THE USE OF NON-DOMESTIC COURTS FOR OBTAINING DOMESTIC RELIEF: JURISDICTIONAL CONFLICTS BETWEEN NAFTA TRIBUNALS AND U.S. COURTS?

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I. DEFINITION OF JURISDICTIONAL CONFLICT

This contribution will examine whether or not there exist jurisdictional conflicts between international tribunals operating under the North American Free Trade Agreement (NAFTA) and the courts of the United States of America, one of the three NAFTA member states. It will be useful first to identify the perceived jurisdictional conflict before investigating whether or not there exists such a conflict at present. We are dealing here with a situation where a non-U.S. claimant in an international proceeding under NAFTAs Chapter 11 complains of a violation of international law founded upon a U.S. judicial act, i.e., one or more decisions of a court, or courts, of the United States. The judicial act essentially constitutes the NAFTA member state's "measure" complained of. This situation must be distinguished from the one in which the

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action challenged is that of another branch of government, as in the case of ADF Group Inc. v. U.S.A.[1]

Is there a problem here? In other words, is there a trend of domestic cases brought as NAFTA cases that should be of concern? As with so many legal problems, there is more to it than initially meets the eye.

As the Tribunal in the Mondev Case, discussed below, explicitly recognized,[2] NAFTA tribunals are faced here with a tension between the following two considerations: International tribunals are not courts of appeal; and NAFTAs Chapter 11 is intended to provide a real measure of protection for foreign investors.

The critical questions that must be asked in this context are threefold. First, is the NAFTA claim in substance an original, or un-remedied, appeal from a municipal decision, or was there true judicial finality? Second, is the NAFTA claimant in essence a foreign party or, rather, a U.S. party? Third, does the NAFTA claim present a colorable case under international law, i.e., is there *prima facie* evidence of a breach of international law constituted by a municipal judicial act?

In investigating whether or not the NAFTA case law points to a problem, it is necessary to distinguish the following two scenarios: Is the judicial act challenged that of a lower municipal court (as in the Loewen Case); or is the judicial act challenged that of the NAFTA member state's highest judicial authority (as in the Mondev Case)?

Assuming that the requirement of diversity of nationality under NAFTA Article 1139 is met, the NAFTA claim might be in substance an improper appeal from a municipal court decision in case of a failure to exhaust local remedies (usually implicated by a failure to file a writ of *certiorari* in the U.S. Supreme Court), or in the absence of a colorable international law claim.

II. NAFTA CASE LAW

Given that the Mondev and Loewen Cases have been referred to as possibly presenting a jurisdictional conflict between NAFTA tribunals and U.S. courts, we will concentrate on these two cases below. A summary of the facts in each of these cases will assist in clarifying their meaning in the present context.

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1. ADF Group Inc. v. United States of America, ICSID Case No. ARB(AF)/00/1 (2003), http://www.worldbank.org/icsid/cases/ADF-award.pdf.

2. Mondev Int'l Ltd. v. United States of America, ICSID Case No. ARB(AF)/99/2, 42 I.L.M. 85 (2003), ¶127 (2002).

A. The Mondev Case

The Mondev Case was brought by a Canadian investor against the U.S. under the "Additional Facility" Rules of the International Centre for Settlement of Investment Disputes (ICSID), Canada not being a party to the ICSID Convention. The case arose from a failed Boston real estate investment by the Canadian investor through its U.S. subsidiary, a Massachusetts limited partnership. The U.S. subsidiary obtained a jury verdict against the City of Boston and the Boston Redevelopment Authority (BRA) in the Massachusetts Superior Court. The court ruled, however, that the BRA was immune from liability for interference with contractual relations based on a Massachusetts statute. Both the City of Boston and the U.S. subsidiary appealed the lower court's ruling. Massachusetts' Supreme Judicial Court affirmed the lower court's ruling with regard to the BRA and also overturned the jury verdict against the City. The U.S. subsidiary's petition for a writ of *certiorari* filed in the U.S. Supreme Court in respect of the contract claim against the City of Boston was denied without giving any reasons, as was its petition for rehearing before Massachusetts' highest court. These decisions effectively put an end to the U.S. subsidiary's claims under Massachusetts law.

The Canadian investor then brought a proceeding under NAFTAs Chapter 11 alleging U.S. violations of Articles 1102 (National Treatment), 1105 (Minimum Standard of Treatment), and 1110 (Expropriation and Compensation), and claiming some fifty million in damages caused to its interests in the U.S. subsidiary.[3] The essence of the Canadian investor's complaint was that the U.S. courts had frustrated its compensation in respect of a failed investment.

In its Award of October 11, 2002, the NAFTA Tribunal allowed as the basis of Mondev's claim under NAFTA only the conduct of the U.S. courts in dismissing the U.S. subsidiary's claims (Art. 1105(1)).[4] In the circumstances, the case turned on the presence or absence of a denial of justice by the U.S. courts. Finding no evidence of such a denial of justice under contemporary international law in the circumstances, the NAFTA Tribunal dismissed Mondev's claims in their entirety.

B. The Loewen Case[5]

The Loewen Case also was an ICSID Additional Facility case brought by a Canadian investor against the U.S. Loewen's case rested on the judgment and judicial orders of a Mississippi trial court and the Mississippi Supreme Court, which judicial acts were alleged to be the relevant government measures under

3. The author's law firm represented the Canadian claimant in the NAFTA case.

4. *Id.* at 110.

5. Loewen Group, Inc. v. United States, ICSID Case No. ARB(AF)/98/3, 42 I.L.M. 811 (2003).

NAFTA Chapter 11 and were alleged to have violated NAFTA Articles 1102, 1105, and 1110. The dispute arose from litigation involving a local funeral home and funeral insurance business in Mississippi State Court against Loewen. This litigation resulted in a $500 million jury award against Loewen, by far the largest verdict ever awarded in Mississippi. The value of the underlying contract in dispute was a mere $980,000. Loewen did not pursue an appeal in light of Mississippi State court decisions refusing to relax excessive bond requirements (125% of the jury award) as a condition to an appeal. Loewen also did not file a petition for a writ of *certiorari* in the U.S. Supreme Court. Loewen finally agreed to settle the Mississippi case for $175 million. Subsequently, it initiated a proceeding under NAFTAs Chapter 11.

In June 2003, the NAFTA Tribunal dismissed Loewen's claim based on its failure to show that it had no reasonably available and adequate remedy under U.S. municipal law in respect of the matters of which it complained.

C. Inconsistent Rulings?

In the light of the facts of these cases, it may be asked: Did the Mondev and Loewen Tribunals provide openings that should concern or disturb us? The Mondev Tribunal did express "some sympathy for Mondev's situation" and found it "implicit in the jury's verdict that there was a campaign by Boston ... to avoid contractual commitments freely entered into."[6] Yet it dismissed Mondev's NAFTA claims. To soften the pain, the Tribunal did not make any order for costs or expenses.

Even though the Loewen Tribunal concluded that there had been a miscarriage of justice by the courts of the U.S. State of Mississippi *vis-à-vis* the Canadian investor, including the trial court's failure to take control of the trial, it still decided not to "use the [NAFTA] weapons at hand to put it right." It did so even after asking itself the following rhetorical question: "What clearer case than the present could there be for the ideals of NAFTA to be given some teeth?"[7]

In order fully to understand the rulings of the NAFTA Tribunals in the Mondev and Loewen Cases, which appear to be sound from an international law perspective, it will be necessary to examine the international law concepts underlying them, in particular those of attribution and exhaustion of local remedies, before a proper evaluation may be made.

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6. *Mondev Int'l Ltd.*, 42 I.L.M. at 116.

7. *Loewen Group, Inc.*, 42 I.L.M. at 850.

III. THE POSITION UNDER GENERAL INTERNATIONAL LAW

A. Attribution

It is well-settled under general international law that the unlawful actions of the U.S. courts, which constitute organs of the U.S. for purposes of international law, entail the U.S.' responsibility under international law. The International Court of Justice has stated that "the conduct of an organ of a state —even an organ independent of the executive power—must be regarded as an act of the state."[8] It also has pointed out in a recent case against the U.S. that "the international responsibility of a state is engaged by the action of the competent organs and authorities acting in that state, whatever they may be."[9] NAFTA Article 105 confirms this fundamental rule of attribution, which also is reflected in Article 4 of the International Law Commission's Articles on State Responsibility, for purposes of NAFTA proceedings.

As the NAFTA Tribunal in ADF Group Inc. v. U.S.A. confirmed "the established rule of customary international law that acts of all its governmental organs and entities and territorial units are attributable to the [s]tate and that that [s]tate as a subject of international law is, accordingly, responsible for the acts of all its organs and territorial units." [10]

Consequently, it is wholly unexceptionable for an international tribunal to examine whether the decisions of the judicial organs of a state gave rise to a violation of that state's obligations under international law, and hence triggered its responsibility under international law.

B. Exhaustion of Local Remedies

When can an investor take action against a foreign state on the international plane? Under general international law, before pursuing an international claim, the claimant is bound to exhaust any local remedy that is adequate and effective so long as the remedy is not obviously futile i.e., so long as it is not clear in advance that the municipal courts of the state concerned will not provide redress for the injured investor. This rule was confirmed in the Ambatielos and Interhandel cases.[11]

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8. Difference Relating to Immunity from Legal Process of a Special Rapporteur of the Commission on Human Rights, 1999 I.C.J. 62, 87 (Apr. 29).

9. LaGrand (Ger. v. U.S.), 1999 I.C.J. 9, 16 (Mar. 3).

10. *ADF Group Inc.*, ICSID Case No. ARB(AF)/00/1 ¶ 166.

11. *See* 23 I.L.R. 306 Interhandel (Switz. v. U.S.), 1959 I.C.J., 27 I.L.R. 475 (Mar. 21).

As we will see, the local remedies rule translates into a rule of judicial finality in NAFTA cases that are based on a judicial act alleged to violate international law.

C. Diversity of Nationality

As stated above, we are dealing here with the situation where a non-U.S. claimant in an international (NAFTA) proceeding complains of a violation of international law constituted by a U.S. judicial act. As is common in investor-state proceedings, NAFTA requires diversity of nationality as between a claimant and the respondent government. Therefore, in each NAFTA proceeding the question must be asked: Is the NAFTA claimant truly a non-U.S. party? In other words, who owns the claim? Mondev involved injury done directly to a U.S. limited partnership fully owned by a Canadian company. Mondev brought the NAFTA claim on its own behalf and not on behalf of its U.S. subsidiary. In the view of the Mondev Tribunal: "It is true that these interests [relating to Mondev's investment in the Boston project] were held by [Mondev's U.S. subsidiary] LPA, but LPA itself was 'owned or controlled directly or indirectly' by Mondev, and these interests were an 'investment or an investor of a Party' as defined in Article 1139" of the NAFTA.[12] The U.S. had urged the Tribunal to pierce the corporate veil. The Tribunal found, however, that faced with the NAFTA scheme, "there does not seem to be any room for the application of any rules of international law dealing with the piercing of the corporate veil or with derivative actions by foreign shareholders."[13]

In the Loewen case, Loewen had assigned its NAFTA claims to a Canadian corporation owned and controlled by a U.S. corporation as part of a reorganization under Chapter 11 of the U.S. Bankruptcy Code. The Loewen Tribunal warned: "If NAFTA could be used to assert the rights of an American investor in the instant case, it would in effect create a collateral appeal from the decision of the Mississippi courts, by definition a unit of the U.S. government."[14] In its view: "[i]n international law parlance, there must be continuous national identity from the date of the events giving rise to the claim, which date is known as the *dies a quo*, through the date of the resolution of the claim, which date is known as the *dies ad quem*."[15] The problem is that NAFTA expressly requires nationality only on the date of the submission of the claim, the treaty being silent on the question of whether nationality must continue to the time of resolution of the claim. The Loewen Tribunal adopted the rule of customary

12. *Mondev Int'l Ltd.*, 42 I.L.M. at 100.

13. *Id.*

14. *Loewen Group, Inc.*, 42 I.L.M. at 847.

15. *Id.*

international law requiring continuous national identity, which it found to emerge from U.S. non-espousal treaties.

The claim of one of the claimants, the Loewen Group, Inc., was dismissed due to a lack of diversity of nationality following U.S. Chapter 11 bankruptcy reorganization as a U.S. corporation. This ruling will dissuade claimants from changing their nationality at tactical points.[16]

IV. EVALUATION OF NAFTA CASE LAW

Back to the critical issue at hand, i.e., the exhaustion of local remedies and its treatment under the NAFTA case law. The Loewen Tribunal held that it "cannot under the guise of a NAFTA claim entertain what is in substance an appeal from a domestic judgment."[17] It rightly pointed out that a "NAFTA claim cannot be converted into an appeal against the decisions of municipal courts"[18] and that "the [s]tate is not responsible for the errors of its courts when the decision has not been appealed to the court of last resort."[19] Most importantly, the Tribunal stated that:

> the whole trial and its resultant verdict were clearly improper and discreditable and cannot be squared with minimum standards of international law and fair and equitable treatment. However, because the trial court proceedings are only part of the judicial process that is available to the parties, *the rest of the process, and its availability to Loewen, must be examined before a violation of Article 1105 [of NAFTA] is established.*[20]

As the Tribunal pointed out, however, the problem is that NAFTA "says nothing expressly about the requirement that, in the context of a judicial violation of international law, the judicial process be continued to the highest level."[21] At the same time, "[n]or is there any basis for implying any dispensation of that requirement."[22] The Tribunal concluded that "Article 1121 involves no waiver of the duty to pursue local remedies in its application to a

16. For an instructive ICSID case containing an elaborate discussion of the diversity of nationality requirement and corporate nationality under international law, *see Tokios Tokeles v. Ukraine, ICSID* Case No. ARB/02/18 (2004), http://www.worldbank.org/icsid/cases/awards.htm#award30.

17. *Loewen Group, Inc*, 42 I.L.M. at 819.

18. Id. at 833.

19. *Id.* at 834.

20. *Id.* at 833 (emphasis added).

21. *Id.* at 837.

22. *Loewen Group, Inc.*, 42 I.L.M. at 837.

breach of international law constituted by a judicial act."[23] It came up with its own version of the international law rule requiring exhaustion of remedies: "It is an obligation to exhaust remedies which are effective and adequate and are reasonably available to the complainant in the circumstances in which it is situated."[24]

Given that Loewen had entered into a settlement agreement instead of appealing the merits of its case, the Tribunal concluded:

> [This] is not a case in which it can be said that it was the only course, which Loewen could reasonably be expected to take. Accordingly, our conclusion is that Loewen failed to pursue its domestic remedies, notably the Supreme Court option.

In other words, it failed to file a petition for a writ of *certiorari* in the U.S. Supreme Court. [25]

Interestingly, the Tribunal attached the following postscript to its decision:

> [W]e find nothing in NAFTA to justify the exercise by this Tribunal of an appellate function parallel to that which belongs to the courts of the host nation. In the last resort, a failure by that nation to provide adequate means of remedy may amount to an international wrong but only in the last resort. The line may be hard to draw, but it is real.[26]

By contrast to the Canadian investor in Loewen, the investor in Mondev did file an appeal and a petition for a writ of *certiori* in the U.S. Supreme Court, and thus had exhausted all local remedies in that there was a final judicial act of the municipal courts. The U.S. initially claimed that there was a lack of a final judicial act, but it withdrew this objection later in the proceeding. As the Tribunal pointed out:

> It will be a matter for the investor to decide whether to commence arbitration immediately, with the concomitant requirement under Article 1121 of a waiver of any further recourse to any local remedies in the host state, or whether initially to claim damages with respect to the measure before the local courts.[27]

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23. *Id.* at 838.

24. *Id.*

25. *Id.* at 845 (emphasis added).

26. *Id.* at 851.

27. *Mondev Int'l Ltd.*, 42 I.L.M. at 103.

In the circumstances, the Mondev Case turned on the question whether or not there had been a denial of justice (the standard of treatment of aliens applicable to decisions of the host state's courts or tribunals) under NAFTA Article 1105(1). As the Tribunal stated:

> It is one thing to deal with unremedied acts of the local constabulary and another to second-guess the reasoned decisions of the highest courts of a state. Under NAFTA, parties have the option to seek local remedies. If they do so and lose on the merits, it is not the function of NAFTA tribunals to act as courts of appeal.[28]

The Tribunal cited another NAFTA case, Azinian v. United Mexican States, which had held that a denial of justice may exist if:

a) The relevant courts refuse to entertain a suit;
b) There was undue delay in the relevant courts;
c) The relevant courts administered justice in a seriously inadequate way; or
d) There was a clear and malicious misapplication of the law.[29]

The standard formulated by the Mondev Tribunal was the following:

> In the end the question is whether, at an international level and having regard to generally accepted standards of the administration of justice, a tribunal can conclude in the light of all the available facts that the impugned decision was clearly improper and discreditable, with the result that the investment has been subjected to unfair and inequitable treatment.[30]

The Loewen Tribunal cited this standard with approval.[31] These considerations by the Mondev and Loewen Tribunals are all perfectly sound from the perspective of international law and should put to rest any concerns that NAFTA tribunals might sit as courts of appeal over municipal decisions of NAFTA member states.

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28. *Id.* at 109.

29. *See Azinian v. United Mexican States*, ICSID Case No. ARB (AF)/97/2, 39 I.L.M. 537, 552 (2000).

30. *Mondev Int'l Ltd.*, 42 I.L.M. at 110.

31. *See Loewen Group, Inc*, 42 I.L.M. at 838. According to the Loewen Tribunal, "a court decision which can be challenged through the judicial process does not amount to a denial of justice at the international level." Id. at 836. "...the pursuit of local remedies plays a part in creating the ground of complaint that there has been a breach of international law." Id. at 838.

V. DISTINGUISHING THE FORK-IN-THE-ROAD PROBLEM

The situation examined here must be distinguished from that where an investor attempts to have a "second bite at the apple" after having pursued domestic proceedings, otherwise known as the "Fork-in-the-Road Problem." This problem may be described as follows: If an investor has initiated domestic litigation (or contractual arbitration) in respect of a particular dispute, does he still have available the alternative of treaty arbitration in respect of that dispute? By comparison, Article 26(3) of the Energy Charter Treaty (ECT) stipulates that, for Contracting Parties who are signatories of the ECTs Annex ID (an opt-out annex), consent to treaty arbitration is not given where the investor has previously submitted the dispute to the courts of the Contracting Party or to a previously agreed dispute settlement procedure. In other words, the ECT prevents a party from pleading treaty breaches in two separate arbitrations. It does not, however, bar a party from pleading contract breach at one time, and treaty breach at another.[32] The NAFTA claims discussed above all concerned alleged breaches of NAFTA and customary international law.

It is true that NAFTA Article 1121 requires that the would-be claimant to a NAFTA arbitration waive its "right to initiate or continue before any administrative tribunal or court under the law of any Party, or other dispute settlement procedures, any proceedings with respect to the measure of the disputing [NAFTA] party that is alleged to be a breach" of Section A of NAFTAs Chapter 11 and must desist from pursuing claims for damages in relation to such measures. But that provision has nothing to do with the local remedies rule. On the other hand, the rule of judicial finality is tied to the local remedies rule.

As the Loewen Tribunal explained, "[a]rticle 1121 involves no waiver of the duty to pursue local remedies in its application to a breach of international law constituted by a judicial act."[33]

In that scenario, "the pursuit of local remedies plays a part in creating the ground of complaint that there has been a breach of international law."[34] On the other hand, the Tribunal pointed out, "Article 1121 may have consequences where a claimant complains of a violation of international law not constituted by a judicial act."[35] It all depends on the essential basis of the cause of action that is pleaded. As the ICSID Tribunal in Vivendi v. Argentine Republic held, "[I]n a case where the essential basis of a claim brought before an international

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32. *See Michael Polkinghorne, Investor-State Dispute Resolution Under The Energy Charter Treaty: Which Fork? Which Road?*, 19 MEALEY'S INT'L ARBITRATION REP. 13 (2004).

33. *Loewen Group, Inc.*, 42 I.L.M. at 838.

34. *Id.*

35. *Id.*

tribunal is a breach of contract, the tribunal will give effect to any valid choice of forum clause in the contract."[36]

Thus, a distinction must be made between, on the one hand, an international claim for breach of treaty (such as NAFTA) and, on the other hand, a breach of domestic legal obligations. As the ICSID Tribunal in SGS v. Pakistan pointed out: "the same set of facts can give rise to different claims grounded on differing legal orders: the municipal and the international legal orders."[37] This distinction is also reflected in Article 3 of the ILCs Articles on State Responsibility. NAFTA cases are restricted to the international legal order.

VI. CONCLUSION

Based on the above review of the decisions in the Mondev and Loewen Cases, the conclusion is inescapable that there is no need for panic. These cases do not present a jurisdictional conflict with U.S. courts. It should be kept in mind that there is no *de novo* review in NAFTA proceedings. As the NAFTA Tribunal in ADF Group, Inc. v. U.S.A. stated:

> The Tribunal has no authority to review the legal validity and standing of the U.S. measures here in question under U.S. internal administrative law. We do not sit as a court with appellate jurisdiction with respect to the U.S. measures. Our jurisdiction is confined by NAFTA Article 1131(1) to assaying the consistency of the U.S. measures with relevant provisions of NAFTA Chapter eleven and applicable rules of international law.[38]

Recent state reluctance to accept that judicial acts may give rise to international claims under the NAFTA Chapter eleven scheme is redolent of arguments raised by Latin American states resorting to the Calvo Doctrine. As the Loewen and Mondev decisions and those of ICSID tribunals demonstrate, non-domestic tribunals have not allowed, and should not allow, themselves to be used for obtaining domestic relief not previously sought in the domestic courts. The claims underlying these decisions were claims under international law for violations of NAFTA. As long as NAFTA tribunals continue to adhere to a strict interpretation of the local remedies/judicial finality and diversity of nationality requirements along the lines of international law, there should be no jurisdictional conflicts.

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36. Compania de Aguas Aconquija S.A v. Vivendi Universal, ICSID Case No. ARB/97/3, ¶ 98 (2002), http://www.worldbank.org/icsid/cases/vivendi_annul.pdf.

37. SGS Societe Generale de Surveillance S.A. v. Islamic Republic of Pakistan, 42 I.L.M. 1290, 1313, ¶ 147 (2003).

38. *ADF Group Inc.*, ICSID Case No. ARB(AF)/00/1 ¶ 190.

Investors will need to file a petition for *certiorari* in the U.S. Supreme Court lest they find themselves struck out under NAFTA Chapter eleven based on the non-fulfillment of the rule of judicial finality. Most importantly, however, if the domestic courts (arguably) got it wrong under international law and if the rule of judicial finality is satisfied, NAFTA remedies should be available and such suits will not be frivolous or abusive.