chapter (ch. VII). Suffice it to observe for the present that the recent nationalizations in the United Kingdom appear to afford adequate compensation and may not unfairly be assimilated either to classical expropriation or to requisition on a large scale. Confiscatory nationalization may equally be assimilated to other types of confiscation. In so far as confiscation may be justified, so, too, confiscatory nationalizations may be justified by municipal law. But municipal confiscations may also be the subject of international complaint if they fall short of international standards. The next chapter is concerned with the nature of confiscations in municipal law which are not likely to give rise to international claims today; later chapters deal with the remedies available when alleged classical expropriations, requisitions, nationalizations or confiscations by municipal law give rise to international claims.

1 *Expropriation in International Law* (1953), p. 6.

S. HRG. 102-795

# BILATERAL INVESTMENT TREATIES WITH THE CZECH AND SLOVAK FEDERAL REPUBLIC, THE PEOPLES' REPUBLIC OF THE CONGO, THE RUSSIAN FEDERATION, SRI LANKA, AND TUNISIA, AND TWO PROTOCOLS TO TREATIES WITH FINLAND AND IRELAND

## HEARING

BEFORE THE

## COMMITTEE ON FOREIGN RELATIONS
## UNITED STATES SENATE

ONE HUNDRED SECOND CONGRESS

SECOND SESSION

AUGUST 4, 1992

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ARTICLE IX

This Treaty shall not derogate from:

(a) laws and regulations, administrative practices or procedures, or administrative or adjudicatory decisions of either Party;

(b) international legal obligations; or

(c) obligations assumed by either Party, including those contained in an investment agreement or an investment authorization,

that entitle investments or associated activities to treatment more favorable than that accorded by this Treaty in like situations.

ARTICLE X

1. This Treaty shall not preclude the application by either Party of measures necessary for the maintenance of public order, the fulfillment of its obligations with respect to the maintenance or restoration of international peace or security, or the protection of its own essential security interests.

2. This Treaty shall not preclude either Party from prescribing special formalities in connection with the establishment of investments, but such formalities shall not impair the substance of any of the rights set forth in this Treaty.

ARTICLE XI

1. With respect to its tax policies, each Party should strive to accord fairness and equity in the treatment of investment of nationals and companies of the other Party.

2. Nevertheless, the provisions of this Treaty, and in particular Article VI and VII, shall apply to matters of taxation only with respect to the following:

(a) expropriation, pursuant to Article III;

(b) transfers, pursuant to Article IV; or

(c) the observance and enforcement of terms of an investment agreement or authorization as referred to in Article VI(1)(a) or (b),

to the extent they are not subject to the dispute settlement provisions of a Convention for the avoidance of double taxation between the two Parties, or have been raised under such settlement provisions and are not resolved within a reasonable period of time.

ARTICLE XII

This Treaty shall apply to the political subdivisions of the Parties.

ARTICLE XIII

1. This Treaty shall enter into force thirty days after the date of exchange of instruments of ratification. It shall remain in force for a period of ten years and shall continue in force unless terminated in accordance with paragraph 2 of this Article. It shall apply to investments existing at the time of entry into force as well as to investments made or acquired thereafter.

2. Either Party may, by giving one year's written notice I; to the other Party, terminate this Treaty at the end of the initial ten year period or at any time thereafter.

3. With respect to investments made or acquired prior to the date of termination of this Treaty and to which this Treaty otherwise applies, the provisions of all of the other Articles of this Treaty shall thereafter continue to be effective for a further period of ten years from such date of termination.

4. The Annex (and Protocol, if any) shall form an integral part of the Treaty.

IN WITNESS WHEREOF, the respective plenipotentiaries have signed this Treaty.

DONE in duplicate at _____ on the day of _____ in the English and _____ languages, both texts being equally authentic.

FOR THE UNITED STATES OF AMERICA

FOR _____

ANNEX

1. The United States reserves the right to make or maintain limited exceptions to national treatment, as provided in Article II, paragraph 1, in the sectors or matters it has indicated below:

air transportation; ocean and coastal shipping; banking; insurance; government grants; government insurance and loan programs; energy and power production; custom house brokers; ownership of real property; ownership and operation of broadcast or common carrier radio and television stations; ownership of shares in the Communications Satellite Corporation; the provision of common carrier telephone and telegraph services; the provision of submarine cable services; use of land and natural resources; mining on the public domain; maritime services and maritime-related services; and primary dealership in United States government securities.

2. The United States reserves the right to make or maintain limited exceptions to most favored nation treatment, as provided in Article II, paragraph I, in the sectors or matters it has indicated below:

ownership of real property; mining on the public domain; maritime services and maritime-related services; and primary dealership in United States government securities.

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## DESCRIPTION OF THE UNITED STATES MODEL BILATERAL INVESTMENT TREATY (BIT)—FEBRUARY 1992

(Submitted by the State Department, July 30, 1992)

### PREAMBLE

The Preamble states the goals of a bilateral investment treaty (BIT), premised on the view that an open investment policy leads to economic growth. These goals include economic cooperation, increased flow of capital, a stable framework for investment, development of respect for internationally-recognized worker rights, and maximum efficiency in the use of economic resources. While the Preamble does not impose binding obligations, it would serve to guide arbitrators in dispute settlement proceedings regarding the purposes of the Treaty.

### ARTICLE I (Definitions)

Article I sets out definitions for terms used throughout the Treaty. As a general matter, they are designed to be broad and inclusive in nature.

*Investment*

The Model BIT's definition of investment is broad, recognizing that contemporary investments take a wide variety of forms. The Model BIT covers investments that are owned or controlled by nationals or companies of one of the Treaty partners and existing in the territory of the other. Investments can be made either directly or indirectly through one or more subsidiaries, including those of third countries. No attempt is made to define control; this would be a factual question. Ownership of over 50 percent of the voting stock of a company would normally convey control, but in many cases the requirement would be satisfied by less than that proportion.

The definition provides a non-exclusive list of assets, claims and rights that constitute investment. These include both tangible and intangible property, interests in a company or its assets, "a claim to money or performance having economic value, and associated with an investment," intellectual property rights, and any right conferred by law or contract (such as government-issued licenses and permits). The requirement that a "claim to money" be associated with an investment excludes claims arising solely from trade transactions, such as a simple movement of goods across a border, from being considered investments covered by the Treaty. Debts of a State to another State also fall outside this definition.

Under paragraph 2 of Article I, either country may deny the benefits of the Treaty to investments by companies established in the other that are owned or controlled by nationals of a third country if 1) the company is a mere shell, without substantial business activities in the home country, or 2) the third country is one with which the denying party does not maintain normal economic relations. For example, the United States does not maintain normal economic relations with Cuba or Libya.

Paragraph 3 confirms that "any alteration in the form in which an asset is invested or reinvested shall not affect its character as investment." For example, a decision to alter the corporate form of an investment will not deprive it of protection under the Treaty.

*Company*

The definition of "company" is broad in order to cover virtually any type of legal entity, including any corporation, company, association, or other entity organized

under the laws and regulations of a Party. It ensures that companies of a Party that establish investments in the territory of the other Party have their investments covered by the treaty, even if the parent company is ultimately owned by non-Party nationals. Likewise, a company of a third country that is owned or controlled by nationals or companies of a Party will also be covered. The definition does not require either Party to recognize particular forms of business enterprises.

The definition also covers charitable and non-profit entities, as well as entities that are owned or controlled by the state. Coverage of state enterprises is important when making the comparison needed to assess whether national treatment under Article II has been provided. (In Article II, each Party agrees to treat nationals and companies of the other Party at least as well as its own nationals or companies).

*National*

The Model BIT defines national as a natural person who is a national of a Party under its own laws. As a practical matter, the term is largely synonymous with "citizen."

*Return*

"Return" is defined as "any amount derived from or associated with an investment," and the Model BIT provides a non-exclusive list of examples, including profits; dividends; interest; capital gains; royalty payments; management, technical assistance or other fees; and returns in kind. The scope of this definition provides breadth to the Model BIT's transfer provisions in Article IV.

*Associated Activities*

The Model BIT recognizes that the operation of an investment requires protections extending beyond the investment to numerous related activities. This definition provides an illustrative list of such investor activities, including operating a business facility, borrowing money, disposing of property, issuing stock and purchasing foreign exchange for imports. These activities are covered by Article II, paragraph 1, which guarantees the better of national or most-favored-nation (MFN) treatment for investments and associated activities.

ARTICLE II (Treatment)

Article II contains many of the Treaty's major obligations with respect to the treatment of investment.

Paragraph 1 generally ensures the better of MFN or national treatment in both the entry and post-entry phases of investment. It thus prohibits both the screening of proposed foreign investment and discriminatory measures once the investment has been made, subject to certain exceptions provided for in a separate Annex. In the Annex, each Party can list the sectors in which it will not bind itself to provide national treatment and, in some cases, MFN.

The U.S. Annex contains a list of sectors and matters in which, for various legal and historical reasons, the Federal Government or the states may not treat foreign investments as they do U.S. investments or investments from a third country. A number of sectors, including air transport, banking, energy and power production, insurance, telecommunications, government grants, and government insurance and loan programs are excluded from national treatment obligations. Ownership of real property, mining on the public domain, maritime and maritime-related services, and primary dealership in U.S. Government securities are sectors excluded from both the MFN and national treatment commitments. The latter three of these sectors in the U.S. Annex are exempted from both MFN and national treatment obligations because of U.S. laws that require reciprocity.

The listing of a sector does not signify that domestic laws have entirely reserved it for nationals. In most cases, foreign investment is limited, but not prohibited. Future restrictions or limitations on foreign investment are only permitted in the sectors listed, must be made on an MFN basis, unless the sector is also listed in the MEN Annex, and must be appropriately notified. Any additional restrictions or limitations which a Party may adopt with respect to listed sectors may not affect existing investments.

Paragraph 2 goes on to guarantee, in addition to MEN and national treatment, "fair and equitable" treatment in accordance with international law. It also prohibits Parties from impairing, through arbitrary and/or discriminatory means, the management, operation, maintenance, use, enjoyment, acquisition, expansion or disposal of investment. This paragraph sets out a minimum standard of treatment based on customary international law.

In paragraph 2(c), each Party pledges to respect any obligations it may have entered into with respect to investments. This provision makes the respect of contracts

between the host country and the investor an obligation under the Treaty. Thus, in dispute settlement under Articles VI or VII, a Party would be foreclosed from arguing, on the basis of sovereignty, that it may unilaterally ignore its obligations to such investments.

Paragraph 3 allows, subject to each Party's immigration laws, the entry of each Party's nationals into the territory of the other for purposes linked to investment and involving the commitment of a "substantial amount of capital." This paragraph serves to render nationals of a BIT partner eligible for a treaty-investor visa under U.S. immigration law and guarantees similar treatment for U.S. investors.

Under paragraph 5, neither Party may impose performance requirements such as those conditioning investment on the export of goods produced or the local purchase of goods or services. Such requirements are major burdens on investors.

Other provisions of Article II contain additional benefits for investors. Investors are guaranteed the right to engage top managerial personnel of their choice, regardless of nationality (paragraph 4); each Party must provide effective means of asserting rights and claims with respect to investment, investment agreements and any investment authorizations (paragraph 6); and each Party must make publicly available all laws, administrative practices and adjudicatory procedures pertaining to or affecting investments (paragraph 7).

Paragraph 8 recognizes that under the U.S. Federal system, states may, in some instances, treat out-of-state residents and corporations in a different manner than they treat in-state residents and corporations. The Model BIT provides that the national treatment commitment, with respect to the states, means treatment at least as favorable as that provided to out-of-state residents and corporations.

Paragraph 9 limits the Article's MEN provisions by providing that' they will not apply to advantages accorded by either Party to third countries by virtue of a Party's membership in a free trade area or customs union or a future multilateral agreement under the auspices of the General Agreement on Tariffs and Trade (GATT). The free trade area exception provides the same exception in the investment area as that provided with respect to tariff preferences in the GATT. The Model BIT's exception for a future multilateral agreement addresses a potential "free rider" problem that could occur if a BIT partner did not sign onto an accord such as the proposed General Agreement on Trade in Services, but could demand, under the Treaty's MEN provisions, the same benefits the United States provides through the multilateral accord.

## ARTICLE III (Expropriation)

Article III incorporates into the Treaty the highest international law standards for expropriation and compensation.

Paragraph 1 describes the general rights of investors and obligations of the Parties with respect to expropriation and nationalization. These rights also apply to direct or indirect state measures "tantamount to expropriation or nationalization," and thus apply to "creeping expropriations" that result in a substantial deprivation of the benefit of an investment without taking of the title to the investment.

Five requirements are listed. Expropriation must be for a public purpose; carried out in a non-discriminatory man..er; be subject to "prompt, adequate, and effective compensation;" be subject to due process; and be accorded the treatment provided in the standards of Article II.2. (These guarantee fair and equitable treatment, national treatment and MEN, and prohibit the arbitrary and discriminatory impairment of investment in its broadest sense.)

The second sentence of paragraph 1 clarifies the meaning of "prompt, adequate, and effective compensation." Compensation must be equivalent to the fair market value of the expropriated investment immediately before the expropriatory action was taken or became known (whichever is earlier); be paid without delay; include interest at a commercially reasonable rate from the date of expropriation; be fully realizable; and be freely transferable at the prevailing market rate of exchange on the date of expropriation.

aragraph 2 entitles an investor claiming that an expropriation has occurred to prompt judicial or administrative review of his claim in the host country, including a determination of whether the expropriation and any compensation conform to international law.

Paragraph 3 entitles investors to the better of national or MFN treatment with respect to war-related losses, but, unlike paragraph 1, does not specify the method for determining compensation for such losses.