# The Standard of Review of Chapter 11 Arbitrations: Deference

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## Introduction

Under the investment chapter of NAFTA, an investor can choose from several choices of arbitration to challenge acts of a member state. To facilitate this arbitration, there is domestic law that recognizes their awards and allows for a limited form of review. Under this domestic law, parties to an arbitration can appeal to the domestic court of the home of the arbitration tribunal. This places a court in the position of reviewing[1] the arbitration award. In many ways this is similar to the administrative law decisions arising out of appeals or judicial reviews of domestic administrative agencies[2] but there are some differences. In this paper, I will analyze the cases coming out of this process regarding the standard of review the courts have used. In addition, I will suggest that courts be highly deferential to arbitration tribunals especially on issues at the core of commercial law.

## The Process

Under Chapter 11 of NAFTA, investors of the members can bring challenges against a state for breaches of the various investment provisions of the agreement. The most contentious and litigated provisions relate to the minimum standard of treatment, Article 1105, and expropriation, Article 1110. When an investor considers that an investment, broadly defined, has been injured, the investor can take the dispute to a choice of arbitration[3]. Two of the arbitration options, the Additional Facility Rules of ICSID (Additional Facility Rules), and the UNCITRAL rules, have the same forms of judicial review. The third option, the ICSID Convention only has an internal form of review and therefore is never argued in a domestic court[4].

1 The terms 'appeal' and 'judicial review' will be used interchangeable to refer to the "Recourse against Arbitral Award" allowed under Article 34 of the Model Law (see below).
2 The terms 'tribunal' and 'agency' will be used interchangeable to denote non-court bodies that operate in an adjudicative manner to resolve disputes.
3 NAFTA Article 1120(1)
4 ICSID Convention rules will only become a usable option if Mexico or Canada ratify the ICSID Convention.

Once the arbitration tribunal has made its award, subject to its own rules and procedures, jurisdiction goes to the location where the tribunal is based. In Canada, most jurisdictions have implemented the Model Law on International Commercial Arbitration[5] (the Model Law) which sets out the rules for, *inter alia*, reviewing commercial arbitration decisions. The Model Law allows a domestic court to review the arbitration exclusively on the limited grounds specified in Article 34. Awards flowing from Chapter 11 disputes have been challenged under the following sections of Article 34[6]:

> (2)(a)(iii) the award deals with a dispute ... not falling within the terms of the submission to arbitration, or contains decisions on matters beyond the scope of the submission to arbitration, ...; or
> (2)(a)(iv) ... the arbitral procedure was not in accordance with the agreement of the parties, ...; or
> (2)(b)(ii) the award is in conflict with the public policy of *Canada*.

## Standard of Review

Domestic courts have had a long history of reviewing decisions of various tribunals and agencies. The field of administrative law has developed describing, *inter alia*, the level and kind of deference the court will use when considering a tribunal's decision. While there is some debate about whether the same domestic administrative law applies to Chapter 11 tribunals, there are some principles that are clearly applicable. One standard issue that is relevant to any discussion of the standard of review is the distinction between law and fact. As with trial courts, tribunals generally receive a high degree of deference on findings of fact in the dispute since the tribunal has seen the evidence prepared by the parties. Another factor that is considered is the level of expertise contained in the tribunal and its decisions. A court is a generalist body hearing a variety of disputes whereas a tribunal usually only hears disputes in a specific area and its members are experts in the field. This expertise suggests deference to the tribunal when it is considering factual and legal issues within its core expertise. These

5 See for instance, in Ontario, International Commercial Arbitration Act R.S.O. 1990; or at the federal level, Commercial Arbitration Act R.S.C., 1985

6 From Canada's Model Law, other Model Laws only differ by the italicized word.

factors are among those incorporated into what is called the 'pragmatic and functional' approach to administrative law that was stated in *Pushpanathan*[7] by the Supreme Court of Canada. This 'pragmatic and functional' has arguable replaced what is called the 'jurisdiction' approach in Canadian administrative law that had been prevalent through most of the century. Using the idea that courts must be able to police the boundaries of a tribunal's power to stop it from expanding its jurisdiction, courts used various means to decide when a tribunal had made a decision outside its jurisdiction. Critics of this approach have suggested than almost any deficiency in the tribunals decision could be defined as 'jurisdiction' reducing the practicality of this approach. In the NAFTA decisions, the courts have tried to define an appropriate standard of review based on these approaches.

## Metalclad v. Mexico

The first chapter 11 complaint and the first judicial review of an arbitration was *Metalclad*. This case arose between Metalclad, a US firm, and Mexico over a regulatory expropriation of a toxic waste dump involving various level of government. After the tribunal ruled against Mexico and awarded around $16 million in damages, Mexico appealed to the Supreme Court of B.C. since the arbitration tribunal was based in Vancouver. In his decision[8], the judge upheld the bulk of the damages but struck down the primary holdings of the tribunal. Mr. Justice Tysoe began by firmly rejected using the 'pragmatic and functional' approach since he says it would be an “error” to import it into the Model Code implementation statute.[9] He goes on to equate the 'scope of submission' language of Article 34(2)(a)(iii) with an 'excess of jurisdiction'. Using this jurisdictional analysis he finds that the tribunal erred by including transparency in the concept of 'fair and equitable' treatment as required by article 1105. He appears to use a correctness standard to determine if the tribunal was within its jurisdiction.

7 Pushpanathan v. Canada (Minister of Citizenship and Immigration) [1998] 1 SCR 982
8 The United Mexican States v. Metalclad Corporation 2001 BCSC 664
9 ibid, para 54

Once it exceeded its the jurisdiction, the decision is found to be null and void. Since the tribunal is found to have based its analysis of the Article 1110 breach upon the 1105 breach, the judge struck down this result as well. Interestingly, when considering the final line of reasoning offered by the tribunal (the post-degree expropriation) the judge considers that only a 'patently unreasonable' decision by the tribunal would place the decision outside its jurisdiction.[10] He finds the decision not to be patently unreasonable and upholds the damages on this basis.

Justic Tysoe in *Metalclad* appeared to use a 'jurisdictional' approach to review the tribunal's decision. The tribunal is found to have "misstated the applicable law"[11] and "incorrectly"[12] considered transparency as part of Chapter 11. The judge concludes:

> "Hence, the Tribunal made its decision on the basis of transparency. This was a matter beyond the scope of the submission to arbitration because there are no transparency obligations contained in Chapter 11."[13]

In addition, the judge has appeared to use a correctness standard to define the jurisdictional boundaries with little deference to the tribunal. While it is debatable whether transparency is an obligation under Chapter 11, the judge appears to have substituted his own judgement on the matter.

## Feldman v. Mexico

This dispute was between Feldman, a US citizen and Mexico over tax rebates for cross border cigarette shipments. At least some of Feldman's Mexican competitors had received the rebates yet they were blocked from him. Mexico's defense was that no company should have received the rebates and the competing companies were being audited for the rebates. At the arbitration tribunal, Mexico claimed it could not disclose any information about the audits or the tax situation of the competitors because of

10 ibid, para 96
11 ibid, para 70
12 ibid, para 71
13 ibid, para 72

Mexican privacy legislation. The tribunal drew negative inferences from the lack of disclosure and held against Mexico.

Mexico appealed the tribunals award to the Superior Court of Justice in Ontario. Justice Chilcott's decision[14] recently came out and upheld the award against Mexico. The court rejects the argument by Mexico and by the intervener, Canada, to allow the introduction of new issues. The countries wanted to introduce arguments on NAFTA Article 2105, an exception provision that allowed states to withhold information that is protected by domestic law because the issue of Article 2105 had never come up during the arbitration.

> "In my opinion, this court only has jurisdiction to set aside an award upon proof of certain circumstances set out in Article 34 of the Model Law, and this court considers it improper to raise the Article 2105 arguments on this review."[15]

Interestingly, after narrowly defining the scope of the review, the court makes a finding on the issue against Mexico.

> "In the view of this court, Mexico could have provided the information [on other taxpayers] - with breaching Section 69 [of Mexico's domestic law] or without divulging the names of the taxpayer."[16]

This mix of narrow scope of review but making findings on the issues continues later in the decision. The judge says, "there is no evidence before this court by which I can conclude that Article 69 would have prevented Mexico from leading [the taxpayer information]..."[17] at the tribunal but then excludes both parties' affidavits on the issue of whether disclosure would have been a violation of domestic law. The affidavits are excluded because there has been no "testing of the credibility or reliability of the deponents of the affidavits by cross-examination"[18] and by recognition of the "finality" of the tribunal.

14 Mexico v. Marvin Roy Feldman Karpa - released December 3, 2003, available at www.naftaclaims.com
15 ibid, para 43
16 ibid, para 45
17 ibid, para 69
18 ibid, para 76

The court goes on to support its high level of deference to the tribunal by incorporating the "definitive"[19] factors from *Pushpanathan*.

> "They are (i) the presence or absence of a privative clause; (ii) the relative expertise of the tribunal; (iii) the purpose of the Act or jurisdiction-conferring enactment as a whole; and (iv) the nature of the problem on judicial review and whether it involves a question of law or fact."[20]

Looking at the enabling statute allowing the review, the court finds a privative clause in Article 34, that forecloses review except on the limited grounds enumerated. The expertise of the panel members of the tribunal in the field of international commercial arbitration was recognized. The other two factors are discussed more in directly but did not draw back from the conclusion that a high level of deference is required.

Critics of the intervention of the court in *Metalclad*, were reassured by the more deferential attitude in this case.

The court moved on to examine the explicit grounds for review under Article 34. The award was found not to be against Ontario's public policy under (2)(b)(ii) of the Model Law. In addition the tribunal's orders did not compromise Mexico's ability to defend itself because, the court found that Mexico could have led evidence and avoided the negative inference.

## Comparison of the Cases

The two cases that have flowed out of Chapter 11 tribunals show major differences in standard of review. Most obviously, *Metalclad* was explicitly reviewed on a jurisdiction or 'scope of submission' basis while in contrast, the court in *Feldman*, appears to have accepted the *Pushpanathan* 'pragmatic

19 ibid, para 82
20 ibid, para 82

and functional' approach. This distinction arises because the *Metalclad* court sees the review under the Model Law as independent from domestic administrative law whereas in *Feldman*, the court refers to the *Pushpanathan* factors applying to "given tribunal"[21], suggesting that a review of an arbitration tribunal should be handled using the same administrative law principles as for domestic agencies.

Both courts suggest that a high level of deference should be given to the arbitration tribunal. Both quote[22] *Quintette Coal Limited v. Nippon Steel Corporation*[23] as recommending a minimal judicial interference in international commercial arbitration to respect the "autonomy of the forum" selected by the parties and to ensure international comity. These reasons suggest the high level of deference in these cases is due to the unique character of the arbitration in contrast to domestic administrative agencies. For example, a Labour Relation Board is commonly given high levels of deference by the courts but this is usually based on the expertise of the Board and the clear intention of the legislature to give the Board the final say on issues within its jurisdiction. Neither court elaborates on the ideas of *Quintette Coal* and the *Feldman* court goes on to base its high level of deference on *Pushpanathan* principles.

After identifying the high level of deference, both courts seem to apply a correctness standard to various findings. A correctness standard usually implies a very low level of deference to the tribunal since the court is substituting its own learned judgement for the tribunal's. With a high level of deference, a court will usually first ask itself if the issue in dispute is within the core expertise of the tribunal and then, assuming it is, determine if the decision is patently unreasonable. Even if the court disagrees with the tribunal's decision, it can still find that there is evidence supporting the decision. In *Metalclad*, the tribunal is found to have "misstated the applicable law" and made an error. The

21 ibid, para 82
22 In Metalclad at para 51; In Feldman at para 78
23 Quintette Coal Limited v. Nippon Steel Corporation [1991] 1 W.W.R. 219, B.C.J. No 2241 (B.C.C.A.)

correctness standard appeared to be used in the *Feldman* decision when the court makes findings on the illegality of Mexico disclosing its tax information. This use of the correctness standard is at odds with the recognition of a high level of deference.

## Discussion of the Standard of Review

After examining the standard of review used in the two arbitration review cases, several observations can be made. Firstly, there is very little shared views between the two decisions. The *Feldman* decision was released about two and half years after *Metalclad* yet the decision contains no reference to the earlier case. This could be because neither party wanted to be associated with the unpredictability of the 'jurisdiction' approach utilized in the *Metalclad* decision. Another reason could be the lack of persuasive value of that trial decision when there are other cases on the subject of judicial review under the Model Law at the appeal level. It will be interesting to see if other Chapter 11 arbitration reviews continue to be decided in isolation or if special jurisprudence gets developed for these cases.

A second observation is the minimal analysis of the level of deference. As noted before, both decisions emphasize that the court should give a high level of deference to the tribunal. In *Metalclad*, the court does not re-examine the application of this level of deference in its analysis of the 'scope of submission' and whether transparency is part of the minimum standard of treatment in Article 1105. I would suggest that the determination of the components of the minimum standard of treatment in accordance with international law is a core aspect of the tribunal's expertise. If the court has recognized the tribunal as made up of experts in international commercial arbitration, and the court feels the tribunal has made a mistake on an issue of international commercial law, the court should point to a fundamental error or completely unreasonable conclusion before overruling the tribunal. The court in

*Feldman* arguable did a better job with the analysis on the level of deference. After refusing to adjudicate the additional issue of Article 1205 and the Mexican domestic privacy law, the court deferred to the tribunal on all the aspects of the tribunal, namely a finding of *de facto* discrimination and no compensation. For instance when discussing the tribunals reasons for allowing the claimants prima facie claim of discrimination stand, the court says, "This court can find no reason to disagree with that conclusion."[24] This suggests that the court is accepting the tribunals reasoning and conclusions rather than doing its own analysis of the evidence and law. I think that this application of deference is a better reflection of the high level of deference both courts recognized in their decisions.

A final observation about both *Metalclad* and *Feldman* is that neither decision refers to the public policy aspect of the arbitration. Since these cases arise out of a dispute between a private party and a state operating in a public manner through its laws and regulations, these arbitrations are in some ways different from a general commercial arbitration between two private parties. The arbitration rules developed by both the ICSID and the UNCITRAL are designed to facilitate the resolution of disputes, "arising in the context of international commercial relations."[25] In both cases, the complainant alleged improper acts by organs of government performing regulatory functions. Perhaps in these cases the facts were such that it was clear the governments were targeting the specific investor with their acts rather than being of general application which supports a more direct relation between the investor and the state. If the government had been acting in a general manner, an argument might succeed that the tribunal deserves a less degree of deference since it is ill suited to resolve inherently public policy matters.

24 Feldman, para 71

25 UNCITRAL, Recommendations to assist the arbitral institutions and other interested bodies with regard to arbitrations under the UNCITRAL Arbitration Rules (1982) at para 1.

## S.D. Myers v. Canada

The dispute of *S.D. Myers v. Canada* will be the next Chapter 11 arbitration review case. The parties presented their arguments before the Federal Court in Ottawa earlier this month but at this time no decision has yet been released. This case arises out of Canada's restrictions on the cross-border shipment of toxic waste that was being disposed of by S.D. Myers in the United States. The arbitration tribunal ruled in October 2002 that S.D. Myers was an investment[26] under Chapter 11 and that Canada's ban on the shipments constituted expropriations of S.D. Myers investment. Canada appealed the decision to the Federal Court in Ottawa and the parties presented their arguments early in December 2003 and the court has deferred its decision.

**S.D. Myers - Canada's Arguments**

Canada argues that the arbitration be given a low level of deference using the 'pragmatic and functional' approach and the court should review the award on the 'correctness' standard.[27] Canada makes three main arguments to support this position. The first is that there is no full privative clause blocking all appeals and review.[28] This argument is unlikely to be persuasive because while there no clause blocking appeals, the award can "only" be reviewed on the limited grounds of Article 34 of the Model Law. These limited grounds do not mention allowing a *de novo* appeal as a full correctness standard of review would imply. Their second argument is that the tribunal members are "not necessarily chosen for their knowledge of trade law generally or of NAFTA Chapter 11 in particular."[29] Canada goes on to compare the ad hoc nature of the tribunals to the standing dispute resolution system of the WTO. This argument is likely to be partially successful. The tribunals are set up for commercial arbitrations not

26 This is a relatively controversial finding and is one of Canada's main arguments in the judicial review. S.D. Myers of the United States does not own S.D. Myers (Canada), the investment, they simply have common shareholders yet S.D. Myers was found to be the 'investor' for the purposes of Chapter 11.
27 Memorandum of Fact and Law of the Applicant, The Attorney General of Canada - available at www.naftaclaims.com
28 ibid, at para 135
29 ibid, at para 136

necessarily for treaty interpretation. The weakness in this argument is that the main substantive issue that Canada is disputing is the effect on the corporate structure of S.D. Myers has on the interpretation of 'investor' and 'investment', a matter that seems to be to fall within the expertise of commercial arbitration. I would suggest that the court might examine this applied expertise of the tribunal rather than the general expertise of the tribunal to resolve Chapter 11 disputes. Canada's argument on the tribunal's expertise is also slightly hypocritical since Canada signed NAFTA knowing that disputes would be resolved through international commercial arbitration panels. Canada's final reason for a low level of deference is the public policy implications beyond the two parties. There is little explanation in Canada's Memorandum explaining how the federal court is any better suited at resolving public policy implications than an arbitration tribunal. In domestic law situations the reverse is usually true with the generalist courts sometimes deferring to a specialized agencies when there are complex balancing of interests. Often in these situations the courts defer to the procedures chosen by the agencies which is not the case here with the generic arbitration rules. While I think a strong case can be made that a commercial arbitration tribunal deserves little deference on matters of public policy, the *Pushpanathan* factor on expertise refers to the relative expertise of the tribunal compared to the court and I see little reason for the Federal Court to have such relative expertise as to completely substitute its decision for the tribunal's.

For these reason, I think that Canada is unlikely to persuade the court that the Pushpanathan factors lead "inexorably"[30] to a 'correctness' standard of review.

30 ibid, at para 143

**S.D. Myers - S.D. Myers' Arguments**

In support of its arguments to uphold the tribunal's award, S.D. Myers argues the tribunal deserves the highest level of deference. First, the respondent points to the high level of deference given to international commercial arbitrations generally and says, "There is no reason to depart from this highly deferential standard in reviewing awards of Chapter 11 arbitral tribunals."[31] S.D. Myers goes on to suggest that the 'pragmatic and functional' approach not be used arguing, as the court found in *Metalclad*, that the standard of review is specified in the Model Law. This argument is interesting because it was under the 'jurisdiction' approach used in *Metalclad* that the court appeared to use the correctness standard in reviewing the decision. This contrasts to the *Feldman* decision, that was not yet released at the time these arguments were made, where the 'pragmatic and functional' approach let to a highly deferential standard of review. S.D. Myers will likely not continue arguing for the *Metalclad* approach after considering the success in *Feldman* for a high level of deference.

S.D. Myers also argues in the alternative that, under the 'pragmatic and functional' approach, the court should be highly deferential to the tribunal. S.D. Myers suggests there is a privative clause which as I mentioned before is likely to be successful. Rebutting Canada's claim that the court holds the relative expertise, S.D. Myers states, "Those assertions are wrong." and goes on to emphasize the consensual nature of picking the panelists and their being "experienced in international law and investment matters"[32] as required under NAFTA Article 1124. As with Canada's arguments, S.D. Myers does not associate the general expertise of the panel to the actual issues in dispute, which I think, would have strengthened S.D. Myers' argument in this case. S.D. Myers' weakest argument is on the public policy implications. S.D. Myers argues that even with third party effects, a high level of deference should be given because of the complex balancing. In addition, the claim is made that, "the effects on third parties

31 Respondent's Memorandum of Fact and Law, S.D. Myers Inc. - available at www.naftaclaims.com, at para 90
32 NAFTA, Article 1124(4)

are minimal."[33] The support for this position is that the remedy given by any Chapter 11 tribunal is only monetary, rather than invalidating domestic laws. This argument is quite powerful because, if accepted, it would neutralize any public policy argument made regarding Chapter 11. It also ignores the conditioning effect on governments considering changes to environmental regulations. In this case, the tribunal awarded over $6 million dollars plus interest[34] to S.D. Myers for the government's regulations of PCBs, an act the government undertook, not to penalize S.D. Myers but to protect the Canadian public. In spite of the weakness of the public policy arguments, the court will likely follow *Feldman*'s 'pragmatic and functional' approach to deference and therefore will be highly deferential to the tribunal.

**S.D. Myers - Conclusion**

As mentioned before, the arguments in this case were heard earlier this month and the decision has not been released yet. Based on the previous cases and on the arguments made by the parties, I think the court will uphold the tribunal's award primarily based on a high level of deference to the tribunal. This case is more likely than the previous cases to contain a discussion on the implications of deference on the issues of public policy, but the limited issues being disputed, none of which directly relate to public policy, do not recommend themselves to a lower level of deference. The issues mentioned in Canada's memorandum appear to be within the core expertise of the tribunal rather than public policy oriented. I think that the court will stick with the 'patent unreasonableness' standard of review because of how limited the public policy affects the issues in the review.

33 S.D. Myers Memorandum on Fact and Law, at para 110
34 S.D. Myers v Canada, Damages Award 21 October 2002, at para 301

## Conclusion

Judicial review of the Chapter 11 arbitration tribunals offers an interesting mix of international trade law, commercial arbitration, domestic administrative law, and high politics. The limited case law to this point offers a glimpse of the possible of the implications of the controversial investment chapter in NAFTA.

The three cases that have made it so far to domestic courts have all been appeals by the state parties against decisions to the investors. Many of the arguments being made by the states appear to go to the appropriateness of using commercial arbitration tribunals to resolve the quasi-public disputes that arise under Chapter 11. This is especially apparent with the limited avenues of appeal allowed under the Model Law and the legal acrobatics being used to squeeze the arguments within these avenues. Perhaps when the court in *S.D. Myers* upholds the tribunal's award, as in *Feldman*, the number of challenges to domestic courts will decline, from the already limited number, and the parties will recognize the finality of the arbitration proceedings.

As I suggested in the discussion above, courts in future decisions are likely to be highly deferential to the tribunals. This is based on the application of the pragmatic and functional approach and recognition of the privative clause of Article 34 in the Model Law, and the relative expertise of the members of the panel to decide investment issues. This level of deference, while not declared explicitly in *Feldman*, is likely the 'patently unreasonable' standard of review. It will be interesting to see if in future decisions, perhaps even in *S.D. Myers*, the court determines that on certain specific matters, such as the implications of a decision on public policy, the tribunal deserve a lower level of deference.

One of the primary purposes of the investment chapter in NAFTA is to ensure a common level of fairness to investors of the other member states. The ability to get judicial review of an arbitration decision based on the domestic law of one of the states, seems to be a possible hole in this common base. In the submissions for *S.D. Myers v. Canada*, S.D. Myers makes the suggestion that tribunals are 'forum shopping' to avoid the highly interventionist jurisprudence in Canada after the *Metalclad* decision[35] since the tribunals are allowed to pick their place of arbitration.[36] It will be interesting to see what courts in the United States and Mexico decide when arbitrations are reviewed in those jurisdictions and if there are any meaningful differences in the level of deference.

A high level of deference is very appropriate for Chapter 11 arbitration tribunals. The *Feldman* decision dealt with the level of deference in a more appropriate manner and I think that the upcoming *S.D. Myers* decision will likely follow that lead. While it is debatable whether commercial arbitration is appropriate for resolving investor-state disputes, that is what is called for under NAFTA, and judicial review is not the forum to relitigate that choice of procedures.

35 S.D. Myers Memorandum on Fact and Law, at para 95
36 See for example ICSID Additional Facilities, Article 21