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Loewen v. United States: Trials and Errors under NAFTA Chapter Eleven

William S. Dodge

LOEWEN V. UNITED STATES: TRIALS AND ERRORS UNDER NAFTA CHAPTER ELEVEN

*William S. Dodge**

INTRODUCTION

There have been many efforts to reform the American civil justice system, stretching back more than thirty years.[1] During the past decade, the United States Supreme Court has begun to play a more active role, using the Due Process Clause to impose both substantive[2] and procedural[3] limitations on punitive damages. The *Loewen* case,[4] a claim filed against the United States under Chapter 11 of the North American Free Trade Agreement (NAFTA),[5] raises another possibility: using international tribunals to correct errors in civil trials.[6]

In 1995, a Mississippi jury ordered a Canadian funeral home company, Loewen Group International (Loewen), to pay $100 million in compensatory damages and $400 million in punitive damages on claims that included fraud and violations of Mississippi antitrust law. Rather than post the $625 million bond necessary to stay execution of the judgment pending appeal, Loewen settled the suit for $175 million. Loewen then filed a claim against the United States under Chapter 11 of NAFTA alleging that its trial was infected with bias concerning nationality, racial attitudes, and economic class; that the $500 million verdict was grossly excessive; and that the bond requirement denied it the chance to appeal. As of this writing, Loewen's claim has been submitted to the arbitral tribunal, and a final award is

* Professor of Law, University of California, Hastings College of the Law. Thanks to Chip Brower, Jack Coe, Richard Epstein, and Richard Lempert for comments on an earlier draft.

1. *See* Note, *"Common Sense" Legislation: The Birth of Neoclassical Tort Reform*, 109 HARV. L. REV. 1765 (1996).

2. BMW of N. Am., Inc. v. Gore, 517 U.S. 559 (1996); TXO Prod. Corp. v. Alliance Res. Corp., 509 U.S. 443 (1993).

3. Cooper Indus., Inc. v. Leatherman Tool Group, Inc., 532 U.S. 424 (2001); Honda Motor Co. v. Oberg, 512 U.S. 415 (1994).

4. The Loewen Group, Inc. v. United States, ICSID Case No. ARB(AF)/98/3 (Nov. 19, 1998).

5. North American Free Trade Agreement, Dec. 7-17, 1992, ch. 11, 32 I.L.M. 605, 639-49 [hereinafter NAFTA].

6. There is currently one other Chapter 11 claim based on a court decision pending against the United States. *See* Notice of Arbitration Claim, Mondev Int'l, Ltd. v. United States, ICSID Case No. ARB(AF)/99/2 (Sept. 1, 1999), *available at* http://www.state.gov/documents/organization/3931.pdf (last visited Oct. 9, 2002).

expected soon. Although Loewen disclaimed any intent to use Chapter 11 as an alternative form of appeal, Loewen sought, as one would on appeal, to correct errors allegedly made at trial.[7]

This Article will argue that review by international tribunals is not a good way to correct trial errors, and Chapter 11 should be changed to require, or at least to encourage, the exhaustion of domestic appeals before resorting to NAFTA arbitration. Part II briefly reviews the *Loewen* trial and the errors that allegedly occurred. Part III identifies Chapter 11's weaknesses as a system of appeal. Part IV then considers two alternatives. The first is to *require* the exhaustion of domestic appeals by enforcing what is known in international law as the "local remedies rule."[8] The second is to allow immediate resort to Chapter 11 but to *encourage* the exhaustion of domestic appeals first by making Chapter 11 enforceable in domestic courts, expressly tolling the statute of limitations for filing NAFTA claims while domestic appeals are exhausted and removing the possibility that domestic court decisions would have a *res judicata* effect in a subsequent Chapter 11 proceeding. Part V briefly considers whether these alternatives might apply not just to trial errors, but also to more typical violations of Chapter 11, such as expropriations. Part VI concludes.

II. TRIAL AND ERRORS

Loewen began with a small, yet somewhat complicated, business dispute.[9] In April 1991, Jeremiah O'Keefe, a funeral home owner from Biloxi, Mississippi, sued Loewen Group International, Inc., alleging interference with O'Keefe's business relations with another Mississippi funeral home. Loewen Group International was an Amer-

7. *Compare* Memorial of The Loewen Group, Inc. 1 (Oct. 18, 1999) (unpublished memorial, on file with author) [hereinafter Loewen Memorial] (stating that "[t]his claim does not seek direct or collateral review of the municipal-law issues addressed by the Mississippi courts in the *O'Keefe* litigation"), *and* Opinion of Sir Robert Jennings at 2 (Oct. 26, 1998), *reprinted in* Loewen Memorial, *supra*, at Exhibit A (opining that Loewen's claim "would not be a claim forming in any way an appeal from the verdicts and judgment of the Mississippi Hinds County Court, but a new and different claim . . . for . . . breaches of the NAFTA Treaty"), *with* Rejoinder of the United States of America at 2 (Aug. 27, 2001) (unpublished memorial, on file with author) (stating that "this international claim is little more than a substitute for the appeal from the trial court's judgment that Loewen elected to forgo in the Mississippi courts").

It is perhaps ironic that all three members of the *Loewen* tribunal have served as appellate judges: Sir Anthony Mason was Chief Justice of the High Court of Australia; Abner Mikva was Chief Judge of the United States Court of Appeals for the District of Columbia Circuit; and Sir Michael Mustill was Lord Justice of the English Court of Appeals.

8. *See generally* C.F. AMERASINGHE, LOCAL REMEDIES IN INTERNATIONAL LAW (1990).

9. Unless otherwise indicated, the facts are taken from the Loewen Memorial. *See* Loewen Memorial, *supra* note 7, at 8-61. For a more colorful account of the trial and the characters involved, see Jonathan Harr, *The Burial*, NEW YORKER, Nov. 1, 1999, at 70.

ican subsidiary of The Loewen Group, Inc., a Canadian company controlled and partially owned by Raymond Loewen, a Canadian citizen. In August 1991, the parties tentatively agreed to settle the suit: Loewen would have purchased two funeral homes from O'Keefe, and O'Keefe would have bought an insurance company from Loewen. The proposed settlement was never finalized, however, and in 1992 O'Keefe amended his complaint to add claims of fraud and violations of Mississippi antitrust law. The suit went to trial in state court in 1995 against Loewen Group International, its Canadian parent, and a local Mississippi funeral chain that Loewen owned. After a seven-week trial, the jury found for the plaintiff and awarded $100 million in compensatory damages (a large portion of which was for emotional distress) and $400 million in punitive damages, for a total award of $500 million. In Mississippi, a losing defendant who wished to stay execution of the judgment pending appeal had to post a bond for 125% of the judgment, although the bond could be reduced for "good cause." In January 1996, the Mississippi Supreme Court denied Loewen's application to reduce the bond, and five days later, Loewen settled the suit for $175 million. Financial difficulties that began around the time of the verdict ultimately forced Loewen into bankruptcy in June 1999.

The Chapter 11 violations alleged by Loewen fall into three basic categories. First, Loewen alleged that "[t]he trial court allowed O'Keefe's counsel to make irrelevant and highly prejudicial comments, and to elicit from witnesses irrelevant and highly prejudicial testimony, about the nationality, racial attitudes, and economic class of the parties in this case."[10] Loewen complained that plaintiff's counsel attempted to whip up anti-Canadian sentiment on the jury by contrasting Loewen's Canadian origins with O'Keefe's Mississippi roots, implied that Raymond Loewen was a racist by calling a series of witnesses to testify that O'Keefe was not one, and emphasized Mr. Loewen's wealth.[11] It is unlikely that Loewen could have relied on these alleged errors to challenge the verdict on appeal because Loewen's counsel failed to object to nearly all of them at trial.[12] Loewen argued, however, that NAFTA Article 1105(1)'s guarantee of "full protection and security" imposed an "affirmative duty"[13] on the trial court "to restrain the hundreds of invidious appeals by plaintiff's counsel to national pride, to disparities in wealth, and even to racial

10. Loewen Memorial, *supra* note 7, at 62.

11. *Id.* at 8-47.

12. Statement of Stephan Landsman, Counter-Memorial of the United States of America, 18-36, Tab C (Mar. 30, 2001) (unpublished memorial, on file with author).

13. Loewen Memorial, *supra* note 7, at 91, 93 & 95.

prejudice."[14] According to Loewen, such prejudicial comments by plaintiff's counsel constituted "procedural denial[s] of justice"[15] in violation of international law and therefore in violation of NAFTA Article 1105,[16] as well as Article 1102's requirement of "national treatment."[17]

Second, Loewen alleged that the $500 million verdict itself was a substantive denial of justice in violation of Article 1105[18] and an expropriation of property in violation of Article 1110.[19] Loewen argued that the punitive damages award of $400 million in particular would have been overturned on appeal under either state or federal standards.[20]

Third, Loewen alleged that the $625 million bond requirement constituted a "procedural denial of justice" in violation of Article 1105.[21] Although the question of whether the Due Process Clause requires reduction of an excessive bond is one the United States Supreme Court left unanswered in *Pennzoil Co. v. Texaco, Inc.*,[22] Loewen chose not to seek Supreme Court review of the bond requirement.

Each of the three kinds of errors of which Loewen complained could have been addressed by U.S. domestic courts on appeal: the allegedly prejudicial comments of plaintiff's counsel if Loewen had objected to them at trial; the $500 million judgment itself as a violation of state and federal standards governing punitive damages; and the $625 million bond requirement as a violation of the Due Process

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14. *Id.* at 96.

15. *Id.* at 90.

16. *See* NAFTA, *supra* note 5, at art. 1105(1) (requiring that "[e]ach Party shall accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security").

17. Loewen Memorial, *supra* note 7, at 71-72. *See also* NAFTA, *supra* note 5, at art. 1102(1) (stating that "[e]ach Party shall accord to investors of another Party treatment no less favorable than that it accords in like circumstances, to its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments").

18. Loewen Memorial, *supra* note 7, at 75-88.

19. *Id.* at 99-104. *See also* NAFTA, *supra* note 5, at art. 1110(1), which states:

> No Party may directly or indirectly nationalize or expropriate an investment of an investor of another Party in its territory or take a measure tantamount to nationalization or expropriation of such an investment ('expropriation'), except: (a) for a public purpose; (b) on a non-discriminatory basis; (c) in accordance with due process of law and Article 1105(1); and (d) on payment of compensation . . . .

Id.

20. Loewen Memorial, *supra* note 7, at 87.

21. *Id.* at 89, 90.

22. 481 U.S. 1 (1987).

Clause.[23] Loewen was not required to exhaust its domestic appeals, however, because Chapter 11 waives the "local remedies rule" and gives foreign investors harmed by the errors of a trial court the option of immediate review by an international tribunal.

III. NAFTA CHAPTER ELEVEN AS A SYSTEM OF APPEAL

As a general matter, customary international law requires that a foreign investor exhaust its domestic remedies before pursuing an international claim.[24] This "local remedies rule" may, however, be waived by treaty,[25] and NAFTA Article 1121 appears to do just that. Article 1121 requires, as condition precedent to arbitration, that the foreign investor 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 Party that is alleged to be a breach."[26] In other words, Chapter 11 requires a foreign investor to waive its domestic remedies rather than to exhaust them.[27] Because court judgments are "measures" covered by Chapter 11,[28] Loewen was entitled to file a Chapter 11 claim based on the judgment so long as it waived its right to appeal that judgment through the domestic court system.

Although Loewen was entitled to file a Chapter 11 claim immediately, it was not required to do so. The language of Article 1121 suggests that an investor may challenge a court judgment or other "measure" in domestic court.[29] It must simply waive the right to "con-

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23. In each case, Loewen's appeal would have been limited to issues of domestic law because, as I explain in more detail below, U.S. legislation implementing NAFTA does not permit violations of NAFTA to be raised in U.S. courts. *See infra* note 33 and accompanying text.

24. *See* Interhandel Case (Switz. v. U.S.), 1959 I.C.J. 5, 27 (Mar. 21) (stating that "[t]he rule that local remedies must be exhausted before international proceedings may be instituted is a well-established rule of customary international law").

25. *See* Case Concerning Elettronica Sicula S.p.A. (ELSI) (U.S. v. Italy), 1989 I.C.J. 15, 42 (July 20) (expressing "no doubt that the parties to a treaty can therein either agree that the local remedies rule shall not apply to claims based on alleged breaches of that treaty; or confirm that it shall apply"). *See generally* AMERASINGHE, *supra* note 8, at 251-75.

26. NAFTA, *supra* note 5, at arts. 1121(1)(b), (2)(b). There is an exception for "proceedings for injunctive, declaratory or other extraordinary relief, not involving the payment of damages," which a foreign investor is permitted to initiate or continue even after submitting a Chapter 11 claim to arbitration. *Id.*

27. For a more extensive discussion, see William S. Dodge, *National Courts and International Arbitration: Exhaustion of Remedies and Res Judicata Under Chapter Eleven of NAFTA*, 23 HASTINGS INT'L & COMP. L. REV. 357, 373-76 (2000).

28. The Loewen Group, Inc. v. United States, Decision on Hearing of Respondent's Objection to Competence and Jurisdiction 9-16 (Jan. 5, 2001), *available at* http://www.state.gov/documents/organization/3921.pdf (last visited Oct. 9, 2002).

29. NAFTA, *supra* note 5, at arts. 1121(1)(b), (2)(b).

tinue" those proceedings once it files a NAFTA claim.[30] Chapter 11 contains a statute of limitations provision requiring a foreign investor to file its claim within three years of the alleged breach and loss.[31] But this means Loewen had the option of pursuing appeals in the United States court system for up to three years without foregoing its right to seek redress under NAFTA.

There are several aspects of Chapter 11, however, that will tend to discourage a foreign investor from exhausting its domestic appeals. First, Chapter 11 does not expressly toll its three-year statute of limitations while those appeals are exhausted.[32] A foreign investor might therefore expend substantial time and resources pursuing its domestic appeals, only to be forced to abandon either those appeals or its potential Chapter 11 claim if the appellate process takes more than three years.

Second, a foreign investor will generally not be able to raise its Chapter 11 claims in domestic court. Both the United States and Canada have passed legislation that precludes private parties from raising NAFTA claims in their courts.[33] Mexico discourages foreign investors from raising Chapter 11 claims in its courts by barring an in-

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30. *Id.*

31. *See id.* at art. 1116(2) (stating that "[a]n investor may not make a claim if more than three years have elapsed from the date on which the investor first acquired, or should have first acquired, knowledge of the alleged breach and knowledge that the investor has incurred loss or damage"); *id.* at art. 1117(2) (stating that "[a]n investor may not make a claim on behalf of an enterprise . . . if more than three years have elapsed from the date on which the enterprise first acquired, or should have first acquired, knowledge of the alleged breach and knowledge that the enterprise has incurred loss or damage").

32. One might argue that Chapter 11 implicitly tolls its statute of limitations while an investor exhausts domestic remedies. The three-year period set forth in Articles 1116(2) and 1117(2) does not begin running until the investor or enterprise acquired, or should have acquired, "knowledge of the alleged breach *and knowledge that the investor [or enterprise] has incurred loss or damage.*" *Id.* at arts. 1116(2), 1117(2) (emphasis added). Arguably, an investor or enterprise would not be certain it has incurred loss or damage until its domestic remedies proved unsuccessful. One might further argue, in the case of court decisions, that there can be no breach of Chapter 11 until domestic appeals have been exhausted and that only then would the three-year statute of limitations begin to run. Neither argument is certain to prevail, however, so the lack of an express provision for tolling is still likely to discourage domestic appeals.

33. *See* 19 U.S.C.A. § 3312(c)(2), which states:

> No person other than the United States . . . may challenge, in any action brought under any provision of law, any action or inaction by any department, agency, or other instrumentality of the United States, any State, or any political subdivision of a State on the ground that such action or inaction is inconsistent with the [NAFTA] . . . .

Id.

See also North American Free Trade Agreement Implementation Act, ch. 44, 1993 S.C. 1924-25 (Can.), which states:

> Subject to Section B of Chapter Eleven of the Agreement, no person has any cause of action and no proceedings of any kind shall be taken, without the consent of the Attor-

vestor who does so from submitting those claims to a subsequent arbitral tribunal.[34] This means an investor must find a domestic law proxy for its Chapter 11 claim. Loewen, for example, could not have argued on appeal that the $500 million judgment against it was a "denial of justice" in violation of customary international law and therefore in violation of NAFTA Article 1105. It would have been limited to arguing that this judgment violated Mississippi law or the Due Process Clause of the Fourteenth Amendment. Although the protections of domestic law are generally better developed than their Chapter 11 counterparts,[35] this may either encourage or discourage a foreign investor from appealing domestically, depending on the strength of its legal case.

Third, a foreign investor who pursues domestic appeals runs the risk that a decision on appeal will be used against it in a subsequent Chapter 11 proceeding. The merits of a Chapter 11 claim itself will generally not be at issue in a domestic appeal because the investor is precluded from raising such claims,[36] but the domestic courts may make findings that bear upon the investor's Chapter 11 claim. In *Azinian v. Mexico*, for example, the NAFTA tribunal arguably treated the Mexican court's conclusion that a concession agreement had been induced by fraud as *res judicata*.[37] A foreign investor may be unwilling to risk prejudicing its Chapter 11 claim by seeking redress in domestic court.

In Loewen's case, two additional factors likely contributed to its decision to seek review through Chapter 11. First, it would have been expensive for Loewen to post the $625 million bond necessary to stay execution of the judgment pending appeal, and Loewen likely judged that its chances of getting the United States Supreme Court to take its case on the due process issue were slim. Second, Chapter 11 offered the possibility of not just recouping the money that Loewen was obligated to pay the plaintiff, but also recovering consequential damages for harm the verdict had allegedly done to its business.

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ney General of Canada, to enforce or determine any right or obligation that is claimed or arises solely under or by virtue of the Agreement.

Id.

34. *See* NAFTA, *supra* note 5, at Annex 1120.1.

35. *See infra* notes 40-43 and accompanying text.

36. *See supra* notes 33-34 and accompanying text.

37. Azinian v. United Mexican States (Nov. 1, 1999), 39 I.L.M. 537, 551 (2000) (stating that "[a] governmental authority surely cannot be faulted for acting in a manner validated by its courts unless the courts themselves are disavowed at the international level") (emphasis omitted). For further discussion of *Azinian*, see Dodge, *supra* note 27, at 376-79.

Within the context of a treaty for the protection of foreign investment, allowing immediate review of court judgments under Chapter 11 has advantages and disadvantages. The principal advantage is that it allows foreign investors to avoid the possibly "biased, inefficient or unfamiliar courts of their host states."[38] This advantage is particularly significant in treaties with less developed countries, and it is important to remember that it was in the context of such treaties that the practice of waiving the local remedies rule and allowing immediate recourse to international arbitration evolved.[39] When the investment treaty is between more developed countries like the United States and Canada, however, a number of disadvantages emerge more clearly. Compared to domestic courts, Chapter 11 review tends to be less determinate, less accountable, less legitimate, and more intrusive on national sovereignty.

Chapter 11 review tends to be less determinate because the applicable law is less developed. One of Loewen's main claims, for example, was that the $500 million judgment, which included $400 million in punitive damages, was a "denial of justice" in violation of customary international law. There are relatively few international decisions defining the scope of a "denial of justice" claim and apparently none that have dealt with this claim in the context of punitive damages.[40] United States domestic law on punitive damages is better defined. By statute, Mississippi requires that a jury awarding punitive damages find "by clear and convincing evidence" that the defendant "acted with actual malice, gross negligence . . . or committed actual fraud" and requires the jury and the trial judge to consider the potential harmfulness of defendant's conduct, the reprehensibility of defendant's conduct, and the defendant's financial condition.[41] The United States Supreme Court has further held that the Due Process Clause of the Fourteenth Amendment prohibits "grossly excessive" awards[42] and requires consideration of the reprehensibility of defendant's conduct, the potential harm it might have caused, and the sanctions applicable to comparable misconduct.[43] Although United States domestic

38. Charles H. Brower, II, *Structure, Legitimacy and NAFTA's Investment Chapter*, 36 VAND. J. TRANSNAT'L L. (forthcoming 2003) (manuscript at 61, on file with author).

39. For a brief discussion of bilateral investment treaties and the local remedies rule, see Dodge, *supra* note 27, at 363-64.

40. The parties' memorials cite none that deal with punitive damages.

41. MISS. CODE ANN. § 11-1-65 (2001). The common law of Mississippi requires an evaluation of similar factors. *See* Andrew Jackson Life Ins. Co. v. Williams, 566 So. 2d 1172, 1190-91 (Miss. 1990).

42. TXO Prod. Corp. v. Alliance Res. Corp., 509 U.S. 443, 458 (1993).

43. BMW of N. Am., Inc. v. Gore, 517 U.S. 559, 575-85 (1996).

standards for punitive damages leave a good deal of discretion to the reviewing court, they offer significantly more guidance and place greater limits on the exercise of discretion than customary international law currently does.

Chapter 11 review also tends to be less accountable because Chapter 11 tribunals are themselves more insulated from review. Whether a Mississippi punitive damages award is excessive is determined in the first instance by the trial judge and ultimately by the Mississippi Supreme Court.[44] Indeed, the U.S. Supreme Court has held that the Due Process Clause requires appellate review of punitive damages awards[45] and that such review must be *de novo*.[46] The decisions of the Mississippi Supreme Court are in turn reviewable by the U.S. Supreme Court to ensure compliance with the substantive requirements of the Due Process Clause discussed above.[47] Although review by the U.S. Supreme Court itself is rare, the possibility of such review exerts a restraining influence on state courts. Review of NAFTA Chapter 11 decisions is far more limited. A court reviewing a Chapter 11 award may not set it aside if the tribunal misinterpreted the law or misapplied it to the facts but only if the tribunal was improperly constituted or decided matters beyond the scope of the arbitration.[48] This more limited review *of* Chapter 11 tribunals increases the chances that review *by* such tribunals will result in errors.

Lack of determinacy and accountability in turn raise problems of legitimacy.[49] As Professor Franck has pointed out, the legitimacy of a rule depends in part on its determinacy.[50] Decisions rendered under new and uncertain standards are more apt to be seen as lawless than those that draw on a more developed jurisprudence. So are decisions rendered by unaccountable decision makers.[51]

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44. *See* Dixie Ins. Co. v. Mooneyhan, 684 So. 2d 574 (Miss. 1996).

45. Honda Motor Co. v. Oberg, 512 U.S. 415, 432 (1994).

46. Cooper Indus., Inc. v. Leatherman Tool Group, Inc., 532 U.S. 424, 435-36 (2001).

47. *See supra* notes 42-43 and accompanying text.

48. *See* William S. Dodge, *International Decision:* Metalclad Corp. v. Mexico, 95 AM. J. INT'L L. 910, 918-19 (2001).

49. For an excellent discussion of legitimacy and Chapter 11, see Brower, *supra* note 38.

50. *See* THOMAS M. FRANCK, FAIRNESS IN INTERNATIONAL LAW AND INSTITUTIONS 30-34 (1995); THOMAS M. FRANCK, THE POWER OF LEGITIMACY AMONG NATIONS 50-66 (1990); *see also* Brower, *supra* note 38 (manuscript at 16-18) (discussing predictability as a factor in establishing legitimacy).

51. *See* Brower, *supra* note 38 (manuscript at 22) (stating that "[t]he use of accountable and transparent institutions to formulate and interpret rules will increase voluntary compliance with—and, thus, the legitimacy of—international legal regimes"); Paul B. Stephan, *The New International Law—Legitimacy, Accountability, Authority, and Freedom in the New Global Order*, 70 U. COLO. L. REV. 1555, 1578 (1999) (stating that "[d]iminished accountability affects the content of rules and puts their legitimacy into question").

Finally, immediate Chapter 11 review results in greater intrusions on sovereignty because it does not give domestic court systems a chance to correct their own errors. The "principal premise" of the local remedies rule is "that the host or respondent State must be given the opportunity of redressing the alleged injury."[52] The rule is "a reflection of the respect accorded the sovereignty of the host or respondent State."[53] Moreover, as a practical matter, the only way in which the United States can correct the errors of local trial courts is through appeals, ultimately to the federal court system.[54] Allowing immediate Chapter 11 review of trial errors denies the domestic legal system the opportunity to correct its own mistakes.

In sum, by waiving the local remedies rule, NAFTA Chapter 11 allows foreign investors the option to seek review of trial court errors by an international tribunal rather than by domestic courts. Other aspects of Chapter 11 create incentives for foreign investors to bypass the domestic appeals process—specifically, the absence of an express tolling provision for Chapter 11's three-year statute of limitations, the fact that Chapter 11 claims themselves cannot be raised in domestic court, and the possibility that a subsequent NAFTA tribunal might treat a domestic decision as *res judicata*. The system NAFTA Chapter 11 creates is unfortunate. It denies domestic courts the opportunity to correct their own mistakes. It also results in decisions that are less determinate, less accountable, and therefore less legitimate than domestic court review.

IV. TWO ALTERNATIVES

If the system for reviewing trial court decisions that NAFTA Chapter 11 creates is less than ideal, what are the alternatives? Chapter 11 could be amended to *require* the exhaustion of domestic appeals before filing a Chapter 11 claim. Alternatively, Chapter 11 could be changed to *encourage* the exhaustion of domestic appeals, although still permitting a foreign investor to seek immediate review by a NAFTA tribunal at its option.

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52. AMERASINGHE, *supra* note 8, at 97.

53. *Id.* at 98.

54. NAFTA tribunals have correctly held that each NAFTA government is responsible for the actions of its state and local officials. *See, e.g.*, Metalclad Corp. v. Mexico (Aug. 30, 2000), 40 I.L.M. 36, 47 (2001). Unfortunately, making Chapter 11 enforceable in U.S. courts would not make a defendant's Chapter 11 claims removable to federal court. *See* Rivet v. Regions Bank, 522 U.S. 470, 475 (1998) (holding that treaty issues that arise only in defense do not qualify for federal question removal). Congress might wish to consider amending this rule.

A. Requiring Exhaustion of Domestic Appeals

Requiring a foreign investor to exhaust its domestic appeals before filing a Chapter 11 claim based on a court judgment would allow the domestic court system to correct its own mistakes. It is safe to predict that in most instances the domestic court systems of the United States and Canada would correct their mistakes because a court judgment that violates Chapter 11 is also likely to violate some provision of domestic law such as, in Loewen's case, the Due Process Clause of the United States Constitution. This means that few Chapter 11 claims based on court judgments would need to be filed. The number of such claims, and the resulting intrusions on national sovereignty, could be reduced further if the substantive provisions of NAFTA Chapter 11 were themselves made enforceable in domestic court. Although these provisions tend to have counterparts in the domestic laws of the NAFTA parties, the contours of domestic and Chapter 11 protections will not always be identical. In sum, with an exhaustion requirement, foreign investors would still be able to have trial errors corrected, and if the appeals process failed, would still be able to file a Chapter 11 claim. Most trial errors, however, would be corrected in domestic courts, through a process that is more determinate, more accountable, more legitimate, and less intrusive upon sovereignty than Chapter 11 review.[55]

To implement an exhaustion requirement, Chapter 11 would have to be amended in several ways. Most obviously, Article 1121 would have to be rewritten so that it is not the *waiver* of domestic appeals that is a condition precedent to filing a Chapter 11 claim on the basis of a court judgment,[56] but rather the *exhaustion* of those appeals. Second, the statutes of limitations in Articles 1116 and 1117[57] would need to be amended to provide expressly for tolling during the appeals process. It would be unfair to preclude a Chapter 11 claim as untimely when the reason for the untimeliness would be an exhaustion requirement imposed by Chapter 11 itself. Finally, it would have to be made clear that the decisions of domestic courts on appeal would in no way bind a subsequent Chapter 11 tribunal. This would be particularly important if Chapter 11 were made directly enforceable in domestic courts as recommended above,[58] since those courts might then be ruling on the merits of an investor's Chapter 11 claims. As I noted in an earlier essay, "[i]f a claimant were required to exhaust local remedies

55. *See supra* notes 40-54 and accompanying text.
56. *See supra* notes 24-28 and accompanying text.
57. *See supra* notes 31-32 and accompanying text.
58. *See supra* note 55 and accompanying text.

and the decision of the local courts were then binding on a subsequent international tribunal, the claimant would be denied meaningful access to an international forum."[59]

The chief drawback of requiring exhaustion, of course, is that foreign investors would have to proceed through a domestic court system that might be at best inefficient and at worst biased. Within the context of Chapter 11, this seems to be of greatest concern with respect to Mexico. Such concerns would increase were Chapter 11 to be extended to cover other less developed countries as part of the Free Trade Area of the Americas (FTAA).[60] In theory, it might be possible to use the futility exception to the local remedies rule to distinguish between those court systems whose appeals an investor should have to exhaust and those whose appeals an investor should not have to exhaust. Under customary international law, foreign investors have not been required to exhaust local remedies if they can show that this would be "obviously futile."[61] In practice, however, it is no small matter to say that the courts of a country are so unable to do justice that resorting to them would be futile, and one would expect an exhaustion requirement to be waived only rarely on grounds of futility.[62] Thus, as a practical matter, the benefits of requiring domestic appeals to be exhausted would likely come at the cost of subjecting at least some foreign investors to systems of appeals that will not correct the errors at their trials.

B. Encouraging Exhaustion of Domestic Appeals

A second alternative would be to allow investors to seek immediate Chapter 11 review of trial court judgments but encourage them to exhaust their domestic appeals first. Indeed, I have argued elsewhere that Chapter 11 was specifically designed to encourage the exhaustion of local remedies.[63] Currently, however, it does this imperfectly because of the disincentives discussed above.[64] To provide greater encouragement, Chapter 11 should be amended to toll expressly the

59. Dodge, *supra* note 27, at 370.

60. *See* Brower, *supra* note 38 (manuscript at 60).

61. AMERASINGHE, *supra* note 8, at 193-94.

62. In an analogous context, U.S. courts considering questions of *forum non conveniens* have rarely been willing to hold that foreign courts did not provide an adequate alternative forum. *Compare* Torres v. S. Peru Copper Corp., 965 F. Supp. 899, 903 (S.D. Tex. 1996) (finding that Peruvian courts were an adequate alternative forum), *and* Banco Mercantil, S.A. v. Hernandez Arencibia, 927 F. Supp. 565, 567 (D.P.R. 1996) (finding that Dominican Republic courts were an adequate alternative forum), *with* Eastman Kodak Co. v. Kavlin, 978 F. Supp. 1078, 1085-87 (S.D. Fla. 1997) (finding that Bolivian courts were not an adequate alternative forum).

63. *See* Dodge, *supra* note 27, at 381-82.

64. *See supra* notes 32-37 and accompanying text.

statute of limitations while appeals are exhausted to allow Chapter 11 claims to be raised in domestic courts and to make clear that domestic decisions do not bind Chapter 11 tribunals as *res judicata*.[65]

While the first alternative—requiring exhaustion of domestic appeals—would place the task of distinguishing good and bad court systems on arbitrators,[66] the second alternative would leave this task to the market. Those countries whose systems of appeals promised to correct trial errors would have their appeals exhausted, while those countries whose systems of appeals were perceived as inefficient or corrupt would find their appellate courts being bypassed. This "market" might even exert some pressure on governments to improve their court systems in order to encourage appeals and discourage Chapter 11 claims.

It is not clear, however, that expressly tolling the statute of limitations, making Chapter 11 enforceable in domestic courts, and eliminating the risk of *res judicata* will be sufficient to encourage most foreign investors to seek review of trial errors in domestic courts first. Moreover, because Chapter 11 review is less determinate and less accountable than domestic court review,[67] it is likely to be most attractive to those foreign investors with the weakest claims. An investor that doubts its chances of success in a domestic appeal may nevertheless be willing to gamble on getting a sympathetic Chapter 11 tribunal whose decision will be largely insulated from review. It may, therefore, be necessary to not simply encourage but to *require* the exhaustion of domestic appeals to achieve the benefits of having domestic court systems correct their own mistakes.

V. EXHAUSTION AND OTHER CHAPTER 11 CLAIMS

So far, we have considered only the correction of trial court errors and whether foreign investors should be encouraged or required to exhaust the domestic appeals process before bringing a Chapter 11 claim based on such errors. But it is not just trial courts that may violate NAFTA. More common are claims that laws or regulatory decisions violate Chapter 11's national treatment or expropriation provisions. Should Chapter 11 be amended to encourage or require the exhaustion of domestic remedies with respect to these sorts of claims as well?

Although a full examination of this question is beyond the scope of this Article, there seems little reason to distinguish court judgments

65. *See supra* notes 57-59 and accompanying text.
66. *See supra* notes 61-62 and accompanying text.
67. *See supra* notes 40-48 and accompanying text.

from other measures with respect to exhaustion. A foreign investor who feels that a regulation in the United States has expropriated its investment in violation of NAFTA Article 1110, for example, could file suit in state or federal court under the Takings Clause of the Fifth Amendment. The guidance of the Supreme Court's takings jurisprudence may not be "too specific"[68] on the question of when a regulation "goes too far"[69] and becomes a taking, but it is more determinate than customary international law. The Supreme Court has held, for example, that a court must consider "[t]he economic impact of the regulation on the claimant and, particularly, the extent to which the regulation has interfered with distinct investment-backed expectations" as well as "the character of the governmental action."[70] It has further held that a regulation that "denies all economically beneficial or productive use of land" requires compensation under the Takings Clause.[71]

By contrast, there is "relatively little international case law dealing directly with regulatory takings,"[72] and NAFTA tribunals faced with the task of defining expropriation have articulated conflicting standards. In *Metalclad Corp. v. Mexico*,[73] the Chapter 11 tribunal stated:

> [E]xpropriation under NAFTA includes not only open, deliberate and acknowledged takings of property, such as outright seizure or formal or obligatory transfer of title in favour of the host State, but also covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use or reasonably-to-be-expected economic benefit of property even if not necessarily to the obvious benefit of the host State.[74]

The *S.D. Myers v. Canada* tribunal, in contrast, said: "In general, the term 'expropriation' carries with it the connotation of a 'taking' by a governmental-type authority of a person's 'property' with a view to transferring ownership of that property to another person . . . . The general body of precedent usually does not treat regulatory action as amounting to expropriation."[75] These sparse and conflicting decisions

68. Palazzolo v. Rhode Island, 533 U.S. 606, 617 (2001) (characterizing takings cases as providing "some, but not too specific, guidance to courts confronted with deciding whether a particular government action goes too far and effects a regulatory taking").

69. Pa. Coal Co. v. Mahon, 260 U.S. 393, 415 (1922).

70. Penn Cent. Transp. Co. v. New York City, 438 U.S. 104, 124 (1978).

71. Lucas v. S.C. Coastal Council, 505 U.S. 1003, 1015 (1992).

72. David A. Gantz, *Potential Conflicts Between Investor Rights and Environmental Regulation Under NAFTA's Chapter 11*, 33 GEO. WASH. INT'L L. REV. 651, 722 (2001).

73. 40 I.L.M. 36 (2001).

74. *Id.* at 50.

75. S.D. Myers, Inc. v. Canada (Nov. 13, 2000), 40 I.L.M. 1408, 1440 (2001).

make Chapter 11's protection against regulatory expropriation less determinate than United States law on regulatory takings.

Chapter 11 tribunals deciding regulatory expropriation cases are also less accountable than domestic courts. In the *Metalclad* case, for example, Mexico asked the Supreme Court of British Columbia, the place of the arbitration, to set aside the award. Although the British Columbian court noted that the Chapter 11 tribunal "gave an extremely broad definition of expropriation," it also acknowledged that "the definition of expropriation is a question of law with which this Court is not entitled to interfere."[76] Of course this lack of accountability, coupled with the Chapter 11 lack of determinacy, raises problems of legitimacy.[77]

Finally, encouraging or requiring a foreign investor to exhaust its domestic remedies with respect to expropriation claims would give the domestic legal system a chance to correct its own mistakes and would thus intrude less on sovereignty.[78] To encourage such exhaustion, Chapter 11 claims should be made enforceable in domestic courts, the statute of limitations should be expressly tolled while domestic remedies are exhausted, and domestic court decisions should not bind Chapter 11 tribunals as *res judicata*.[79] To require such exhaustion, Article 1121 should additionally be amended to make exhaustion of domestic remedies, rather than their waiver, a condition precedent to bringing a Chapter 11 claim.[80]

VI. CONCLUSION

Trial courts make mistakes; so do other government officials. Such mistakes should be corrected, and national practices should be held to international standards. The system that NAFTA Chapter 11 creates for doing this, however, is less than ideal. It allows foreign investors to skip appeals through the domestic court system that might remedy their complaints and take their chances with a less determinate, less accountable, and less legitimate international tribunal. A better system would be to put domestic courts on the front line in enforcing Chapter 11, and to make Chapter 11 tribunals the appeal of last resort.

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76. Mexico v. Metalclad Corp., 2001 B.C.S.C. 664, at ¶ 99 (B.C. Sup. Ct., May 2, 2001), *available at* http://www.courts.gov.bc.ca (last visited Oct. 9, 2002). For a fuller discussion of the *Metalclad* award and the British Columbia judgment, see Dodge, *supra* note 48.

77. *See supra* notes 49-51 and accompanying text.

78. *See supra* notes 52-54 and accompanying text.

79. *See supra* text accompanying note 65.

80. *See supra* text accompanying note 56.