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Mexico City, 9 November 2001

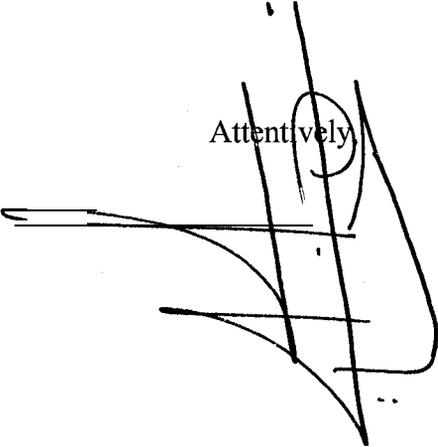
Margarete Stevens
Secretary of the Tribunal
International Centre for Settlement of Investment Disputes
1818 H Street, N.W.
Washington, D.C. 20433
U.S.A.

**RE: The Loewen Group, Inc. and Raymond L.
Loewen v. The United States of America
ICSID Case No. ARB(AF)/98/3
SECOND SUBMISSION OF THE UNITED
MEXICAN STATES**

Dear Ms. Stevens:

Following the Tribunal's instructions at the hearing, enclosed please find the Second Submission of the United Mexican States under Article 1128 of the North American Free Trade Agreement.

Attentively



Enclosure

cc. Mr. Kenneth L. Doroshov, Civil Division, Federal Programs Branch, U.S. Department of Justice
Mr. Barton Legum, Office of the Legal Adviser, U.S. Department of State.
Mr. Christopher F. Dugan, Jones, Day, Reavis and Pogue.
Ms. Meg Kinnear, General Counsel, Trade Law Division, Department of Foreign Affairs and International Trade. Canada

**THE LOEWEN GROUP, INC. AND RAYMOND L. LOEWEN
V.
THE UNITED STATES OF AMERICA**

ICSID Case No. ARB(AF)/98/3

**SECOND ARTICLE 1128 SUBMISSION
OF THE UNITED MEXICAN STATES**

Pursuant to Article 1128 of the NAFTA, the Government of Mexico makes the following submission on the interpretation of the NAFTA. Mexico takes no position on the facts of this dispute and the fact that a legal issue arising in the proceeding is not addressed in this submission should not be taken to constitute Mexico's concurrence with a position taken by either of the disputing parties.

The Governing Law

Article 1131 sets out the governing law of the proceeding. Under paragraph 1 of the Article, the Tribunal must apply the Agreement and applicable rules of international law. In addition, paragraph 2 of the Article requires the Tribunal to apply an interpretation of any provision rendered by the Free Trade Commission. Accordingly, in the context of this dispute, the 31 July 2001 Interpretative Note is part of the governing law.

Mexico observes that during the hearing questions were posed that occasionally mixed together Articles 1102 and 1105. The articles comprising Section A of Chapter Eleven contain separate and distinct legal tests and it is important that they not be mixed together. As the Tribunal noted towards the end of the hearing, Article 1102 contains a relative standard of national treatment whereas Article 1105 contains an absolute standard, the minimum standard of treatment required by international law. This is not to say that a measure might not offend both articles; however, the fact that the measure offends one does not give rise to a presumption that it

offends the other. The measure would have to be tested and found wanting under both articles in order to violate both¹.

The proper application of the NAFTA also requires this Tribunal to pay careful attention to (a) the definitions of the terms used in the treaty, including those for “investor,” “investment” and “measure” and (b) the specified beneficiaries of the obligations set out in Section A of Chapter Eleven. For example, the obligation set out in Article 1105(1) is owed to the investment, not to the investor (in contrast with the obligations in Article 1105(2) and Article 1102(2)).

Customary International Law

The content of customary international law has been raised as an important issue in this proceeding. Article 38 of the Statute of the International Court of Justice describes customary international law as:

(b) international custom, as evidence of a general practice accepted as law; [Emphasis added].

During the hearing there were references to various authorities said to support the existence of certain customary international law rules. Customary international law results from the accretion and broadening of State practice until it assumes widespread acceptance. It usually takes many years to accrete and almost always lags behind the development of conventional international law (*i.e.*, treaties). For example, if the NAFTA were not in effect, Mexico would have no customary international law obligation to accord national treatment to investors of the United States or Canada, even though the obligation of national treatment is included in many multilateral and bilateral treaties. National treatment is thus not yet part of customary international law².

To determine the content of customary international law, the International Court of Justice looks to the *opinio juris* of States: that is, whether States by their conduct evidence a willingness to be bound by the rule of law that is being propounded³. This requires the survey of many States and many different legal systems. While complete uniformity is not required, substantial uniformity is. Although customary international law can mature quickly on occasion

1. In this regard, Mexico notes that all three NAFTA Parties, while approving of the *S.D. Myers* Tribunal’s analysis of the customary international law applicable to Article 1105, have all agreed that the majority of the *S.D. Myers* Tribunal erred in applying the law when it found that a breach of Article 1102 also gave rise to a breach of Article 1105. The approach taken by the dissenter, Arbitrator Chiasson, was endorsed in subsequent proceedings by all three NAFTA Parties. It also forms the basis for paragraph B.3. of the 31 July 2001 Interpretative Note.

2. A further example is the proposed accession of the People’s Republic of China to the World Trade Organization. Even though 142 States are Members of the WTO (as of July 2002), and therefore WTO rules such as the obligation to accord national treatment and most-favoured nation treatment to goods of other countries bind the vast majority of the international community, until China formally accedes it is not entitled to the benefit of such rules nor must it accord such treatment to the goods of other WTO Members.

3. See Georg Schwarzenberger, *International Law as Applied by International Courts and Tribunals*, 3rd ed., (Stevens & Sons Limited: London, 1957) at pp. 38-43. Ian Brownlie, *Principles of Public International Law* (5th ed., 1998) at pp. 7-11.

(for example, rules relating to fishing zones⁴), generally States are not quick to acknowledge the existence of a new customary rule of international law.

Accordingly, only settled and well-accepted legal principles fall within this category of international law. By way of example, the International Court of Justice's most recent pronouncement on the local remedies rule in the context of a bilateral investment treaty, rendered in 1989, the *Elettronica Sicula S.p.A. Case* (the "ELSI Case"⁵), identified and applied long-standing principles of customary international law. The strict tests for the local remedies rule and denials of justice formulated in the early part of the last century and applied since then are settled and well-accepted, and therefore are properly characterized as rules of customary international law.

During the hearing, counsel referred to non-NAFTA arbitral awards, to law review articles, treatises, law codification reports, and decisions of national and international courts. The relevance of such sources to this Tribunal's consideration of the NAFTA and applicable rules of international law requires comment.

Other Treaties

In Mexico's respectful submission, in light of the Free Trade Commission's interpretation of 31 July 2001, the Tribunal may not to rely on awards issued by other tribunals that are inconsistent with the Commission's interpretation. Excess of jurisdiction can result from the application to NAFTA disputes of terms or treaty formulations that are not contained in the NAFTA. The Supreme Court of British Columbia identified this type of error during judicial review of the *Metalclad Award*⁶.

The Partial Award in *CME Czech Republic B.V. (The Netherlands) vs. The Czech Republic*, which was submitted at the hearing, should also not be relied on by the Tribunal⁷. The *CME* Tribunal split seriously (see paragraph 625 of the Award signed by two arbitrators and the dissenting opinion). The majority's criticisms of the dissenter and *vice versa* raise questions about the soundness of the arbitration⁸. Mexico also observes that another award on the same facts (but brought by the person who controlled CME in his personal capacity under the U.S.-Czech BIT) was rendered ten days before the *CME* award. That award, *Ronald S. Lauder v. The Czech Republic*, unanimously rejects a claim based upon the same facts, finding no breach of

4. *Fisheries Jurisdiction Case (United Kingdom v. Iceland)*, I.C.J. Reports [1974], 3 at pp. 23-26.

5. *Case Concerning Elettronica Sicula S.p.A. (ELSI)* (United States v. Italy) [1989] I.C.J. Rep. 15.

6. *United Mexican States v. Metalclad Corporation*, [2001] 89 B.C.L.R. (3d) 359 at paragraphs 64-65.

7. *CME Czech Republic B.V. (The Netherlands) vs. The Czech Republic*, UNCITRAL Award, issued in Stockholm, Sweden, on 13 September 2001. This Tribunal was comprised of Judge Stephen M. Schwebel, JUDr. Jaroslav Handl and with Dr. Wolfgang Kuhn as Chairman.

8. In an article in *Legal Business*, entitled "Clifford Chance entangled in bitter Lauder arbitrations", October 2001 edition, it is noted that "Both Schwebel and Kuhn [the majority] are understood to have stopped short of an outright denial of the [dissenter's] accusations, but have stated that they are inaccurate."

that BIT's fair and equitable treatment standard⁹. This casts further doubt on the usefulness of the *CME* award. Finally, Mexico points out that the *CME* award cites *Metalclad Corporation v. United Mexican States* with approval at paragraph 606, apparently unaware of the fact that the Tribunal's findings regarding Article 1105 were set aside by the Supreme Court of British Columbia.

Law Codification Reports

During the hearing, reference was made to the International Law Commission's Draft Articles on the Responsibility of States for Internationally Wrongful Acts¹⁰. Particular attention was drawn to Article 15 (Breach consisting of a composite act¹¹) and Article 44 (Admissibility of claims¹²). Although the Draft Articles are an authoritative source for determining the general law of State responsibility, the Tribunal should keep in mind that they do not purport to establish the primary legal obligations that would apply in the instant case. The International Law Commission made this clear in its Report:

...The emphasis is on the secondary rules of State responsibility: that is to say, the general conditions under international law for the State to be considered responsible for wrongful acts or omissions, and the legal consequences which flow therefrom. The articles do not attempt to define the content of the international obligations breach of which gives rise to responsibility. This is the function of the primary rules, whose codification would involve restating most of substantive international law, customary and conventional.¹³

And further,

...it is not the function of the articles to specify the content of the obligations laid down by particular primary rules, or their interpretation...It is a matter for the law of treaties to determine whether a State is a party to a valid treaty, whether the treaty is in force for that State and with respect to which provisions, and how the treaty is to be interpreted. The same is true, *mutatis mutandis*, for other "sources" of international obligations, such as customary international law. The articles take the existence and content of the primary rules of international law as they are for the relevant time; they provide the framework for determining whether the

9. *Ronald S. Lauder v. The Czech Republic, Final Award in the Matter of an UNCITRAL Arbitration*. This Tribunal was comprised of Lloyd N. Cutler, Bohuslav Klein, with Robert Briner as Chairman. See paragraphs 292-304.

10. Report of the International Law Commission, 53rd Sess. (23 April-1 June and 2 July-10 August 2001) A/56/10.

11. This arose in discussions regarding when the alleged denial of justice first arose.

12. This arose in discussing the role of the local remedies rule (*i.e.*, a claim is inadmissible where the rule of the exhaustion of local remedies applies and any available and effective local remedy has not been exhausted).

13. *Supra*, note 12 at p. 59.

consequent obligations of each State have been breached, and with what legal consequences for other States.¹⁴

Thus, the Draft Articles do not state the content of the international law that is applicable in this case. Rather, in accordance with the Free Trade Commission's Note of Interpretation, that content must be found in "the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to investments of investors of another Party"¹⁵.

The Writings of Publicists

The Statute of the International Court of Justice makes clear that not all writings of commentators are to be considered authoritative in the search for the content of customary international law. Article 38 of the Statute directs the Court to use as a "subsidiary means for the determination of rules of law", the teachings of the most highly qualified publicists. Therefore, the musings of academic commentators must be analyzed carefully before giving them weight. Their credentials and experience should be of the highest level in order to be considered authoritative. While not disavowing the resort to writings of qualified publicists, particularly the most authoritative ones, Professor Brownlie has commented:

It is, however, obvious that subjective factors enter into any assessment of juristic opinion, that individual writers reflect national and other prejudices, and further, that some publicists see themselves to be propagating new and better views rather than providing a passive appraisal of law.¹⁶

When seeking to establish the content of a rule of customary international law, the writings of qualified publicists who provide a passive appraisal of law are to be preferred over those who prescribe views as to what the law should be¹⁷.

The Tribunal's Role in Review of Judicial Acts and Domestic Law

This Tribunal has ruled that judicial actions can constitute measures under Article 201 of the NAFTA. That finding does not amount to a rejection of the fundamental distinctions that international law has made and continues to make between acts of the judiciary and the acts of other organs of the State. International tribunals defer to the acts of municipal courts not only because the courts are recognized as being expert in matters of a State's domestic law, but also because of the judiciary's role in the organization of the State. This does not mean that a judicial

14. *Supra*, note 12 at p. 61.

15. Free Trade Commission's 31 July 2001 Interpretative Note at paragraph B.1.

16. Brownlie, *supra* note 3 at pp. 24-25.

17. Mexico takes no position on what weight should be accorded to the testimony of the qualified publicists who have been retained to provide expert evidence in this proceeding. Mexico notes, however, that much of the testimony seems to be directed to the ultimate issues of the case, the resolution of which fall within the province of the Tribunal.

act cannot give rise to State responsibility; rather, it means that the acts of the courts are to be seen as part of a process of applying complex municipal law in light of specific facts. The application of the law and corrective actions can occur at multiple levels of the judiciary.

In an article that a previous NAFTA Tribunal has cited with approval, Eduardo Jiménez de Aréchaga, a former president of the International Court of Justice and accepted qualified publicist, has written:

It is not for an international tribunal to act as a court of appeal or of cassation and to verify in minute detail the correct application of municipal law. The essential business of an international tribunal in these cases is to see whether gross injustices have been committed against an alien and, if so, whether the three indicated requirements are present. The angle of examination is different from that of an appeal judge: it is not the grounds invoked by the domestic tribunal which must be scrutinized, but rather the result of the decision which must be evaluated, taking into account the elements of justice and equitable consideration¹⁸.

Accordingly, and as recognized by this Tribunal, the Tribunal does not sit as a court of appeal but rather as an international tribunal with a different governing law and jurisdiction. In considering any allegation of denial of justice, the Tribunal must examine the respondent's legal system as a whole, including the means provided by that system to do justice on its own. This "angle of examination" is different from that of the domestic courts.

An important policy concern underlies the international tribunal's "angle of examination". The domestic legal systems of States contain complex laws, rules and procedures relating to the conduct of trials and appeals. Unless the rules themselves are indicted at the international level, their application in the normal course by domestic courts must be respected by international tribunals. There is a danger that if the strictness of the customary international law standard for establishing a denial of justice is relaxed, would-be claimants may see great advantage in forswearing the rigors of local remedies, preferring instead to impugn the acts of lower courts on the basis of subjective considerations of fairness and equity¹⁹. In Mexico's respectful submission, there is a greater risk of such forum-shopping than may have been suggested during the hearing.

Mexico shares Judge Mikva's view that the possibility that a claimant could invoke NAFTA State responsibility for any lower court decision, without more, would have "awesome"

18. Eduardo Jiménez de Aréchaga, "International Law in the Past Third of a Century," 159 *Receuil des Cours I* (hereinafter "Aréchaga"), at p. 282. This article was cited with approval by the Tribunal in *Robert Azinian et al. v. United Mexican States*, ICSID Case No. ARB(AF)/97/2 at paragraph 98. It should be noted that although the *Azinian* Tribunal took it upon itself to analyze the international law consistency of the domestic courts' actions as a means of confirming the legality of the municipality's actions, the disputing parties did not make submissions on the issue of judicial finality nor did the claimants allege a denial of justice.

19. In the same International Law Commission ("ILC") Report cited above at note 12, the ILC's discussion of the current effort to codify the law relating to diplomatic protection underscored that denial of justice is "essentially a primary rule" (as opposed to a secondary rule). See the Report at page 173, paragraph 495.

implications. It would be extraordinary and, in Mexico's view, unintended, if the NAFTA Parties had created a mechanism by which reviewable decisions of the lowest courts immediately could be elevated to the international level²⁰. In Mexico's view, the continued availability of domestic relief is always relevant in determining whether an international wrong and hence State responsibility can be established.

In this regard, the Claimants' slide presentation of a limited exchange between counsel and a tribunal member in *Metalclad* may have given an incorrect impression of Mexico's position on this issue. In *Metalclad* and elsewhere, Mexico consistently has taken the position both in oral argument and in written submissions that the State's legal system as a whole must be examined to determine whether there has been a breach of the NAFTA. Counsel for Mexico stated in this respect at the *Metalclad* hearing:

Of course, there is a local remedies rule that exists in the NAFTA. It requires the claimant to determine whether or not to pursue a claim for damages in the domestic courts or to go to the NAFTA. A claimant is still entitled to pursue damages in the NAFTA and pursue injunctive or other extraordinary relief in the domestic courts, but that issue of making the choice of the forum only arises if there is a substantive obligation that can be challenged, the breach of which can be challenged at the NAFTA.²¹

Mexico's post-hearing submission in *Metalclad* stated:

Actions which fit within the category of public acts from which appeals on juridical grounds is provided in law, cannot be treated in isolation; the entire juridical structure must be considered in order to determine whether fair and equitable treatment has been accorded.²²

The Tribunal should also be advised that the part of the *Metalclad* Award on which the Claimants have relied in this proceeding was set aside by the Supreme Court of British Columbia on judicial review.

Article 1121: Conditions Precedent to the Submission of a Claim to Arbitration

The disputing parties have differed as to the effect of Article 1121 on the local remedies rule. The specific language of Article 1121 must be examined in light of the body of customary international law on the local remedies rule.

20. Mexico made submissions on this point during the *Metalclad* hearing and in its post-hearing submission, but they were not addressed in the Award.

21. Transcript of proceedings for *Metalclad Corporation v. United Mexican States*, Vol. IX at p. 106.

22. Respondent's Post-Hearing Submission, *Metalclad Corporation v. United Mexican States*, ICSID Case No. ARB(AF)/97/1, paragraph 316.

At customary international law, the well established rule is that all available local remedies must be exhausted before a claim can be brought to the international plane. The International Court of Justice has so confirmed:

The rule that local remedies must be exhausted before international proceedings may be instituted is a well-established rule of customary international law.²³

It is established that the international responsibility of a State cannot be engaged unless the measure complained of has been tested at municipal law and thus become final by pronouncement of the highest competent authority. As Oppenheim states:

So long as there has been no final pronouncement on the part of the highest competent authority within the state, it cannot be said that a valid international claim has arisen.²⁴

Sørensen explains further:

The rule's function is granting the respondent State an opportunity, before being declared internationally responsible, to do justice in accordance with its own legal system, and to forward an investigation and obtain a declaration by its own courts on the legal and factual questions contained in the claim. From an international tribunal's point of view, the requirement that local remedies be exhausted is a wise measure of judicial limitation because, if this is done, it may be that the need for a proceeding

23. *Interhandel Case* (Switzerland v. United States) I.C.J. Rep. (1959). See also Brownlie, pp. 496-497 ("A Claim will not be admissible on the international plane unless the individual alien or corporation concerned has exhausted the legal remedies available to him in the state which is alleged to be the author of injury."); Malanczuk, *Akehurst's Modern Introduction to International Law* (7th Revised Ed., Routledge, 1998) p. 268 ("An injured individual (or company) must exhaust remedies in the courts of the defendant state before an international claim can be brought on his behalf"); Oppenheim, pp. 522-523 ("It is a recognized rule that, where a state has treated an alien in its territory inconsistently with its international obligations but could nevertheless by subsequent action still secure for the alien the treatment (or its equivalent required by its obligations, an international tribunal will not entertain a claim put forward on behalf of that person unless he has exhausted the legal remedies available to him in the state concerned.") (footnotes excluded); *Restatement of the Foreign Relations Law of the United States (Third)* § 713, comment f, p 219 and § 902, comment k, p. 348 ("Under international law, ordinarily a state is not required to consider a claim by another state for an injury to its national until that person has exhausted domestic remedies..."); Gómez Robledo Verduzco, Alonso, *Temas Selectos de Derecho Internacional* (1st ed., Ed. UNAM/Instituto de Investigaciones Jurídicas, México, D.F., 1986), p.39 ("The recognition of the norm that provides for the need to exhaust local remedies as a prior phase to initiating an international type proceeding: diplomatic, arbitral or judicial action, seems to be currently undisputed. Thus, in principle, in every hypothesis were we are faced with international claims for damages caused to private persons, the rule of the prior exhaustion of local remedies shall be found to be applicable.)

24. *Oppenheim's International Law*, 9th ed, edited by Robert Jennings and Arthur Watts (Longman, 1996), pp. 523-524.

before an international tribunal and its consequent determination may never arise.²⁵

At customary international law, the failure to exhaust local remedies results in the claim being inadmissible. The rule amounts to a procedural bar and strictly applied²⁶. Where a claimant has failed to comply with the rule, its claim must be dismissed.

Any suggestion that the local remedies rule is an antiquated customary international law rule that does not belong to modern treaty practice is incorrect. In the human rights treaty context, for example, conventions as recent as the 1984 Convention against Torture contain requirements that matters may be raised to the international plane only after “all domestic remedies have been invoked and exhausted in the matter, in conformity with the generally recognized principles of international law”²⁷.

Moreover, in the *ELSI Case*, decided in 1989, a Chamber of the International Court found that it is not to be presumed that the local remedies rule has been done away with in an investment treaty. The Chamber stated:

50. The United States questioned whether the rule of the exhaustion of local remedies could apply at all to a case brought under Article XXVI of the FCN [Friendship, Commerce and Navigation] Treaty. That Article, it was pointed out, is categorical in its terms, and unqualified by any reference to the local remedies rule; and it seemed right, therefore, to conclude that the parties to the FCN Treaty, had they intended the jurisdiction conferred upon the Court to be qualified by the local remedies rule in cases of diplomatic protection, would have used express words to that effect; as was done in an Economic Co-operation Agreement between Italy and the United States of America also concluded in 1948. The Chamber has no doubt that the parties to a treaty can therein either agree that the local remedies rule shall not apply to claims based upon alleged breaches of that treaty; or confirm that it shall apply. Yet the Chamber finds itself unable to accept that an important principle of customary international law should be held to have been tacitly dispensed with, in the absence of any words

25. Max Sørensen, “Responsabilidad Internacional” in *Manual de Derecho Internacional Público*. (1st ed., Ed. Fondo de Cultura Económica), (3rd reprint, México, D.F., 1985), p.552.

26. See Peter Malanczuk, *Akehurst’s Modern Introduction to International Law*. 7th revised ed., (Routledge, 1997), p. 268.

“But apart from cases where local remedies are obviously futile, the rule is to be applied very strictly. For instance in the *Ambatielos* case, a Greek ship owner, Ambatielos, contracted to buy some ships from the British government and later accused the British government of breaking the contract. In the litigation which followed in the English High Court, Ambatielos failed to call an important witness and lost, his appeal was dismissed by the Court of Appeal. When Greece subsequently made a claim on his behalf the arbitrators held that Ambatielos had failed to exhaust local remedies because he had failed to call a vital witness and because he had failed to appeal from the Court of Appeal to the House of Lords.”

27. Convention against Torture, 1984, Article 21(1)(c).

making clear an intention to do so. This part of the United States response to the Italian objection must therefore be rejected.²⁸
[Emphasis added]

ELSI involved allegations of violations of investment protections including the obligation to provide “constant protection and security” of nationals of each Party “for their person and property” (established by a Friendship, Commerce and Navigation Treaty)²⁹.

Having found that the local remedies rule had not been tacitly dispensed with, the International Court required it to be shown that the U.S. shareholders in *ELSI* on whose behalf the United States had brought the claim had exhausted all local remedies. The Court posed the issue as follows:

59. With such a deal of litigation in the municipal courts about what is in substance the claim now before the Chamber, it was for Italy to demonstrate that there was nevertheless some local remedy that had not been tried; or at least, exhausted. This burden Italy never sought to deny...the local remedies rule does not, indeed cannot, require that a claim be presented to an international tribunal, applying different law to different parties: for an international claim to be admissible, it is sufficient if the essence of the claim has been brought before the competent tribunals and pursued as far as permitted by local law and procedures, and without success.³⁰ [Emphasis added]

The Court examined the Italian contention that there was one such remedy that the U.S. shareholders ought to have exhausted and did not. Because the remedy had not occurred to two Italian jurists who had been consulted by the shareholders at the time, the Court determined that the remedy was obscure and local remedies had been exhausted. Hence, the Court concluded that Italy had not discharged the burden of proving that there was a remedy which was open to the U. S. shareholders in *ELSI* and which they failed to employ:

63. It is never easy to decide, in a case where there has in fact been much resort to the municipal courts, whether local remedies have truly been “exhausted”. But in this case Italy has not been able to satisfy the Chamber that there clearly remained some remedy which Raytheon and Machlett, independently of *ELSI*, and of *ELSI*’s trustee in bankruptcy, ought to have pursued and exhausted.³¹

As noted at the outset, when examining other arbitral authorities, it is important to determine the precise content of the treaty rights and obligations that govern such authorities. It

28. *Supra*, note 5 at paragraph 50.

29. Article V, paragraphs 1 and 3 of the 1948 Treaty of Friendship, Commerce and Navigation between Italy and the United States of America.

30. *Supra*, note 5 at paragraph 59.

31. *Id.* at paragraph 63.

appears to have been asserted by the Claimants that *ELSI* is distinguishable from a NAFTA claim because it was a State-to-State claim rather than an investor-State claim and that the very creation of the investor-State mechanism amounts to an implicit waiver of the local remedies rule.

This is not the case. In a State-to-State dispute, the respondent is entitled to require the claimant to compel its investor to exhaust local remedies, and in practice, claimant States will do so before espousing a claim. In an investor-State dispute, the respondent State can raise this issue directly against the investor. The point was made in the Commentary to Article 22 of Baxter and Sohn's 1961 Draft Convention on the International Responsibility of States for Injuries to Aliens (which contemplated the right of an alien to present a claim against a State, but "only after he has exhausted the local remedies provided by the State against which the claim is made")³². The drafters stated in connection with the alien's right to bring a claim:

Allowing an individual to present his international law claim directly to the respondent State means no more than the State against which the claim is asserted may not refuse to receive or consider a claim on the jurisdictional ground that the claim was not submitted by a State. If, consistently with the view taken in this draft Convention, the wrong is done to the alien rather than to the State of which he is a national, there is no reason why he should not be allowed to present a claim directly to the foreign ministry of the State alleged to be responsible, provided, of course, he has first exhausted his local remedies.³³ [Emphasis added]

The ICSID Convention contemplates the elimination of the local remedies rule as a procedural bar to ICSID arbitration unless the Contracting State requires resort to local remedies prior to the commencement of an ICSID claim. Article 26 of the Convention states in this regard:

Consent of the parties to arbitration under this Convention shall, unless otherwise stated, be deemed consent to such arbitration to the exclusion of any other remedy. A Contracting State may require the exhaustion of local administrative or judicial remedies as a condition of its consent to arbitration under this convention. [Emphasis added]

The first sentence of Article 26 was required due to the unique structure of the ICSID Convention (which is "self-contained" and thus ousts the jurisdiction of national courts) and its governing law. Under Article 42 of the Convention, unless the parties otherwise agree, ICSID tribunals apply "the law of the Contracting State party to the dispute (including its rules on the conflict of laws) and such rules of international law as may be applicable" and thus tribunals

32. Garcia-Amador, Sohn and Baxter, *Recent Codification of the Law of State Responsibility for Injuries to Aliens* (1974) p.143; 1961 Draft Convention on the International Responsibility of States for Injuries to Aliens, Article 1(2)(a).

33. *Id.* at p. 288.

assume the domestic courts' role of interpreter of domestic law. In contrast, the governing law of a NAFTA dispute is the "Agreement and applicable rules of international law", not domestic law³⁴.

The ICSID Convention's contemplation of the continued retention of the local remedies rule as a procedural bar to ICSID arbitration shows that the mere existence of investor-State arbitration does not amount to an implicit waiver of the requirement to exhaust local remedies³⁵. Investor-State arbitration under the ICSID Convention still permits a Contracting State to insist on compliance with the procedural requirements of the local remedies rule. Hence, the investor-State mechanism does not amount to an implicit waiver of the local remedies rule. It need hardly be said that whether an ICSID Contracting State waives the rule or not, all substantive defenses remain available to the State, including those going to the ripeness of the claim.

Mexico has already pointed out the danger of relying upon arbitral awards applying different treaties and has expressed its reservations about the *CME* award. That tribunal's discussion of the local remedies rule is suspect. One of the contentions of the respondent State, the Czech Republic, was that litigation between the private parties whose dispute formed part of the factual context for the BIT proceeding was still underway in the Czech courts (in fact, before the Supreme Court of the Czech Republic). The majority found this to be of no import. It also went on to assert that the local remedies rule did not apply:

417. ...The Respondents' view is that the Claimant cannot prove any loss as long as the Claimant did not exhaust the legal remedies under the Czech Civil Court system. This contention is not acceptable. A purpose of an international investment treaty is to grant arbitral recourse outside the host country's domestic legal system. The clear purpose is to grant independent judicial remedies on the basis of an international, accepted legal standard in order to protect foreign investments. As the Treaty is silent on the obligation of exhaustion of local remedies, the Claimant is entitled and in the position to substantiate its loss without being obligated to have its subsidiary CNTS obtain a final civil law court decision by the Czech Supreme Court.³⁶

This led the majority of the Tribunal to ignore the domestic legal proceedings that were underway at the same time. It is observed that Judge Schwebel was one of two arbitrators who

34. See Interim Decision on Preliminary Jurisdictional Issues in *Marvin Roy Feldman Karpa v. United Mexican States*, ICSID Case No. ARB(AF)/99/1 at paragraph 61: "The Tribunal has taken due knowledge of the parties' respective allegations and observes that its jurisdiction under NAFTA Article 1117 (1)(a), which is relied upon in this arbitration, is only limited to claims arising out of an alleged breach of an obligation under Section A of Chapter eleven of the NAFTA. Thus, the Tribunal does not have, in principle, jurisdiction to decide upon claims arising because of an alleged violation of general international law or domestic Mexican law."

35. The point was made by the *Report of the Executive Directors on the Convention* when discussing Article 26: "In order to make clear that it was not intended thereby to modify the rules of international law regarding the exhaustion of local remedies, the second sentence explicitly recognizes the right of a State to require the prior exhaustion of local remedies." ICSID Document No. 2 (1965), paragraph 2.

36. *Supra* note 7 at paragraph 417.

held this view. Yet, whilst a judge on the International Court of Justice, even in dissent, Judge Schwebel subscribed to the majority's view in *ELSI* that the fact that an investment treaty was silent on the local remedies rule did not give rise to a waiver of such an important rule of customary international law³⁷. The position articulated in *CME* seems to be opposite to that taken by the International Court in *ELSI*³⁸.

In substantive terms, the *Lauder* case took a very different view of the relationship between the international arbitration and the Czech court proceedings. That Tribunal commented:

314. The investment treaty created no duty of due diligence on the part of the Czech Republic to intervene in the dispute between the two companies over the nature of their legal relationships. The Respondent's only duty under the Treaty was to keep its judicial system available for the claimant and any entities he controls to bring their claims and for such claims to be properly examined and decided in accordance with domestic and international law. There is no evidence - not even an allegation - that the Respondent has violated this obligation. On the contrary, the numerous Czech court proceedings ...show that the Czech judicial system has remained fully available to the Claimant.³⁹

It is respectfully submitted that this approach is consonant with the settled international authorities requiring that the State's system as a whole be examined.

Given *ELSI* and other decisions of the International Court of Justice on the importance and continued vitality of the local remedies rule as a rule of customary international law, the question then is what effect should be given to the specific text of the NAFTA. There is no express waiver of the local remedies rule in Articles 1120 and 1121, nor did the NAFTA Parties include express language akin to Article 26 of the ICSID Convention that would reverse the normal international law presumption that the rule continues to apply. The waiver contemplated in Article 1121 is for claims *for damages only* in "any administrative tribunal or court under the law of any Party, or other dispute settlement procedures". Article 1121 expressly contemplates that proceedings for "injunctive, declaratory or other extraordinary relief, not involving the payment of damages" need not be waived.

While the NAFTA Parties offered to submit to the jurisdiction of a tribunal for claims for damages and thus admitted the possibility of claims for damages against them, they did not concede liability where it would not otherwise arise under the specific obligations of Section A, including the customary international law rules covered by Article 1105. All other international

37. *Supra* note 5 at p. 83 of the ICJ Report (the opening part of Judge Schwebel's dissenting opinion).

38. It appears that the Tribunal may have been influenced by the positions taken by the disputing parties on this issue. It is not clear that the respondent State urged any form of the local remedies rule upon the Tribunal.

39. *Lauder, supra*, note 11 at paragraph 314.

law requirements and defenses remain available to them should an investor of a Party choose to assert a claim that a Party has breached an international obligation owed under the NAFTA.

The agreement to arbitrate that affects the procedural bar contained in the local remedies rule is procedural only and does not modify the substantive obligations owed by a Party. In order to succeed substantively, the investor must still make out the breach of the relevant obligation. The existence of local remedies may be relevant to establishing the breach. Direct access to investor-State arbitration in a denial of justice claim does not eliminate the requirement that the investor make out on a substantive basis the alleged denial of justice and that cannot be done where there exist available, unexhausted local remedies.

At the international plane, the conduct of the respondent State must be viewed not in respect of isolated acts, but rather comprehensively, considering “the whole system of legal protection as provided by municipal law”⁴⁰. As recognized by various comments of the Tribunal’s members, in this regard, even though a would-be claimant is able, as a matter of procedure, to commence an international claim for damages, it faces the substantive hurdle of establishing a breach of international law. In the denial of justice context, the failure to exhaust local remedies may mean that no breach of the treaty can be made out.

The point has been made recently by the International Law Commission’s *rapporteur* on diplomatic protection, Professor John Dugard:

There remains one last issue to be considered: whether a denial of justice further necessitates the exhaustion of remaining local remedies, not only in the context of the situation described in paragraph 64⁴¹ but also where denial of justice follows a violation of international law. Authors who have expressed an opinion on this issue in the works reviewed support the view that local remedies need to be exhausted in such cases. This is logical if one perceives a denial of justice as a violation of international law. This is not contradicted by codification attempts, international decisions or state practice.⁴²

Article 1102: National Treatment

Mexico submits that that the national treatment obligation requires very careful application where the claim involves judicial acts. Unlike Article 1105, Article 1102 requires a comparative analysis. The treatment accorded to the investor/claimant, which is the subject of complaint, must be compared to the treatment accorded by the Party (or in this case, the state of Mississippi) to others. The class of those in like circumstances must be identified.

40. *Ambatielos Case* (Greece v. United Kingdom), 1951, 12 R. Int’l Arb. Awards.

41. Second Report, 28 February 2001; UN Doc. A/CN.4/514. The reference to paragraph 64 is to the injury to the alien as a result of a violation of national but not international law.

42. *Id.*, para 65.

The precise wording of Article 1102(3) is important and states that a Party must accord to the investor:

...treatment no less favorable than the most favorable treatment accorded, in like circumstances, by that state or province to investors, and to investments of investors, of the Party of which it forms a part. [Underlining added]

The paragraph does not invite a comparison between the treatment accorded to the investor with another investment of the Party. Rather, it requires the claimant's treatment to be compared to that accorded to investments (plural) or investors (plural) in like circumstances.

To illustrate the point, an evaluation of whether the Mississippi Supreme Court's refusal to relax the requirement that the full amount of the bond be posted in order to obtain a stay of execution amounted to a denial of national treatment, requires evidence of the treatment accorded to investors or investments of investors of the United States who, like the Loewen Group, have sought a relaxation of the bonding requirement.

If it were shown either that the bonding requirement on its face or in its application singled out investors of another Party for less favorable treatment with respect to the requirement to post the full amount of the bond, a violation of national treatment might be made out. There must be an adequate class of domestic persons to which the claimant's treatment can be compared in order to perform a national treatment analysis, or specific evidence of effective discrimination against the foreign investor, in comparison to all others.

In addition, when applying the national treatment rule, the *only* relevant issue of status is the investor's nationality. In other words, discrimination based on race or economic class cannot constitute a breach of Article 1102, even if the affected person incidentally happens to be a non-national. Where, as here, the allegation is that the Claimant's Canadian nationality was one of a number of alleged bases for discrimination, it is less favorable treatment based on the Claimant's Canadian nationality *only* that can trigger a breach of Article 1102. Discrimination based on other factors will not given rise to a claim of breach of the national treatment rule⁴³.

Article 1105: Minimum Standard of Treatment

At customary international law, in order to make out a denial of justice, the legal system as a whole must fail. On its face, the provision of a right to appeal without an automatic stay of execution would not amount to a denial of justice at international law. Many civilized systems of law do not grant any automatic stay of execution proceedings pending appeal, or any automatic stay on the posting of a bond.

43. See *In the Matter of Cross-border Trucking Services*, Secretariat File No. USA-MEX-98-2008-01, Final Report of the Panel, February 6, 2001, for an illustration of the operation of NAFTA's national treatment rule and the designation of classes of domestic investors for the purposes of comparative treatment. The case was a State-to-State dispute administered under NAFTA Chapter Twenty.

In many jurisdictions, the right of appeal is limited in different ways, including costs bonds, and appeal bonds, or by a leave requirement. Many jurisdictions, including most recently the United Kingdom, require leave to appeal to the intermediate Court of Appeal in the majority of cases.

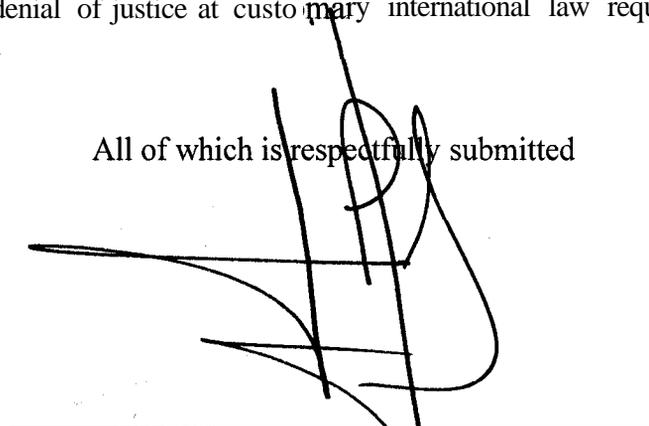
An international tribunal, mindful of the vast and entirely legitimate differences in national legal systems, cultures and traditions must be careful to avoid formulating a broad international legal obligation that does not comport with the legal systems and practice of States. If the domestic system provides for an appeal and it is available, that route must be utilized before any international denial of justice can be established.

When considering whether the acts complained of give rise to a denial of justice, the International Court of Justice's discussion of arbitrariness in international law is instructive of the international tribunal's angle of examination:

Arbitrariness is not so much something opposed to a rule of law, as something opposed to the rule of law. This idea was expressed by the court in the Asylum case, when it spoke of "arbitrary action" being "substituted for the rule of law" It is a willful disregard of due process of law, an act which shocks, or at least surprises, a sense of judicial propriety.⁴⁴

The settled litmus test for a denial of justice at customary international law requires an outrage or flagrant disregard of law.

All of which is respectfully submitted



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9 November 2001

44. *Supra* note 5 at p.