

Renegotiating NAFTA: Reducing the Number of Chapter 11 Claims for Canada

by
Mary Weiler

Bachelor of Arts, Simon Fraser University, 2016

Project Submitted in Partial Fulfillment of the
Requirements for the Degree of
Master of Public Policy

in the
School of Public Policy
Faculty of Arts and Social Sciences

© Mary Weiler 2018

SIMON FRASER UNIVERSITY

Spring 2018

Approval

Name: Mary Weiler

Degree: Master of Public Policy

Title: **Renegotiation NAFTA: Reducing the Number of Chapter 11 Claims for Canada**

Examining Committee:

Chair: Dominique Gross
Professor, School of Public Policy, SFU

Nancy Olewiler
Senior Supervisor
Professor

Joshua Gordon
Supervisor
Assistant Professor

Maureen Maloney
Internal Examiner
Professor

Date Defended/Approved: March 14, 2018

Abstract

This paper explores NAFTA Chapter 11 claims filed against Canada through a closer examination of claim funding. Findings indicate that where investor-state dispute settlement cases were once brought forward to protect foreign investors against state expropriation, they are now considered a viable avenue of financial speculation. Familiar speculative tools identified as portfolio investments, third party funding, and shareholder reflective loss are transforming the very rationale of investor-state dispute settlement. Amid greater calls for transparency, this paper analyzes and proposes four policy options to reduce NAFTA Chapter 11 claims against Canada. Aside from the status quo, proposed options, which are conditional on complete transparency, include full disclosure of claim funding, capping the award recovery to funders, and prohibiting all financial speculation. Analysis based on five societal and governmental criteria indicates that full disclosure of claim funding will best meet the objective of reducing the number of NAFTA claims against Canada.

Keywords: NAFTA; Chapter 11; investor-state dispute settlement; financial speculation; third party funding; portfolio investments

Dedication

I dedicate my capstone to my family for their unwavering love and support. I want to thank my daughter Hailey for her continued encouragement and constructive dialogue on any thoughts, ideas, or concerns I had in writing this paper and to my partner Wes for providing the supportive environment for me to succeed in my studies.

Acknowledgements

I would like to sincerely thank Professor Nancy Olewiler for her supervision, guidance, and support on this project. I would also like to extend my thanks to Professor Maureen Maloney whose valuable comments helped deepen my understanding on this topic. I would also like to thank the faculty at the SFU School of Public Policy, especially Dawn Allison for always being there when needed.

Table of Contents

| | |
|---|-----------|
| Approval | ii |
| Abstract | iii |
| Dedication | iv |
| Acknowledgements | v |
| Table of Contents | vi |
| List of Tables | viii |
| List of Figures | ix |
| List of Acronyms | x |
| Glossary | xi |
| Executive Summary | xii |
| Chapter 1. Introduction..... | 1 |
| Chapter 2. Methodology | 3 |
| 2.1 Data Limitations | 3 |
| Chapter 3. North American Free Trade Agreement, Chapter 11, and Dispute Settlement | 5 |
| 3.1. Chapter 11 - Investments | 5 |
| 3.2. The Investor-State Dispute Settlement Mechanism..... | 7 |
| 3.3. Reasons for Claims | 10 |
| Chapter 4. ISDS Today | 13 |
| 4.1. Current Trends in ISDS | 13 |
| 4.2. NAFTA ISDS Outcomes | 15 |
| 4.3. Administrative and Institutional Costs of ISDS Claims | 16 |
| Chapter 5. The Changing Focus of ISDS Claims | 18 |
| 5.1. Portfolio Investment | 18 |
| 5.1.1. Advantages to the Foreign Investor | 19 |
| 5.1.2. Implications for Canada..... | 20 |
| 5.2. Third Party Funding..... | 22 |
| 5.2.1. Advantages to the Foreign Investor | 22 |
| 5.2.2. Implications for Canada..... | 23 |
| 5.3. Shareholder Reflective Loss | 25 |
| 5.3.1. Advantages to the Foreign Investor | 27 |
| 5.3.2. Implications for Canada..... | 28 |
| Chapter 6. Policy Options..... | 31 |
| 6.1. Policy Option 1 - Status Quo | 32 |
| 6.2. Policy Option 2 - Full Disclosure of Claim Funding | 32 |

| | |
|--|-----------|
| 6.3. Policy Option 3 - Cap on Award Recovery to Funder | 33 |
| 6.4. Policy Option 4 - Prohibit All Financial Speculation | 34 |
| Chapter 7. Criteria and Measures | 35 |
| 7.1. Effectiveness | 35 |
| 7.2. Impact on Foreign Direct Investment | 36 |
| 7.3. Fairness and Justice | 37 |
| 7.4. Political Acceptability..... | 37 |
| 7.5. Stakeholder Acceptability..... | 38 |
| Chapter 8. Analysis of Policy Options..... | 40 |
| 8.1. Effectiveness..... | 40 |
| 8.1.1. Will the policy reduce NAFTA Chapter 11 claims? | 40 |
| 8.2. Impact on Foreign Direct Investment | 43 |
| 8.2.1. Will the policy encourage FDI flows into Canada? | 43 |
| 8.3. Fairness and Justice | 45 |
| 8.3.1. Will policy prevent foreign investor to bring claim forward?..... | 45 |
| 8.4. Political Acceptability..... | 47 |
| 8.4.1. Will the policy be acceptable to political actors?..... | 48 |
| 8.5. Stakeholder Acceptability..... | 49 |
| 8.5.1. Will the policy be acceptable to stakeholders?..... | 51 |
| 8.6. Summary of Policy Analysis | 52 |
| Chapter 9. Policy Recommendations and Implications..... | 53 |
| Chapter 10. Conclusion..... | 54 |
| References..... | 56 |
| Appendix International Arbitration Framework | 65 |
| Institutional vs. Ad Hoc Arbitration Framework | 65 |
| ISDS Forums: International Centre for Settlement of Investment Disputes vs. United Nations Commission on International Trade Law | 67 |

List of Tables

| | | |
|------------|---|----|
| Table 3-1. | Comparison of International Arbitration Forum Rules..... | 10 |
| Table 4-1. | Fee Comparisons for UNCITRAL and ICSID..... | 17 |
| Table 5-1. | Table of NAFTA Claims under Shareholder Reflective Loss | 26 |
| Table 7-1. | Criteria and Measures | 35 |
| Table 8-1. | Scoring for Effectiveness..... | 40 |
| Table 8-2. | Scoring for Impact of FDI..... | 43 |
| Table 8-3. | Scoring for Fairness and Justice | 45 |
| Table 8-4. | Scoring for Political Acceptability..... | 48 |
| Table 8-5. | Scoring for Stakeholder Acceptability | 50 |
| Table 8-6. | Scoring of Policy Options..... | 52 |

List of Figures

| | | |
|-------------|--|----|
| Figure 3-1. | Foreign Direct Investment Inflows as a Percent of GDP, 2005 - 2016 | 6 |
| Figure 4-1. | Trends in known ISDS claims, 1987 - 31 July 2017 | 13 |
| Figure 4-2. | NAFTA damages claimed against Canada, 1996 - 2015 | 15 |

List of Acronyms

| | |
|----------|--|
| FIPA | Foreign Investment Promotion and Protection Agreement |
| ICSID | International Centre for Settlement of Investment Disputes |
| ISDS | Investor-State Dispute Settlement |
| IIA | International Investment Agreement |
| NAFTA | North American Free Trade Agreement |
| UNCTAD | United Nations Conference on Trade and Development |
| UNCITRAL | United Nations Commission on International Trade Law |
| WTO | World Trade Organization |

Glossary

| | |
|-----------------------------|---|
| Derivatives | A security whose price is dependent on one or more assets |
| Foreign Direct Investment | An investment made by a company or individual in one country in business interests in another country through an established business |
| Notice of Intent | A written notice stating the intention to submit a claim to arbitration |
| Portfolio Investment | An investment where the investor remains passive and does not have any management control |
| Shareholder Reflective Loss | A loss incurred as a result of a loss in value of shares |
| Third Party Funding | An arrangement between a funder and a client where the funder agrees to finance litigation and arbitration costs |

Executive Summary

The investor-state dispute settlement (ISDS) mechanism plays a crucial role in international investment arbitration. This mechanism, found in Chapter 11 of the North American Free Trade Agreement (NAFTA), provides confidence to foreign investors in their foreign investment decisions. The initial intention of the ISDS mechanism was to protect foreign investments from government expropriation but has since moved towards the lucrative industry of financial speculation. Three tools that are used in international investment arbitration for the purpose of financial gain are identified as portfolio investments, third party funding, and shareholder reflective loss.

Each of these financial instruments provides the necessary monetary benefits required to initiate a Chapter 11 NAFTA claim. In addition, each instrument offers further incentives to foreign investors. Portfolio investments offer the distribution of risk when packaging ISDS claims for investors. This investment also provides the flexibility to utilize capital for other investment or business purposes. Third party funding provides access to the dispute settlement system in which some foreign investors may not otherwise have access. Shareholder reflective loss claims, often used in NAFTA Chapter 11 claims, is viewed as an added protection for investors. Under shareholder reflective loss, the foreign investor is able to initiate a claim on its own behalf. All three of these financial tools grant foreign investors the opportunity to “treaty shop,” by selecting the trade agreement that offers the best chance of success with a claim.

Canada faces a number of implications as a result of the claims brought forward. Portfolio investment, for example, does not directly benefit Canada and is highly susceptible to capital volatility. Many of these claims have direct effects on social and environmental issues leaving the public unable to participate in proceedings. All of these funding avenues are conducted under the well protected veil of secrecy which encourage foreign investors to bring cases forward potentially increasing Chapter 11 claims for Canada. Even when the likelihood of success for the claimants is low and Canada will not be found in violation, there can be significant costs to Canada in the form of time and resources tied up with legal cases.

The four policy options chosen are to reduce incentives for financial speculation and therefore encourage reduction in the number of NAFTA Chapter 11 claims Canada faces. First is the status quo maintaining current NAFTA Chapter 11 procedures. The second option is the full disclosure of claim funding. Steps in disclosure in international investment arbitration are already being advanced through the recently ratified Canada-European Union Comprehensive Economic and Trade Agreement (CETA). The third option is to cap award recovery to the funder. When awards are made, it is the foreign investor, and not the funder, that will receive the greatest monetary benefit. Policy option four is to prohibit all financial speculation in Chapter 11 claims. All policy options, other than the status quo, depend on full disclosure of claim funding.

Analysis supports the adoption of the second policy option of full disclosure of claim funding. This policy option will best meet the objective of this paper to reduce the number of NAFTA Chapter 11 claims brought against Canada. This option is viewed as a logical progression in international investment arbitration that has already been introduced on the international stage.

Chapter 1. Introduction

The North American Free Trade Agreement (NAFTA) is a multilateral free trade agreement that came into force on January 1, 1994, signed by Canadian Prime Minister Brian Mulroney, Mexican President Carlos Salinas, and American President George W. Bush. More than 23 years after the implementation of NAFTA, trade volume among all three countries has more than tripled (Government of Canada, 2017). The amount of foreign investment in all three countries has also increased.

An important, and often contentious, component of NAFTA (and other trade agreements) is the investor-state dispute settlement mechanism. Initially created as an incentive for investment in developing countries, the ISDS mechanism offers the guarantee of special protection for investors when dealing with foreign legal systems. Enshrined in Chapter 11 of NAFTA, this protection allows foreign investors to challenge domestic laws affecting their investments by seeking redress through binding international arbitration. Based on international law, arbitration panels adjudicate a case brought under Chapter 11 and remedies are retrospective usually in the form of monetary compensation. Yet, viewed as an innovative policy tool to reduce potential investor conflict, the ISDS mechanism is often surrounded by controversy. The ISDS mechanism may be changing from its original intent as an instrument of investment protection from expropriation into a lucrative new industry.

The original intent of Chapter 11 was to promote trade, protect foreign investors from expropriation, and provide a mechanism to challenge actions by a country that denies investors national treatment, i.e., applying the same laws and regulations to foreign investment as to domestic. However, over time, there appears to be a growth industry in bringing ISDS claims financed by speculators and on different grounds than initially intended. These factors increase both the number of claims filed and the costs borne by governments. Expropriation was the most common reason to bring a dispute forward in the past, but the potential of receiving large awards has created an incentive for financial speculation. The advent of portfolio investment, third party funding, and

shareholder reflective loss, the loss incurred by shareholders in the value of the company invested in, contribute to the rising number of claims. These factors increase the likelihood that frivolous cases will be brought forward, and even if they are dismissed by the tribunals, they will still impose administrative costs, create bottlenecks in the system, and may impact foreign investments. This capstone examines the impacts of financial speculation through portfolio investments, third party funding, and shareholder reflective loss with the goal of identifying policy options to help reduce the number of ISDS cases, found in NAFTA's Chapter 11, that are brought on these grounds against Canada. The policy problem is that there are too many cases brought under ISDS that are inconsistent with the intent of the agreement and have deleterious impacts on Canadian governments, companies, and foreign investment. This paper explores measures that can reduce the number of these claims.

Chapter 2. Methodology

The primary methodology used to derive policy alternatives consists of an analysis of existing ISDS and NAFTA Chapter 11 dispute settlement claims and those of other countries through the three arbitration forums: International Centre for Settlement of Investment Disputes (ICSID), the Additional Facility Rules of ICSID, and the United Nations Commission on International Trade Law (UNCITRAL). These claims are sourced from Global Affairs Canada, the NAFTA Secretariat, United Nations Conference on Trade and Development (UNCTAD) reports, and the World Trade Organization (WTO) website. Statistical data will be retrieved from Statistics Canada, the Organization for Economic Cooperation and Development (OECD) statistics website, UNCTAD, and other governmental and arbitration funding websites.

2.1 Data Limitations

Lack of transparency of claim proceedings prohibits a comprehensive collection of information on the issues that arise from Chapter 11 claims. Once a claim has been concluded, neither party is required to make any information public. It is only with the agreement of both parties that any information on claim proceedings can be made public. Additionally, even though Canada has signed on to UNCITRAL's Rules of Transparency, the government's own administrative costs are not always available.

Due to reasons of confidentiality, expert interviews are not included in this paper. Experts in the field of ISDS were approached with interview requests but each declined the opportunity to discuss their positions. The experts explained that they are not in a position to provide any more information than is already publicly available.

Timeliness of claims is another important factor. Delays in the arbitration process can hinder information on the level and distribution of any assessed damages to either the claimant or the Government of Canada. As an example, damages in the 2008 claim between *Clayton/Bilcon v. Canada*, are still undetermined. Even though this case has been decided in favour of the foreign investor, legal arguments continue to delay final

damages (Clayton/Bilcon v. Canada, 2008). The next chapter will provide further analysis of NAFTA's Chapter 11 ISDS provision.

Chapter 3. North American Free Trade Agreement, Chapter 11, and Dispute Settlement

This chapter defines Chapter 11 and its importance to foreign investment in Canada. The dispute settlement mechanism is described along with an explanation of the typical process for bringing claims that is found in many international investment agreements (IIAs). The process is then contrasted with the recent changes in motivation for filing Chapter 11 claims

3.1. Chapter 11 - Investments

Chapter 11 of NAFTA is the foreign investment component establishing a framework of rules for investors from NAFTA member countries. These rules have been established to form a predictable, rules-based investment culture, with timely dispute settlement procedures (Global Affairs Canada, 2013).

Foreign investments defined in NAFTA Chapter 11, include a number of requirements. From the NAFTA text (GOC, 2016a), investments are defined as:

1. An enterprise, or company, that is existing or created, for profit or not, and is private or government-owned,
2. Debt securities of a company that must be held by the investor for a minimum of three years,
3. Equity securities of a company in which ownership is held by shareholders in the form of shares,
4. Loans that are made to the company with the loan maturity being at least three years,
5. Shares that are held in a company with the expectation of receiving profits,
6. Any real estate or property for the purpose of economic benefit to the company,
7. Any interests originating from contracts with the company for the purpose of producing profit.

Canada relies heavily on foreign investment. In most years from 2005 to 2016, except for 2009, 2010, and 2016, foreign investment as a percent of Gross Domestic Product (GDP) in Canada was greater than in Mexico and the US as illustrated in Figure 3-1. The average level of foreign investment in Canada over this period was US\$50 million (OECD, 2016a).

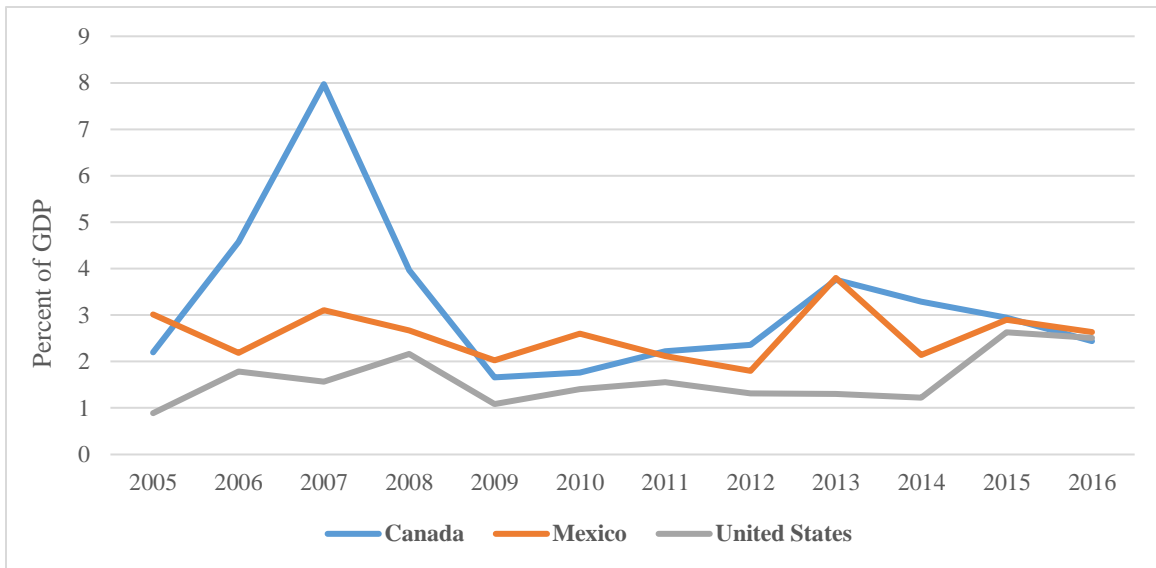


Figure 3-1. Foreign Direct Investment Inflows as a Percent of GDP, 2005 - 2016
Source: OECD, 2016a

When foreign companies invest in Canada, there is an expectation that they will receive national treatment. National Treatment is a basic tenet in international law that prohibits discrimination between foreign and domestic goods or services. As one of the most disputed articles under NAFTA, National Treatment entitles foreign investors the same treatment as domestic companies. Most-Favoured-Nation (MFN) treatment is often cited together with national treatment in an ISDS claim. MFN prohibits discriminatory trade practices favouring one-member state over another. If one NAFTA member receives certain trade benefits, this same benefit must be extended to all NAFTA members. Of even greater concern to foreign investors is fair and equitable treatment compared to domestic investors.

The Minimum Standard of Treatment is the most cited article in dispute settlements under NAFTA. The Minimum Standard of Treatment accounts for not only

fair and equitable treatment, but also accords foreign investors full protection and security of their investment. In all cases filed against Canada, each Notice of Intent includes Minimum Standard of Treatment (GOC, 2017). A Notice of Intent is a written notice detailing the intention to submit a claim to arbitration. The vague language of fair and equitable treatment may allow for broad interpretation tending to favour foreign investors in a dispute settlement claim. Due to this broad interpretation, NAFTA attempts to narrow the scope through the Notes of Interpretation of Certain Chapter 11 Provisions (Foreign Trade Information System, 2001). By stating that treatment will not go beyond the customary international minimum standard of treatment of foreign nationals, this sets the bar that no state can go below (GAC, 2013a).

Expropriation is one of the core components of investment agreements. Expropriation can be both direct and indirect. Direct expropriation is when a host state takes away a foreign company's private property. Indirect expropriation is where state regulatory action deprives foreign investors of their expected economic benefits from their investment. If a foreign company is deemed to have experienced expropriation, compensation equal to fair market value will be made (GOC, 2017). An example of a clear-cut case of expropriation occurred in 2009 with AbitibiBowater Inc., an American company that owned timber mills and hydroelectric generation facilities in the province of Newfoundland and Labrador. In the 2009 claim of *AbitibiBowater Inc. v. Canada*, Newfoundland and Labrador authorized legislation to directly expropriate the company's hydro generation facilities and indirectly expropriate by rescinding the company's forestry and water rights (GAC, 2017a). Without these rights, the foreign investors could not operate their facilities and thus lost the ability to benefit from their investment. This case was settled with AbitibiBowater Inc. receiving fair market value through NAFTA's dispute settlement mechanism (GAC, 2017a).

3.2. The Investor-State Dispute Settlement Mechanism

The ISDS mechanism is found in IIAs to aid in the resolution of conflicts between foreign investors and the host country. In Chapter 11 of NAFTA, the purpose of the ISDS mechanism is to establish procedures for the settlement of investment disputes

ensuring equal treatment for both parties through reciprocity and due process before an impartial tribunal (GOC, 2016). A description of this process follows.

The ISDS process begins when a foreign company first submits a Notice of Intent to submit a claim to arbitration. This notice must include the articles in NAFTA that have allegedly been breached including the issues and all relevant facts for the claim. The notice must also include the expected relief and the amount of damages claimed. This claim must be launched within three years from the date the foreign company first received knowledge of the breach and the resulting losses (GOC, 2016). As part of the Chapter 11 process in dispute settlement, the Notice of Intent includes a first step at resolution through notification of consultation or negotiation. If consultations are successful, then further arbitration is not necessary. If consultations are unsuccessful, the foreign investor must wait six-months since the time of events giving rise to the claim occurred then proceed to the next step with submission of a claim to arbitration.

Second, after the six-month waiting period from the time the events began, the foreign investor can proceed with a claim to arbitration. The foreign investor can choose under which legal framework to hold arbitration. NAFTA Chapter 11 provides three choices. These include the ICSID, the Additional Facility Rules of ICSID, or UNCITRAL. These settlement facilities are described in greater detail in the appendix.

Third, each party then consents to the submission of a claim to arbitration. Consent must meet the procedural requirements of three separate commercial arbitration conventions. These conventions include the ICSID Convention, the New York Convention, and the InterAmerican Convention on International Commercial Arbitration (GOC, 2016). The requirements from each convention confirm that each disputing party shall recognize arbitration awards as binding and enforceable according to jurisdiction (ICSID, 2016; New York Convention Guide, 2017; Organization of American States, 2018).

Fourth, the number of arbitrators and method of appointment for the arbitration tribunal is established. If a tribunal is established to hear a consolidation of cases, or unless both disputing parties agree to other arbitrator appointment methods, three

arbitrators will preside over an arbitration claim. Procedural rules are set out detailing the appointment of each arbitrator. These rules also cover instances where there is disagreement between parties as to the appointment of arbitrators.

Fifth, the foreign company filing a claim then sends notice of the claim and all pleadings, formal statements of the cause of an action or defence, to the opposing party. This notice must be submitted to arbitration within 30 days after the date of the claim submission. Sixth, arbitration shall take place in a selected country abiding by the ICSID, ICSID Additional Facility Rules, or UNCITRAL Rules unless parties have agreed to alternate arrangements.

Arbitration tribunal proceedings are followed under the governing law of NAFTA as well as pertinent international law. Final awards are binding between the disputing parties only. ISDS awards are determined by each claim's own facts as there are no precedent-setting requirements (De Mestral, 2015). This process alone is criticized as bringing unpredictability and inconsistency to ISDS cases. While enforcement for the collection of awards may be pursued through further arbitration panel proceedings, the number of international arbitration frameworks is limited.

As there are no established universal international investment arbitration methods, investor disputes are settled through two main arbitration frameworks, institutional or ad hoc. The institutional arbitration model is one in which a specialized institution provides administrative services to the arbitration process and has no role in deciding disputes. These institutions provide procedural rules for both parties and arbitrators to follow as well as offer a location in which to carry out dispute settlement proceedings. Alternatively, disputing parties choosing ad hoc arbitration are responsible for determining all aspects of the settlement process. This includes both parties agreeing to the selection of arbitrators, arbitration rules, location, and applicable laws and procedures.

Under NAFTA, the two main ISDS forums used are the ICSID, or UNCITRAL. When a foreign investor files a claim under NAFTA's Chapter 11, the claimant has the advantage because it can select which forum to choose. Due to the differences in

arbitration rules offered through ICSID or UNCITRAL, a foreign investor may feel that one particular forum could be more beneficial over the other in the outcome of the claim. While there are general similarities such as the number of arbitrators and rules of transparency, the differences are notable. Under ICSID, arbitrators are to utilize both state and international law in determining settlement, where UNCITRAL only considers state law. Determining the cost allocation of awards is highly discretionary involving not only the total award amount, but potential interim awards as well as interest. Table 3-1 offers a comparison of both ICSID and UNCITRAL forums (for greater detail of the international arbitration framework, please refer to the appendix). While the ISDS process can vary between dispute settlement forums, so can the reasons for initiating claims.

Table 3-1. Comparison of International Arbitration Forum Rules

| Forum Rules | ICSID | UNCITRAL |
|----------------------------|---------------------------------|-----------------------------|
| Dedicated facilities | Yes | No |
| Number of Arbitrators | 1 or 3 | 1 or 3 |
| Nationality of Arbitrator | Different from both parties | Different from both parties |
| Jurisdictional Laws | State law and international law | State law |
| Determining Interim Awards | Tribunal to recommend | Tribunal to grant |
| Cost Allocation | Discretion of tribunal | Loser pays method |
| Rules of Transparency | Yes | Yes |

3.3. Reasons for Claims

Since the development of the ISDS mechanism in 1959, governments are facing a growing number of arbitration claims (ICSID, n.d.). Canada in particular has been billed as “...the most-sued country under the North American Free Trade Agreement...” due to the ISDS provision it embraces (Freeman, 2015). One reason for this increasing number of claims is the change in the purpose of the ISDS mechanism. Originating as a tool to protect foreign investment from government expropriation, it appears that ISDS has transformed into a new speculative financial industry (Eberhardt, & Olivet, 2012). New

reasons to bring an ISDS claim forward include portfolio investments, third party funding, and shareholder reflective loss, as explained below.

In recent years, ISDS provisions have provided an opportunity to make money by speculating on lawsuits through portfolio investments. Portfolio investment is described as a less than 10 percent ownership interest in a company which does not allow the portfolio investor to contribute in the management of the investment (Gaukrodger, 2014). Generally, portfolio investors are concerned with the appreciation of the value of their capital and the return that a company can generate. A typical portfolio fund consists of several ISDS cases grouped together. Portfolios include certain “anchor cases” that are large or close to decision forming the principal collateral of the portfolio (Burford, 2017a, p.8).

Third party funding is one of the oldest speculative financial assets. It is an arrangement between a funder and a client where the funder agrees to finance litigation and arbitration costs. As part of the contract, the funder receives a share of the proceeds or awards. Previously, under common law, an agreement to pursue a party’s claim solely for the possibility of judgement proceeds, referred to as champerty and maintenance, was illegal (OECD, 2012a; Gaukrodger, 2012). Today, this practice has developed into a successful financing model even though some jurisdictions still recognize this process as prohibitive. Attracted by high-value claims and enforcement of awards, this funding activity has experienced a marked increase focusing on ISDS claims (ICCA, 2017).

ISDS claims by company shareholders for reflective loss are increasing the investment arbitration caseload. A shareholder’s reflective loss is incurred when there is a loss in the value of shares of the company in which a shareholder has invested. This claim allows foreign investors to bring a separate cause of action to arbitration that is independent from the company in which shares are held. Under NAFTA, a shareholder can initiate a claim on its own behalf under Article 1116, or on behalf of a company under Article 1117 (GAC, 2016). A growing number of IIAs provide shareholders the opportunity to bring claims to arbitration on behalf of the company. It is NAFTA that

has been instrumental in modeling this derivative action for other investment treaties such as the Chile-Japan and the Japan-Mexico treaties (Gaukrodger, 2014).

In summary, NAFTA encompasses a broad definition of foreign investments covering not only real estate, but debt and equity securities, loans, shares, and interest from contracts with the company. As such, these foreign investments are an important component in Canada's economy. Therefore, to encourage greater economic activity, foreign investors need confidence that their investments will be protected. The ISDS mechanism is the provision placed in IIAs to do just that. This formal process is followed to resolve conflict amongst foreign investors and the state. Yet the reasons for claims have changed over the years. Originally implemented as a tool for conflict resolution, the ISDS mechanism is changing into a new industry of financial speculation. The next chapter will take a closer look at current ISDS trends.

Chapter 4. ISDS Today

This chapter assesses publicly available outcomes of ISDS claims globally. Further analysis explores NAFTA claims and the resulting impacts on Canada.

4.1. Current Trends in ISDS

In 2016, a total of 69 new ISDS claims were initiated globally bringing the total cumulative number of known ISDS claims to 817 (United Nations Conference on Trade and Development, 2017). Claims include non-ICSID cases and UNCITRAL including cases arbitrated through the International Chamber of Commerce (ICC) Court of Arbitration and the Stockholm Chamber of Commerce (SCC) Arbitration Institute. As not all ISDS cases are made publicly available, the actual number of claims filed is likely to be higher.

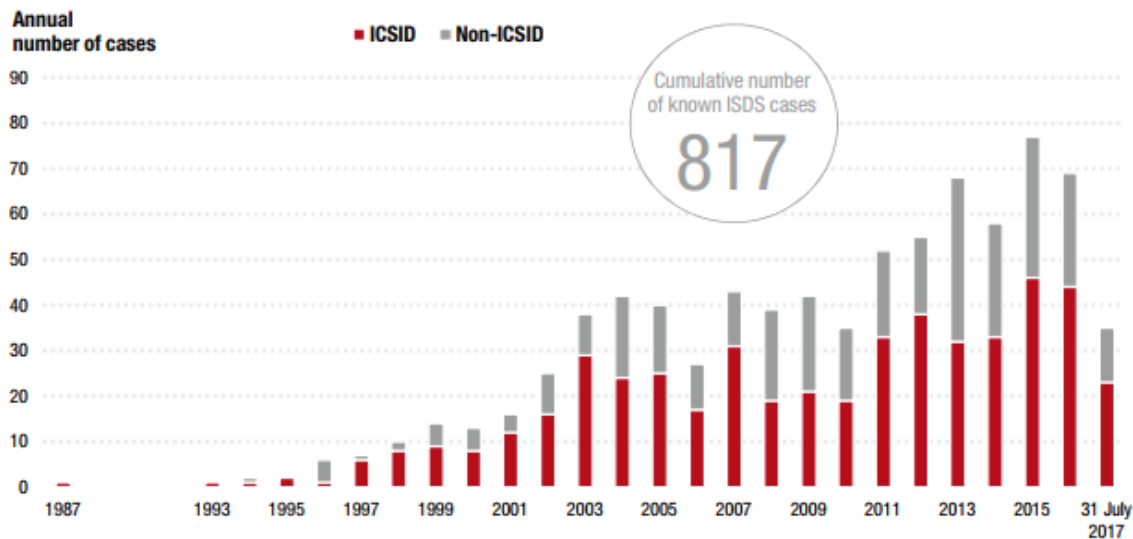


Figure 4-1. Trends in known ISDS claims, 1987 - 31 July 2017

Source: UNCTAD, 2017a used with permission

By July 31, 2017, out of the total number of ISDS claims, 530 were concluded (UNCTAD, 2017a).¹ Of these claims, approximately 37 percent of decisions favoured

¹ The number of claims remains fluid due to the continual change in the number of ISDS cases.

the state, 27 percent favoured foreign investors, 23 percent were settled,² 11 percent were discontinued, and two percent of the cases noted treaty breaches that did not warrant monetary compensation (UNCTAD, 2017a).

Generally, claimants whose cases were decided in their favour received approximately 40 percent of the damages claimed (Rosert, 2014; UNCTAD, 2017). Many of these resulted in large awards to the successful party. In 2016 alone, the average ISDS award claimed (not including interest) was US\$1.4 billion with the average award amounting to US\$545 million (UNCTAD, 2017). This compares to an average ISDS award in 2012 of US\$225 million (UNCTAD, 2013e).

Arbitral tribunals have considerable latitude in deciding not only compensation, but also interest payments on the amount of damages being claimed by the plaintiff. Interest can have a significant impact on total awards especially when lengthy arbitrations ensue. Interest begins accruing from the date of expropriation which can result in higher payments than the award itself (Gotanda, 2007). Many IIAs note that interest is to be made at a commercially reasonable rate or can set any applicable interest rate (Rosert, 2014; GOC, 2016). In *Wena v. Egypt*, the arbitral tribunal awarded compensation of US\$8 million with US\$11 million in interest (Rosert, 2014). Whether to assign simple or compound interest can add even greater costs to the claim.

When simple interest is applied to awards, it is charged to the principle amount only. Compound interest is charged not only on the principle amount, but also on the accumulated interest at the discretion of the tribunal. Over the period of 1990 to 2010 reviewing 43 decisions favouring the foreign investor, compound interest was awarded more than twice as many times than simple interest (Rosert, 2014). Tribunals generally did not extend explanations for their decision on selecting compound over simple interest, but rather relied on their autonomous decision-making privileges (Rosert, 2014). However, in two ICSID case awards, the tribunals noted that the award of compound interest was twofold. First, the goal is to ensure the claimant receives the full present value, and second, to prevent the state from unjustly gaining due to payment delay

² ISDS claims were concluded but specific terms of settlement remain confidential.

(Gotanda, 2007). This same latitude in determining interest types is also found in NAFTA final award regulations (GOC, 2016).

4.2. NAFTA ISDS Outcomes

About 20 percent of all ISDS cases have been brought under NAFTA (UNCTAD, 2017). NAFTA Chapter 11 ISDS claims have increased from US\$200 million to more than US\$658 million over the period from 1996 to 2015 (See graph 4-2) (GAC 2017). In recent years, two claims against Canada have exceeded the billion-dollar mark (not included in graph 4-2). These cases were initiated in 2010 by the Detroit International Bridge Company for damages claiming US\$3.5 billion and in 2015 by CEN Biotech Inc. for US\$4.8 billion (GAC, 2017). The Detroit International Bridge Company claim, conducted under UNCITRAL Arbitration Rules, was dismissed while CEN Biotech remains an active case (GAC, 2017).

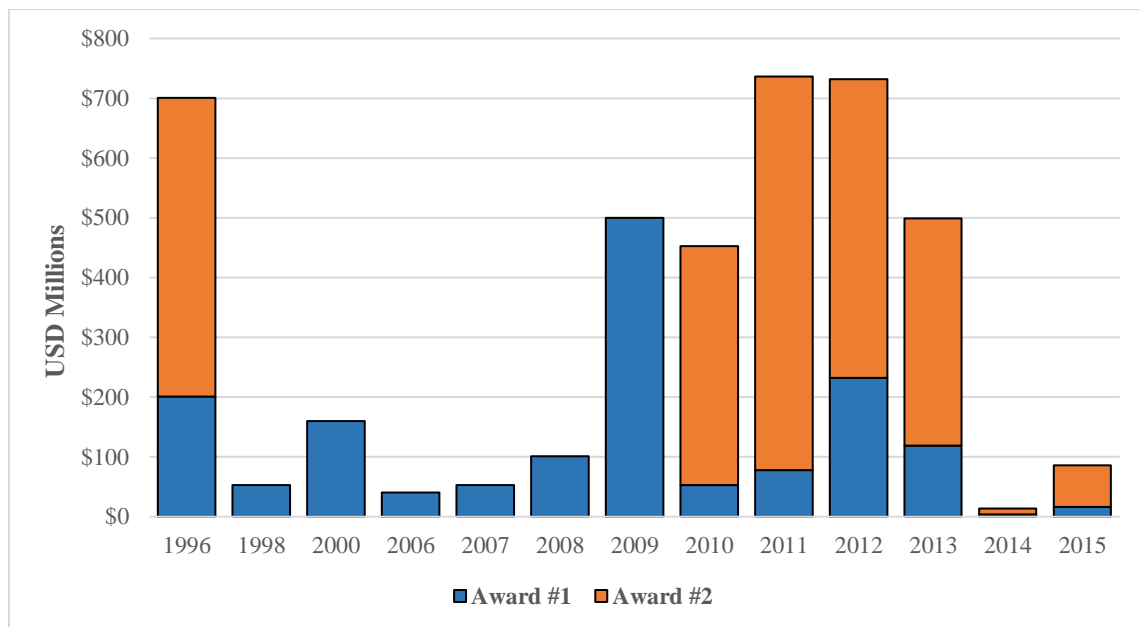


Figure 4-2. NAFTA damages claimed against Canada, 1996 - 2015

Source: Global Affairs Canada, 2017

To date, Canada has paid out more than CAN\$200 million in damages (GAC, 2017; UNCTAD, 2013a). A discussion of the breakdown of costs follows.

4.3. Administrative and Institutional Costs of ISDS Claims

Chapter 11 ISDS claims under NAFTA impose significant costs on the parties involved. Broadly defined for the purposes of this paper, costs include the monetary amount of the awards; disputing party costs including legal expenses, experts, and witnesses; and tribunal costs which entail administrative and institutional expenses. Publicly available information on damages and awards claimed by either party are the benchmark from which costs in this paper are assumed. This section provides examples of the administrative and institutional costs.

In 2012, the Organization for Economic Cooperation and Development (OECD) held a public consultation on the investor-state dispute settlement and found that the largest cost in ISDS claims are the fees and expenses of legal counsel (2012). It is estimated that legal expenses are an average of 82 percent of total costs (OECD, 2012a; Rosert, 2014). Top private sector legal firms can charge upwards of US\$1,000 per hour (Rosert, 2014). Legal expenses include not only those fees from one party's own legal counsel, but potential expenses from the opposing party through full or partial adjusted costs orders (Hodgson, 2015). Arbitrator fees came in next at 16 percent with institutional costs covering administrative and secretariat services of two percent of total costs (OECD, 2012a; Rosert, 2014). On average, damages claimed in ISDS cases covering legal and arbitration costs top US\$8 million per claim (OECD, 2012a).

While costs from arbitration are not always publicly available, the ICSID arbitration forum provides a fee schedule covering arbitrators' and institutional fees (Table 1 below). Other direct costs such as subsistence allowances and travel expenses are dictated to be within reasonable limits (ICSID, 2017b). In comparison, UNCITRAL Arbitration Rules set no institutional limits. Without boundaries, parties are allowed to request a review by the appointing authority as to the reasonableness of arbitrator, expert, and legal fees and expenses (UNCITRAL, 2010). However, there is a notable difference in average tribunal costs under both ICSID and UNCITRAL forums.

Table 4-1. Fee Comparisons for UNCITRAL and ICSID

| Costs | UNCITRAL | ICSID |
|--|-----------------|--|
| Arbitrator's Fees | Variable | US\$3,000/day and direct expenses |
| Administrative Fees | Variable | US\$42,000 per annum for request for arbitration, conciliation, or post award proceeding |
| Supplementary Decisions or Resubmission Requests | No Fee | US\$10,000 each |

Source: UNCITRAL, 2010 and ICSID, 2017b

In a recent study on the costs of investment treaty arbitration, the average tribunal costs in ICSID claims are US\$769,000 and in UNCITRAL proceedings are US\$853,000 (Hodgson, 2014). The 10 per cent difference can be accounted for by the cap ICSID places on arbitrator's fees (Hodgson, 2014). In comparing UNCITRAL's variable arbitrator fees, the ICSID US\$3,000 per day fee for time spent on the case, along with a subsistence allowance, can keep arbitration tribunal costs in check.

This chapter has explored several issues in ISDS. Current trends point to a growing number of ISDS claims. These trends also show that the amount of damages awarded can be substantial and have averaged approximately one-third of the original claim. Interest is also determined as part of the award and is decided by the arbitration panel. Looking closer at NAFTA outcomes for Canada, the damages claimed have exceeded the US\$4 billion mark. Along with paying out possible claims, administrative and institutional costs also impact government expenses. The next chapter reviews three factors that are transforming the rationale behind ISDS claims.

Chapter 5. The Changing Focus of ISDS Claims

This chapter describes the ways in which ISDS claims under NAFTA Chapter 11 have changed from protection against expropriation of assets (financial and real) to a process motivated by portfolio investments, third party financing, and shareholder reflective loss. The sub-sections will describe each method, advantages to the foreign investor, and implications for Canada. Information is taken from the literature on dispute resolution and ISDS cases.

5.1. Portfolio Investment

Portfolio financing can take many forms, but is generally structured in a few major arrangements. Funding can consist of either a client of the firm holding a claim, or with other corporate claim holders or entities involved in multiple legal disputes (International Council for Commercial Arbitration, 2017). This type of structuring requires cross-collateralization where the funder's return depends on the overall financial performance of the portfolio instead of each individual outcome (ICCA, 2017). Once packaged, the portfolio proceeds to corporate financiers to sell shares. Currently, the biggest financiers are: Burford Capital, Juridica Investment Ltd., Omni Bridgeway, Fulbrook Management, and Calunius Capital (Eberhardt, & Olivet, 2012). With the growing need to finance ISDS claims, the value of these financial assets has been increasing dramatically. Estimates of current capital available has reached somewhere in the low billions (Fulbrook Management, 2012). The success of portfolio management has moved private financiers to the public stage.

For example, the Burford Group is a law corporation providing corporate finance to international arbitration. Burford Capital is an investment fund that can be publicly traded (ICCA, 2017; Burford Capital, 2017). These corporate finance investment funds are found in a sub-market of the London Stock Exchange known as the Alternative Investment Market (AIM) Stock Exchange. As of December 2016, investment assets with Burford Capital are valued over UK£475 million (US\$623 million) (London Stock Exchange, 2016). In total, Burford has over US\$2 billion invested in litigation financing

(Burford, 2017a). Companies such as Burford pool these claims to give investors the allure of a diversified portfolio. NAFTA claims have the potential to become one more investment in these portfolios.

Recently, Burford reported on a favourable international arbitration investment result. In the case of *Teinver S.A. and Others v. Argentina*, the claim focused on expropriation of the investors' shares in two Argentine airlines (UNCTAD, 2013b; LSE, 2016a). In July 2017, the total damages awarded to the investor were in excess of US\$324 million as well as pre- and post-award compound interest (LSE, 2016a). On this claim alone, the loan-to-value ratio will exceed the predicted value. The estimated share of award to Burford Capital is in the neighbourhood of US\$140 million after investing only US\$13 million (LSE, 2016a).

5.1.1. Advantages to the Foreign Investor

The greatest advantage of portfolio investment to the foreign investor is the availability of financing to fund an ISDS claim. For the portfolio investor, it is the distribution of risk. Distributing the risk over a wider investor base lowers the chances of large financial losses in the event of any single unsuccessful investment arbitration outcome. Historically, portfolio financing has shown that losses can be offset by the wins. If the value of the winning claims is greater than with the losing cases contained in the portfolio, the funder will see a favourable return (ICCA, 2017). With a portfolio package of five to six claims, the chances of profit are considerable. Due to this diversified risk, pricing for portfolio funding is generally lower than other funding arrangements (Burford Capital, 2017a).

Hedge funds, high risk investment methods, and investment bank managers are taking advantage of sophisticated financial packages focusing on ISDS claims. Specifically, hedge fund and investment managers consider ISDS arbitration an attractive litigation risk as it has no relationship with markets (Molot, 2010). This means that outcomes of arbitration proceedings do not depend on stock or bond market fluctuations. While there is no market risk to consider, ISDS claims are still highly volatile due to the lack of set standards in international investment arbitration.

Portfolio investments are considered more flexible than other funding arrangements such as loans or insurance as they allow corporate claimants to monetize their portfolio. This funding approach allows foreign investors to utilize capital that is secured against the dispute portfolio for purposes other than legal expenses (ICCA, 2017; Burford Capital, 2017a). This type of capital is considered valuable as it can be directed to usual portfolio matters such as paying fees and expenses incurred or to unexpected situations that may occur.

Another benefit from portfolio investment funding is the lack of control of the portfolio investor. This type of investment keeps the portfolio investors at arms length with no control in the direction of litigating the foreign investor's claim or outcome. However, this investment method does impact respondent states.

5.1.2. Implications for Canada

Despite portfolio investment being included under NAFTA, this type of investment is considered less desirable than foreign direct investment (FDI). Due to the passive nature of portfolio investment, it does not directly benefit Canada's economy. This type of investment does not bring technology transfers that may accompany foreign businesses. As well, portfolio investment does not include management resources. Companies cannot take advantage of new management skills and strategies as there is no addition of foreign management personnel. Ultimately, there is no employment or training of local employees that would contribute to growth in Canada's economy. Portfolio investments are financial instruments that benefit their investors who may or may not then use any of their returns to invest in real assets.

Another impact of portfolio investment is that capital can easily be withdrawn. This can create the potential for capital volatility in the face of economic turmoil. Learning from the 1997 Asian financial crises, the Association of South-East Asian Nations (ASEAN) Investment Area of 1998 has purposefully excluded portfolio investments (UNCTAD, 2011). The ease of capital mobility presents other issues. As portfolio investment is not as easily monitored compared to FDI, concerns exist that this funding model may be used to launder money and evade taxes (UNCTAD, 2016; World

Trade Organization, 2017). Even with the presence of Canada's financial intelligence unit, the Financial Transactions and Reports Analysis Centre (FINTRAC), money laundering schemes still go undetected. As noted by the U.S. Department of State, Canada is recorded as a "jurisdiction of primary concern" on its list of major money laundering countries (U.S. Department of State, 2014). These jurisdictions are identified as financial institutions that engage in currency transactions involving significant proceeds from all serious crimes or are vulnerable to this activity due to weak supervisory or enforcement regulations (U.S. Department of State, 2014).

As new financial regulations are implemented, successful financiers continually look for ways to work around the regulations to be able to continue to offer their portfolio investment devices. For example, Fulbrook Management is analyzing existing financial tools to package the portfolio in different ways to increase expected returns. They are considering the use of derivatives in their investment portfolio. In investment terms, a derivative is a security which derives its value from an underlying asset, such as futures, options, and forwards (The Economic Times, 2018). With this tool, Fulbrook would then be able to fund a single motion in an ISDS claim rather than the entire case (Eberhardt, & Olivet, 2012). As derivatives indicate a higher risk, a higher rate of return would be offered increasing the attractiveness of ISDS claims.

The idea also exists of packaging ISDS claims together and reselling these debt contracts to other parties, similar to credit default swaps (Eberhardt, & Olivet, 2012). Having diverse portfolio investments available to fund claims removes a great deal of risk. Although, in the absence of large risk, the criteria of potentially winning a case based on merit may be overshadowed by the chance of collecting a substantial award. As more of these innovative financing solutions become available, the more likely foreign investors will consider launching ISDS claims. Third party funding presents similar challenges.

5.2. Third Party Funding

The evolving role of third party funding is geared towards risk management, reducing legal costs, and reallocating financial resources for the foreign investor (ICCA, 2017). Together, these reasons are making litigation of ISDS claims more attractive. Over the last decade, costs of international arbitration have been rising thereby putting a strain on foreign investors' budgets. As ISDS claims continue to grow in importance and complexity, there is an increased demand by foreign investors for funding of their ISDS claims (UNCTAD, 2017).

Generally, third party funders are litigation or investment firms. To meet this demand, there are currently more than 50 third party funders found in Australia, the United Kingdom, and United States that are expanding to new jurisdictions (ICCA, 2017; International Arbitration Attorney Network, n.d.). According to one American financial capital firm, there is a potential market for foreign investors who need financial support in the range of US\$8 billion to US\$10 billion (ICCA, 2017).

The process of third party funding varies among funders. When a request is brought before a funder, each potential claim undergoes a preliminary case assessment. Cases are usually reviewed for a high realistic claim value and settlement probability compared to the arbitration budget (ICCA, 2017). In the NAFTA case *Eli Lilly and Company v. Canada*, this claim was believed to warrant merit resulting in a claim seeking US\$500 million in damages (GAC, 2017c). The claimant alleged that Canadian patent rules violated NAFTA obligations under fair and equitable treatment, and expropriation. Even though this case cleared the criteria of the third party funders, it was recently found without merit and dismissed.

5.2.1. Advantages to the Foreign Investor

There are several advantages of third party funding for a foreign investor. First, third party funding provides a means for foreign investors to access justice in international investment arbitration. This type of funding may be considered as an additional means of funding and not as the only means. Second, foreign investors who

pursue third party funding and have successful claim outcomes are better off than if they did not bring forward a claim and thus receive nothing. Third, the use of third party funding does not impose any direct additional financial burden of the respondent state (Jackson, 2009). If foreign investors seek other funding arrangements, such as a conditional fee agreement, this may increase the state's costs. If an award is made to the foreign investor under a conditional fee arrangement, the respondent state is still liable for the foreign investor's legal costs if ordered by the arbitral tribunal (Jackson, 2009). Alternatively, third party funding may become an even more important financial tool if arbitral tribunal awards determine that contingency fee arrangements or other financing methods are deemed irrecoverable (Jackson, 2009).

Finally, due to the fact that third party funders have no direct ties to ISDS claims, a valuable benefit that funders bring to dispute settlement is an unbiased detailed assessment of claims. The position of third party funding is not to be confused with either the foreign investor or its legal team. The foreign investor has a direct interest in the case and may be influenced by monetary incentives and perceptions of the fundamentals of the claim. Likewise, the foreign investor's legal team may bring a claim forward for its own potential monetary gains. Even though there is financial incentive, third party funders can offer a neutral, independent, and critical assessment of a potential case (ICCA, 2017). These benefits of third party funding have implications on subsequent ISDS claims.

5.2.2. Implications for Canada

In light of the increasing availability of third party funding, there are implications on the number of ISDS claims for Canada. As foreign investors do not have to declare third party funding, this lack of transparency can lead to conflicts of interest. Considering there is a small group of experts and law firms specializing in international investment arbitration, there is potential for conflict of interest between arbitrators and both sets of legal teams. Many lawyers who litigate ISDS claims also sit on ISDS arbitration panels (Eberhardt, & Olivet, 2012). Undisclosed ties from foreign investors may give rise to the removal of an arbitrator or challenge of an arbitral award (Goldsmith, & Molchionda,

2016). It is these additional legal maneuvers that not only slow arbitral proceedings considerably, but significantly increase costs of arbitration.

In *South American Silver v. Bolivia*, Bolivia challenged the claim with a procedural order requesting the disclosure of third party funders. In this case, Bolivia believes that the claimant does not “...have enough economic means to bear the costs and expenses of this arbitration...” (Italaw, 2016, p.4). Thus, there is the possibility that if third party funding was not available, the foreign investor may not have otherwise made a claim. Requests for disclosure can further lead to increasing costs through a security for costs order.

A security for costs order is another part of the legal footwork available to delay arbitration. These costs orders are usually intended to assure the state that the foreign investor is able to pay the winner’s legal costs, or adverse costs awards, if they lose (ICCA, 2017). These orders are also used to deter frivolous claims. Frivolous claims increase costs to the respondent state by bringing cases forward that are without merit. In the case of *Mesa Power Group LLC v. Canada*, the NAFTA panel dismissed the claim with damages totalling US\$658 million as Mesa did not establish that Canada was in breach of its obligations (GAC, 2016). The panel determined all costs of arbitration and a portion of Canada’s legal bill are to be paid by Mesa (GAC, 2016). Alternatively, if third party funders do not see substantial returns, many foreign investors will be unable to bring legitimate, meritorious claims forward.

An important ramification of third party funding is that it remains unregulated. There are guidelines that offer best practices through the International Bar Association, although they focus mainly on issues of conflicts of interest (International Bar Association, 2014). Without regulations, third party funders will look for new ways to improve their returns and drive up costs. Some funders are expanding their services by seeking to have more influence on litigation strategies. Omni Bridgeway offers advice on arbitrations and expert witnesses (Eberhardt, & Olivet, 2012). As well, certain third party funders select claims on the basis of potential arguments or procedural matters in order to influence the international investment arbitration process as a whole (Eberhardt, &

Olivet, 2012). Moving from a claim to resolve a dispute to affecting international law will add to the reasons to bring an ISDS claim forward. Another factor in rising ISDS cases for Canada is the claim of shareholder reflective loss.

5.3. Shareholder Reflective Loss

Generally, when shareholders launch Chapter 11 ISDS claims through NAFTA arbitration panels and win, awards are paid to the company and not the shareholder. In NAFTA, both the foreign company and shareholder are allowed to bring separate claims. Of the NAFTA claims brought forward against Canada, 65 percent, or 15 out of the 23 previous or current cases, have been initiated under shareholder reflective loss. As shareholder reflective loss is the only one of the three financial speculative methods made publicly available, the following table details these cases only (Table 7-1 below). While both NAFTA Articles 1116 and 1117 are brought forward by a shareholder, the primary difference is how awards are distributed. Under Article 1117, awards go directly to the company instead of to the shareholder under Article 1116.

Table 5-1. Table of NAFTA Claims under Shareholder Reflective Loss

| Shareholder Reflective Loss | | |
|------------------------------------|---------------------------|---------------------------|
| Company | NAFTA Article 1116 | NAFTA Article 1117 |
| Resolute Forest Products Inc. | ✓ | ✓ |
| Eli Lilly and Company ³ | ✓ | ✓ |
| Lone Pine Resources Inc. | | ✓ |
| Mercer International Inc. | ✓ | ✓ |
| Mesa Power Group | ✓ | |
| AbitibiBowater Inc. | ✓ | ✓ |
| Centurion | | ✓ |
| Dow AgroSciences | ✓ | ✓ |
| Clayton/Bilcon | ✓ | |
| United Parcel Service of America | ✓ | |
| V.G. Gallo | | ✓ |
| SD Myers | ✓ | |
| David Bishop | | ✓ |
| Merrill & Ring Forestry | ✓ | |
| Pope & Talbot | ✓ | |

Source: GAC, 2017

Recent rulings of NAFTA shareholder claims found that there is a lack of consistency in NAFTA arbitral tribunal panels. Results of some ISDS claims have shown that NAFTA panels are uncertain as to interpret relevant case law. In *Mondev v. United States*, a shareholder of a Montreal based construction company brought the claim against the United States on its own behalf (Gaukrodger, 2013). While the tribunal ruled that this

³ Eli Lilly claim was also a recipient of third party funding.

case should have been brought under Mondey's interest, another NAFTA tribunal rejected the argument that shareholder reflective loss claims are limited to company interest under NAFTA rules (Gaukrodger, 2013). Yet, in the shareholder *Pope & Talbot v. Canada* ruling, total awards were paid to the foreign investor (Gaukrodger, 2013).

Shareholder claims for reflective loss in domestic corporate law are much different. Here, shareholder claims for reflective loss are denied. It is believed that the company is better positioned to initiate the same claim for company losses (Gaukrodger, 2014). Under domestic corporate law, whether the company decides to initiate a claim or not, shareholders are prohibited from initiating a separate cause of action (Gaukrodger, 2014). An individual shareholder's only access to justice is then through international investment arbitration.

5.3.1. Advantages to the Foreign Investor

Shareholder reflective loss presents several advantages to the foreign investor. Bringing a claim under a shareholder reflective loss can improve foreign investor protection. If the company in which the foreign investor holds shares chooses not to seek the remedy of a NAFTA Chapter 11 claim, the shareholder can initiate arbitration proceedings. Some reasons why a company may refuse arbitration include concerns for bureaucratic relationships and potential future benefits (Gaukrodger, 2013). As well, if company directors settle for a lower value for their own benefits instead of considering the company as a whole, shareholders can bring their own claim forward (Gaukrodger, 2013).

Allowing shareholders to make a claim for reflective loss however, can be to the disadvantage of the company's creditors. When a shareholder brings a claim, awards to the shareholder can injure other company shareholders and creditors of the company through lack of compensation. Because shareholder claims can bypass the corporate structure, they can effectively position themselves to receive the greatest benefit at the expense of the others.

Shareholders have the opportunity to shop for the best deal. If reflective loss claims are admissible, shareholders can treaty shop for the forum that is most favourable to them. Reflective loss also qualifies shareholders to initiate more than one claim. Under international arbitration rules, shareholders can seek separate claims for the same cause under different treaties. While this is a pricey possibility for the foreign investor, the potential damage awards can outweigh costs involved.

The reflective loss mechanism also applies to domestically incorporated companies that have foreign control. In addressing shareholder qualification to bring a case forward, the ICSID Convention clarifies the eligibility of those shareholders who are able to initiate ISDS claims (ICSID, 2006). If the resulting eligibility of a claim is in question, a company might modify its shareholder ownership structures (Gaukrodger, 2014). This process of company restructuring was used in the *Philip Morris v. Australia* claim over tobacco plain packaging legislation. Philip Morris, an American company, could not sue Australia for changes to its packaging regulations under the US-Australia Free Trade Agreement as there is no ISDS mechanism in this agreement. To circumvent this barrier, Philip Morris restructured its assets to qualify as a Hong Kong investor under the Australia-Hong Kong, China SAR Bilateral Investment Treaty (BIT) (1993) to be eligible to file an ISDS claim against Australia (AFTINET, 2017; UNCTAD, 2013c). As the recovery of a claim could be beneficial for the shareholder, company restructuring can increase the number of ISDS claims for respondent states.

5.3.2. Implications for Canada

One of the biggest concerns for respondent states is the matter of multiple claims under shareholder reflective loss. As shareholders are able to bring separate causes of action against states, the likelihood of multiple claims can increase cost effects for Canada. Even though NAFTA allows for multiple claims to be decided at once, multiple shareholder claims will increase government costs (GAC, 2016). These costs include increased administrative duties, litigation, additional experts and witnesses contributing to lengthy tribunal hearings. Multiple shareholder claims can be initiated through several different means.

Historically, the most common approach to bring an ISDS claim forward is by the foreign corporate firm. Now domestic companies that have substantial foreign shareholder interests can step forward multiplying the number of ISDS claims. These companies include both passive investors from pensions and mutual funds as well as more active investors through hedge funds (Gaukrodger, 2014).

Creditors are also able to launch ISDS claims to protect their interests from shareholder claims and other claimants on corporate assets (Gaukrodger, 2013). Acting in a pre-emptive effort, creditor claims may be launched to secure protection on these company asset holdings such as bonds, stocks, or other corporate securities (Gaukrodger, 2013; OECD 2016). Under NAFTA, bonds are included within the scope of shareholder claims (GAC, 2016). Alternatively, under domestic corporate law, the protection of creditors of a company alone is a main reason to prohibit shareholder claims for reflective loss (Gaukrodger, 2013).

Continuing shareholder reflective loss claims under NAFTA may be more difficult to settle than with company claims. In multiple cases, the likelihood of inconsistencies in approach and results of arbitration tribunals exist. Under the no reflective loss rule in domestic law, courts decide the outcome of disputes through greater legal consistency. Shareholder consent for settlement may become difficult or impossible to obtain due to greater legal inconsistencies found in international investment arbitration (OECD, 2012a). Even with the settlement of one shareholder claim, there is no guarantee that the issue has been resolved. As a result, there may be multiple claims arising out of the same issues (Gaukrodger, 2013). Multiple claims such as these will clearly result in increasingly higher legal costs for Canada and respondent states.

In summary, each of these financial tools motivates foreign investors to initiate claims under NAFTA's Chapter 11. Portfolio investments diversifies risk to both the foreign investor and holders of the portfolio. Third party funding in international arbitration is not subject to disclosure. This increases the chances of funding frivolous cases while ignoring conflict of interests among arbitrators and legal counsel. Meanwhile, shareholder reflective loss claims allow for multiple cases to be brought

forward. Claims can also be launched by shareholders of the company, through different investment funds, and by creditors. Together these motivations can increase NAFTA Chapter 11 claims brought against Canada. In the next chapter, the policy problems, options, and stakeholders will be defined further.

Chapter 6. Policy Options

This chapter outlines four policy options to reduce NAFTA Chapter 11 claims brought against Canada. The goal is to reduce the number of claims to the Canadian government while at the same time ensuring that Canadian companies retain the right to use Chapter 11 when they initiate a claim against the United States or Mexico. These options range from continuing with the current NAFTA requirements to a complete elimination of all types of financial speculation. The following policy options, excluding the status quo, are all contingent on full disclosure of claim funding. This knowledge is needed not only for greater transparency, but for arbitrators to more precisely allocate awards. This chapter begins with a closer look at all relevant stakeholders.

There are several stakeholders motivated by the policy problem that too many cases brought under ISDS claims are inconsistent with the intent of the agreement. The major Canadian stakeholders that are affected when submitting NAFTA claims include all levels of the Canadian government. The goal of each level of government is to attract foreign investment to increase economic growth. Governments benefit as foreign investors increase government revenue through taxation and reduce unemployment through the creation of new jobs. Foreign investors are the other main stakeholders. Foreign investors rely on NAFTA's Chapter 11 as investment protection. This ISDS provision gives confidence to the investor that investments are secure and that there is an effective method of handling disputes should they arise.

There are also several secondary stakeholders with an interest in this policy problem. Canadian businesses look to dispute settlement as a means of resolving conflict if they are to invest in either the United States or Mexico. Although more Canadian businesses may consider investing in the other NAFTA states, policies outlining financial speculation may discourage Chapter 11 submissions.

Interest groups, especially in the natural resource sector, will be aware of any changes made to the dispute settlement process. Lumber associations would be concerned about new policies that limit their ability to bring claims to arbitration to

protect their investment. Mining associations, who are seeking revenue to increase facilities or production through foreign investment, may not receive the foreign investment needed to expand operations.

Civil society and the public also have an interest in NAFTA Chapter 11 claims. Labour and environmental groups can be directly affected with rulings made from arbitration tribunals. Previous proceedings that have ruled in favour of the foreign investor hold possible regulatory implications for Canada.⁴

6.1. Policy Option 1 - Status Quo

Under this option, there is no change to NAFTA's Chapter 11 dispute process or to the definition of allowable investments. Foreign investors continue to have full access to the established dispute settlement procedures. Yet, in current NAFTA renegotiations, Canada is requesting improvements to Chapter 11. Specifically, Canada is seeking reform to governments' "unassailable right to regulate in the public interest," (Dattu, Glossop, Pavic, Anand, 2017). As these negotiations are currently underway, the existing Chapter 11 will be used as the status quo.

6.2. Policy Option 2 - Full Disclosure of Claim Funding

This policy option would require full disclosure of all funding agreements or contracts of both disputing parties. With no legislation requiring disclosure of funding, there is growing pressure to bring greater transparency to international investment arbitration. Aside from long-standing conflict of interest concerns, which may impede impartiality and independence of arbitrators, disclosing financial arrangements of claimants is garnering more recent attention. While Canada has agreed to sign the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP), all parties approved of suspending ISDS provisions to the financial services chapter (GOC,

⁴ *S.D. Myers Inc. v. Canada*. Canada's export ban of PCB waste to the U.S.

2018). The ratification of the Canada-European Union Comprehensive Economic and Trade Agreement (CETA) has incorporated funding disclosure.

In terms of accountability, CETA is the first treaty to implement the disclosure of third party funding. When a claimant takes advantage of third party funding, disclosure of the name and address of the funder must be made available to the other disputing party (European Commission, 2016). This will reveal any potential conflicts of interest among arbitrators, legal teams, and third party funders. Armed with the requirement of full disclosure of claim funding, this policy will remove the veil of privacy and confidentiality that currently shelters funding agreements. Public knowledge of these agreements can have repercussions on not only the third party funder, but the foreign investor seeking financing. Arbitrator decisions may not favour funding and reflect this view when allocating awards. Foreign investors pursuing claims for profit over expropriation may damage their company image and subsequent profits. As a result, both investors and funders may rethink pursuing arbitration.

While CETA is a significant first step in imposing disclosure rules, this policy option is more transparent by requiring full disclosure of all aspects of funding contracts. This includes not only names and addresses of all funders, but the terms of financing and award allocation which are to be made publicly available. Full disclosure of funding renegotiated in NAFTA can be a prudent step towards decreasing the number of Chapter 11 claims brought against Canada.

6.3. Policy Option 3 - Cap on Award Recovery to Funder

This policy option proposes a cap on the recovery of awards allocated to the funder. As noted, full disclosure of claim funding must be included with this option in order for arbitrators to be aware of existing funding agreements in which to determine the correct allocation of funds. The cap must be low enough to deter third party funders from seeking claims to finance. In awards going to cases funded by portfolio investments or third party funding, the larger portion of the award will be allocated to the claimant. In cases of awards decided in favour of the claimant under shareholder reflective loss, the

remaining portion of the award will be assigned back to either the shareholder under NAFTA's Article 1116 or the company under Article 1117.

6.4. Policy Option 4 - Prohibit All Financial Speculation

The proposed policy option to prohibit financial speculation is not new. Several states have attempted to ban financial speculation. The Dodd-Frank Wall Street Reform and Consumer Protection Act served as a measure of financial reform passed by the Obama administration in 2010 in response to the 2008 financial crisis. Regulating derivatives, such as shareholder reflective loss and portfolio packaging of ISDS claims, were among the provisions set to limit speculation but have since been repealed through the Financial CHOICE Act (Investopedia, 2018). Likewise, champerty and maintenance doctrines, that were once illegal, are now considered an acceptable means of access to justice opening the door for third party financing.

While this option is considerably more restrictive than the previous policy options, the number of Chapter 11 claims would be greatly reduced. This option will not only encourage greater consultation and negotiated settlements but reduce the chances of frivolous claims.

The decision to package portfolio investments, third party funding, and shareholder reflective loss together will give a broader reach for regulation instead of singling out one of the three speculative methods only. If only one of the three is chosen as a policy option, that option may reduce some instances of Chapter 11 claims leaving the other two methods available as alternatives to fill in the gap. By increasing the scope of this policy option by bundling all three financial speculative tools together, there will be a greater likelihood of seeing an increased reduction in Chapter 11 claims for Canada.

Chapter 7. Criteria and Measures

This section provides the framework used to evaluate the previous four policy options. The goal of the policy options is to reduce the number of Chapter 11 claims being brought against Canada. Relevant societal and governmental objectives have been selected and defined to determine which policy will achieve this goal. The objectives are effectiveness, impact on FDI, fairness and justice, and political and stakeholder acceptability. The table below summarizes the selected criteria and measures.

Table 7-1. Criteria and Measures

| Criteria | Definition | Measure | Value |
|----------------------------------|---|---|--|
| Effectiveness | Will policy reduce number of claims? | Perceived negative effect on foreign investor | High Med Low |
| Impact on FDI | Will policy encourage FDI flows in Canada? | Share of foreign investments in GDP in Canada | High - > 4 percent Med - 2 - 4 percent Low - < 2 percent |
| Fairness and Justice | Will policy prevent foreign investor from bringing claim forward? | Impinges on ability of foreign investors to bring claim forward | Yes No |
| Political Acceptability | Will policy be acceptable to political actors? | Congruency with government objectives | High acceptance Med acceptance Low acceptance |
| Stakeholder Acceptability | Will policy be acceptable to business groups? | Increase in lobbying of government by business | High acceptance Med acceptance Low acceptance |

7.1. Effectiveness

Effectiveness is used to measure the impact of each policy option in decreasing NAFTA Chapter 11 claims against Canada. Each option will be reviewed for the likelihood of reducing Chapter 11 claims through the level of deterrence. Deterrence is

measured by foreign investors' level of perceived negative effects. Potential outcomes include negative media attention which could affect the foreign investor's reputation or induce further litigation for the investor. The greater the perceived negative effects on the foreign investor, the greater the likelihood of a Chapter 11 claim not being submitted. For policies other than the status quo, full disclosure is critical in ranking the policy options.

Scoring is based on the perceived negative effects for the foreign investor. Scoring is set out with a high value if the policy is determined to be so restrictive that the likelihood of initiating a Chapter 11 claim is nil. A medium score is given if the policy is perceived as less restrictive and the investor is still willing to file a claim, while a policy receives a low score if the policy does not deter a foreign investor in starting a claim at all. Therefore, the greater the likelihood in reducing the number of claims, the higher score that policy option receives.

7.2. Impact on Foreign Direct Investment

One factor in economic efficiency is growth through foreign investment. Current literature has found that trade and FDI inflows improve economic efficiency (Iyer, Rambaldi & Tang, 2008). For every CAD\$1 billion increase in new FDI in Canada on average, more than 45,000 jobs are generated adding CAD\$4.5 billion to Canada's GDP (GAC, 2017d). As well, countries with sophisticated financial markets, such as Canada, will see greater gain from FDI inflows than in developing countries (Iyer et al., 2008). Therefore, policies that attract FDI inflows can increase economic efficiencies. As a means to attract more FDI, IIAs such as NAFTA are an important tool in Canadian foreign investment strategies.

The impact of FDI criterion chosen to measure economic gain against all four policy options is the likely increase in percent of foreign investments in GDP in Canada. To receive a high score, total foreign investments in Canada would exceed four percent of GDP. A medium score will be between two to four percent and a low score less than

two percent. The more restrictive the policy option, the lower the likelihood of foreign investors investing in Canada.

7.3. Fairness and Justice

A necessary part of international dispute resolution is the ability to access justice, which is to “obtain legal advice and representation and to secure any adjudication through the courts of their legal rights and obligations” (Jackson, 2009). It is this access to justice, particularly in international investment arbitration, that is considered an essential means of recourse for foreign investors. Without another channel to fund claims, foreign investors would lack the means to pursue protection for their investments.

Each policy option is measured to the extent that the option will impinge on the foreign investor’s ability to bring a Chapter 11 claim forward. A measure of “yes” indicates the policy will negatively affect the ability of the foreign investor to seek justice through initiating a claim. A measure of “no” indicates that the policy does not impinge the foreign investor’s ability to file a Chapter 11 claim.

7.4. Political Acceptability

The measure of political acceptability determines whether the policy option is acceptable to political actors and policy makers. In this paper, acceptability will assess the extent to which the three political parties agree with current NAFTA renegotiations including Chapter 11. If all three political parties agree with a policy, it receives a high score. If only two parties agree, the policy receives a medium score. If one party or none of the parties agrees, the policy is ranked low.

In recent cabinet discussions, the Canadian Liberal government clearly identified its position on the ISDS mechanism. The Government of Canada is seeking improvements to the ISDS mechanism instead of removing it from NAFTA’s Chapter 11 (Ramsey, 2017). The popularity of the ISDS mechanism is evident as it is found in almost all of Canada’s IIAs. In Canada’s free trade agreements (FTAs) and foreign

investment promotion and protection agreements (FIPAs), 56 out of 57 include the ISDS mechanism (GOC, 2017a).

In the December Standing Committee Report on International Trade (2017), both the Conservative Party and New Democrat Party (NDP) expressed their level of acceptance (Canada, 2017). As Official Opposition, the Conservative Party believes that the government must maintain a positive working relationship with both the United States and Mexico. It is this working relationship that has been critical for the success of NAFTA (Canada, 2017). Therefore, the Conservatives agree to “...support efforts that advance free trade in North America and free trade amongst market economies” (Canada, 2017).

The NDP does not support NAFTA’s Chapter 11. The NDP states that the ISDS mechanism conflicts with public interest (Canada, 2017). In this report, the NDP specifically mention the impact of the ISDS on the “...domestic environmental, energy and water regulations...” in Canada (Canada, 2017). In concluding recommendations, the NDP request the government to eliminate NAFTA’s Chapter 11 ISDS provisions and to exclude ISDS provisions in all future trade agreements (Canada, 2017).

7.5. Stakeholder Acceptability

As important actors in the Canadian economy, businesses regularly interact with government through lobbying efforts. Lobbying is increased when there are proposed changes to the international trade and political arena. Therefore, businesses increase their lobbying efforts indicating their lack of acceptance to future policy changes.

The criterion used to measure stakeholder acceptance is the degree of acceptability business stakeholders would have. High acceptance indicates that these stakeholders are responsive to current policies and therefore engage in less lobbying with government departments. Medium acceptance indicates enough concern to step up attempts to speak with political actors. Low acceptance indicates the business community disagrees with the proposed policy and escalates lobbying action.

From 2008 to 2017, the increase in lobbying on the topic of international trade rose 961 percent (Office of the Commissioner of Lobbying of Canada, 2017). Yet from 2013 to 2015 leading up to the federal election, lobby efforts in international trade saw a decline of 80 percent (OCLC, 2017a). However, as a result in recent changes in the United States administration, international trade has received the highest number of lobbying efforts to date. An increase in registered lobby communication reports topped 1046 percent from November 2015 to November 2017 (OCLC, 2017b). The next chapter will analyze each policy option against each criterion.

Chapter 8. Analysis of Policy Options

8.1. Effectiveness

The criterion of effectiveness reveals a clear relationship to the four policy options. The more restrictive the policy option is, the lower the number of claims that are brought forward therefore the higher the resulting score.

Table 8-1. Scoring for Effectiveness

| Criteria | Policy Option 1 | Policy Option 2 | Policy Option 3 | Policy Option 4 |
|---|--|----------------------------------|------------------------------|------------------------------------|
| | Status Quo - No change to NAFTA Chapter 11 | Full disclosure of claim funding | Cap award recovery to funder | Prohibit all financial speculation |
| Will the policy reduce NAFTA Chapter 11 claims? | Low | Medium | High | High |

8.1.1. Will the policy reduce NAFTA Chapter 11 claims?

Status Quo – No change to NAFTA Chapter 11

In reviewing previous Chapter 11 cases, it is unlikely that this policy will have any effect of reducing NAFTA claims against Canada. Under the status quo, foreign investors do not have to disclose any such funding arrangements when initiating a Chapter 11 claim, therefore there will be no perceived negative effects to consider if this information were to be released for public record. This option is ranked low.

Full disclosure of claim funding

This policy option will reduce the number of Chapter 11 claims. As financiers rely on the right to privacy and confidentiality, requiring full disclosure of all claim funding will address the willingness of funders to bankroll ISDS claims. Funders may not want to reveal their involvement for fear of either business or personal reprisals (McDonald, n.d.). Even though the majority of NAFTA Chapter 11 claims are brought through shareholder reflective loss, the funding arrangements of any of these claims (except *Eli Lilly*) have not been divulged. Where this policy may face barriers is due to perceived lack of authority.

As international arbitration panels do not prohibit private funding agreements, panels tend to wait for procedural requests for disclosure from the opposing party. As well, many arbitration panelists believe they do not hold the authority to order funding disclosure (OECD, 2012a). Besides, even if full disclosure was provided, secret funding arrangements may still exist. While full disclosure can reduce the number of claims brought against Canada, this policy option is ranked medium.

Cap award recovery to funder

As noted earlier, this policy option must be implemented with the second policy option of full disclosure of claim funding. Full disclosure is needed to be able to cap any recovery of awards that may go to funders. Recovery of awards in third party financing agreements varies. Generally, third party funders expect approximately one-third of any award or settlement (Smith, 2012). As mentioned in section 5.1., third party funder Burford Capital is expected to receive US\$140 million in compensation, or just over one-third from the total award of US\$324 million decided in the investor's favour (LSE, 2016a). While a 10 percent cap would still leave a considerable profit, US\$32 million may not cover all risks and costs to the funders. The chance of a lengthy recovery or reduction in award still exists. In the case of *Teinver S.A. and Others v. Argentina*, the investor received 20 percent of damages claimed (UNCTAD, 2013d). Placing a 10 percent cap on amount of recovery can prohibit funding speculation, therefore reducing the number of ISDS claims brought forward. The rank for this criterion is high.

Prohibit all financial speculation

This option is likely to greatly reduce NAFTA Chapter 11 claims. Removing all means of profiting from international arbitration will greatly reduce frivolous cases being brought forward. With full disclosure of claim funding arrangements being required by all parties, opposing parties may be more diligent in abiding by the regulations rather than leaving enforcement up to the arbitration panel. Yet, if full disclosure is not provided or secret financing is discovered, panels can set aside the award or award costs to the opposing party.

Foreign investors may instead place greater emphasis on consultation and mediation in order to come to a less costly settlement. However, states may believe they have the upper hand and not settle at all. Only those cases that can afford international arbitration will continue to initiate claims. This criterion is ranked high.

8.2. Impact on Foreign Direct Investment

For the impact on FDI, the first two policy options scored highest. The first policy option score is due to the fact that the current NAFTA Chapter 11 is a well-established, predictable, and stable method of dispute settlement. Policy option 2 also scored high as the demand for disclosure is growing in international investment arbitration. Policy options 3 and 4 scored lower due to smaller economic gains resulting from more restrictive policies.

Table 8-2. Scoring for Impact of FDI

| Criteria | Policy Option 1 | Policy Option 2 | Policy Option 3 | Policy Option 4 |
|---|--|----------------------------------|------------------------------|------------------------------------|
| | Status Quo - No change to NAFTA Chapter 11 | Full disclosure of claim funding | Cap award recovery to funder | Prohibit all financial speculation |
| Will policy encourage FDI flows in to Canada? | High | High | Medium | Low |

8.2.1. Will the policy encourage FDI flows into Canada?

Status Quo – No change to NAFTA Chapter 11

This policy already promotes high economic gains as NAFTA appears to have significantly increased FDI in Canada (Globerman & Shapiro, 1999). The present NAFTA Chapter 11 provisions will continue to encourage FDI flows into Canada. Therefore, this policy option is ranked as high.

Full disclosure of claim funding

The second policy option will also encourage FDI flows into Canada. As noted in CETA, this multilateral agreement has included a chapter on disclosure of third party

funding. Taking disclosure on third party funding agreements further to include financial information will address several issues. First, respondent states will be confident that the claimant will have the necessary funds to pay damages if awarded in the state's favour. Second, requiring full disclosure will reduce arbitration time and costs. Arbitration panels will not be weighed down with numerous procedural orders requesting funding information to be disclosed. Third, requiring full disclosure may also prevent bad behaviour from disputing parties. These tactics are often employed by experienced legal teams to draw out arbitration or persuade respondent states to come to a quicker settlement. Overall, full disclosure will provide necessary information to address concerns up front. This option is ranked high.

Cap award recovery to funder

This policy option is ranked with a medium score. With the realization that funders' profits will be capped at a low percent of the final award, the likelihood of foreign investment in to Canada will be reduced. Foreign investors will have to more carefully weigh Canada's domestic laws against their target goals before making an investment. If there is a greater chance of future disputes, the investor must consider the chances of solely financing a claim or finding agreeable funders.

Prohibit all financial speculation

Prohibiting all financial speculation on NAFTA Chapter 11 claim funding will be a disincentive to foreign investment in Canada. Only large multinational corporations will consider investing in Canada as they would not need to be funded in an investment dispute. Canada's percent of GDP of FDI would decrease the number of jobs and government revenues. Therefore, this policy option receives a low score.

8.3. Fairness and Justice

This criterion received either a score of yes or no in determining if each policy will prevent foreign investors from bringing claims forward. Three out of the four policy options indicate that the foreign investor retains the ability to initiate a Chapter 11 claim using a method of financial speculation.

Table 8-3. Scoring for Fairness and Justice

| Criteria | Policy Option 1 | Policy Option 2 | Policy Option 3 | Policy Option 4 |
|--|---|---|-------------------------------------|---|
| | Status Quo - No change to NAFTA Chapter 11 | Full disclosure of claim funding | Cap award recovery to funder | Prohibit all financial speculation |
| Will policy prevent foreign investor to bring claim forward? | No | No | No | Yes |

8.3.1. Will policy prevent foreign investor to bring claim forward?

Status Quo – No change to NAFTA Chapter 11

Under the status quo, foreign investors will not be prevented from seeking funding to bring a Chapter 11 claim against Canada. Of the 23 current or previous Chapter 11 cases, 15 cases, or 65 percent, were brought forward under shareholder reflective loss claims (GAC, 2017). This policy option receives a score of no.

Under NAFTA’s Section B detailing settlement of disputes between a party and an investor of another party, shareholders can file claims under Articles 1116 and 1117.

As domestic courts do not allow shareholder reflective loss claims in commercial arbitration, NAFTA's Chapter 11 does not prevent foreign investors from bringing a claim forward.

Full disclosure of claim funding

Typically, the existence of funding and the identity of a third party funder is not privileged information. Securing third party financing and managing the funding relationship usually requires disclosure of information that would otherwise be privileged, between a client and its counsel only. However, when privileged and confidential information is shared with a third party, privilege and confidentiality are generally considered waived. Therefore, without the claim of privilege, full disclosure will not prevent foreign investors from accessing justice through a Chapter 11 claim. This policy option receives a score of no.

Full disclosure is also beneficial to the foreign investor. Full disclosure of claim funding can protect the investor from funders who seek greater control over a Chapter 11 claim. As a funder's motivation may be directed at receiving a larger profit, a foreign investor's rationale may include other considerations. Investors may need to think about long term company goals, employees, and potential change in the future political environment.

Cap award recovery to funder

In terms of foreign investors being prevented from bringing a Chapter 11 claim forward, capping award recovery will not reduce the rights of investors although some funders may be dissuaded by a low recovery cap. Some forms of funding, such as arbitration insurance policies and portfolio investments, may find a low recovery cap acceptable. With current awards averaging USD\$500 million, a ten percent cap still results in a large USD\$50 million award.

As the level of risk is low with portfolio financing, premiums or funding terms may not require such high profit margins. However, with most funding offered through well-established third party funders, expectations for greater returns are likely. While the

intentions of foreign investors seeking funding to file a Chapter 11 claim may differ from funders, this option does not preclude a claim from being brought forward. Therefore, this policy option receives a score of no.

Prohibit all financial speculation

Prohibiting financial speculation to finance Chapter 11 claims is a bold option. This idea is generally in response to third party funding and its lack of reciprocity in international arbitration. Yet, as all of these funding methods are already established in the United Kingdom and the United States, Canada is taking a more cautionary approach. Third party funding is still being explored in many provincial courts with mixed results. The British Columbia Supreme Court validated third party funding agreements but that portions of the agreement were protected by privilege while the amount of funder control over a claim may be subject to disclosure (Chiasson & Parsons, 2013). The Ontario Superior Court supports third party funding agreements, yet disagrees with the issue of privilege, especially in class action suits. The Court stated that litigation funding agreements are not privileged and should be completely transparent to the purpose of the claim (Chiasson & Parsons, 2013).

As old laws of champerty and maintenance are slowly being repealed in domestic law, third party funding especially is establishing a formal foothold as a means to access justice. This policy option would prevent foreign investors from bringing a Chapter 11 claim forward and is scored as yes.

8.4. Political Acceptability

Political acceptability is an important criterion with the results taken from the top three federal political parties. For political acceptability the results show a medium or low score, yet there are different reasons behind the rankings. Policy option 1 is ranked as medium while option 2 is ranked high. The high score for option 2 indicates that as both the Liberal government and the Conservatives are in agreement with the status quo, requiring full disclosure is a more protective measure for both governments and businesses as seen in the CETA ratification. Options 3 and 4 are ranked low as the

Liberal government and Conservatives would see these options are too restrictive and as a barrier to trade. The NDP disagrees with all policy options and requests complete elimination of the ISDS mechanism in NAFTA’s Chapter 11.

Table 8-4. Scoring for Political Acceptability

| Criteria | Policy Option 1 | Policy Option 2 | Policy Option 3 | Policy Option 4 |
|--|---|---|-------------------------------------|---|
| | Status Quo - No change to NAFTA Chapter 11 | Full disclosure of claim funding | Cap award recovery to funder | Prohibit all financial speculation |
| Will the policy be acceptable to political actors? | Medium | High | Low | Low |

8.4.1. Will the policy be acceptable to political actors?

Status Quo – No change to NAFTA Chapter 11

Current NAFTA ISDS provisions in Chapter 11 are acceptable to two of Canada’s three major political parties. The positions of all parties are unlikely to change therefore option 1 ranks medium.

Full disclosure of claim funding

Canada is foreseeably on the way to full disclosure of claim funding. Canadian courts overseeing disclosure in litigation are increasingly ruling in favour of transparency. Both the Liberal and Conservative parties promote transparency through several disclosure agreements. Canada is a signatory with UNICTRAL’s Rules of Transparency and has also ratified CETA confirming that disclosure is playing a larger part in multilateral trade agreements. Further implementation of claim funding disclosure

is on track with the Government of Canada's values. For these reasons, this option is ranked high.

Cap award recovery to funder

The third policy option receives a low score due to lack of support by all parties. Both the Liberal government and the Conservatives would see this option as more restrictive for foreign investment. Possible outcomes from this option could include declining FDI in Canada and lower economic gain. The NDP party would not be in agreement with this option as the party only considers full elimination of the ISDS mechanism.

Prohibit all financial speculation

The fourth option also receives a low rank. This policy would not garner any agreement between parties. As the United States is Canada's largest trading partner, the government views NAFTA's Chapter 11 as a necessary provision. If foreign investors are willing to invest in Canada, then there must be a dispute settlement provision in place. Even though most of the Chapter 11 claims are generated by American investors, Canada considers trade disputes a normal business practice (M. Berdichevsky, Global Affairs Canada, personal communication, August 2017). The Conservatives also support this position of having access to a dispute settlement mechanism available to foreign investors. The NDP are still not in agreement and would continue to petition for the elimination of the ISDS mechanism.

8.5. Stakeholder Acceptability

While scoring is based on those Canadian businesses that invest outside of Canada, domestic businesses may not be in complete agreement. Medium to large sized companies are aware of exporting opportunities and the potential of business growth. Yet firms that choose to remain domestic may view NAFTA's Chapter 11 as a greater advantage to foreign investors. Chapter 11 grants foreign investors the added opportunity

to seek redress outside of Canadian laws when pursuing dispute settlement whereas domestic companies are not entitled to this measure.

Stakeholder acceptability of interest groups demonstrates a complete lack of support for each policy option. These stakeholders believe that none of the policy options reflect social values of freedom, security, and non-discrimination for Canadians. Instead, these groups believe that greater emphasis should be placed on better labour standards and environmental regulations. The only support from these stakeholders is for the total removal of Chapter 11 in current renegotiations.

Since businesses that export demand security of their foreign investments from their governments, it is this group that will be reviewed. For Canadian business groups, the criterion of acceptance for policy option 1 receives a high score. Policy option 2 receives a rank of medium while options 3 and 4 show a low rank due to the more restrictive investment measures.

Table 8-5. Scoring for Stakeholder Acceptability

| Criteria | Policy Option 1 <i>Status Quo - No change to NAFTA</i> | Policy Option 2 <i>Full Disclosure of claim funding</i> | Policy Option 3 <i>Cap award recovery to funder</i> | Policy Option 4 <i>Prohibit all financial speculation</i> |
|--|--|---|---|---|
| Will the policy be acceptable to stakeholders? | High | Medium | Low | Low |

8.5.1. Will the policy be acceptable to stakeholders?

Business Groups

Status Quo – No change to NAFTA Chapter 11

Business groups are familiar with the status quo and can work within these parameters. Lobbying efforts are lower due to Canada's predictable laws and regulation. This option received a rank of high.

Full disclosure of claim funding

As disclosure is already making its entry into international arbitration, businesses may still lobby to prevent full disclosure of funding agreements. Businesses will try to protect information they deem private and confidential. Information released to the public may impact company reputation and future profits. This option receives a medium score.

Cap award recovery to funder

Seen as a restrictive barrier to foreign investment, businesses will lobby to prevent caps on award recovery to the funder. Businesses may possibly cite that this option is an impediment in seeking appropriate compensation as well as in accessing justice. Businesses will also view this option as a negative impact on their investments in the partnering NAFTA countries. This option receives a low score.

Prohibit all financial speculation

Businesses will view prohibiting all financial speculation as an obstacle in bringing a claim forward. If Canadian businesses need to file a Chapter 11 claim, this policy can also negatively impact their investment. Restricting financial speculation may be a company's only avenue to funding a meritorious claim. Consequently, businesses will then undertake stronger lobby efforts to prevent this restriction. This option is ranked low.

8.6. Summary of Policy Analysis

Table 8-6. Scoring of Policy Options

| Objective | Criteria | Policy Option 1 | Policy Option 2 | Policy Option 3 | Policy Option 4 |
|----------------------------------|---|--|---|-------------------------------------|---|
| | | <i>Status Quo - No change to NAFTA</i> | <i>Full disclosure of claim funding</i> | <i>Cap award recovery to funder</i> | <i>Prohibit all financial speculation</i> |
| Effectiveness | <i>Will policy reduce claims?</i> | Low | Medium | High | High |
| Impact on FDI | <i>Will policy encourage FDI flows in Canada?</i> | High | High | Medium | Low |
| Fairness and Justice | <i>Will policy prevent foreign investor to bring claim forward?</i> | No | No | No | Yes |
| Political Acceptability | <i>Will policy be acceptable to political actors?</i> | Medium | High | Low | Low |
| Stakeholder Acceptability | <i>Will policy meet the needs of Canadian business groups?</i> | High | Medium | Low | Low |

Chapter 9. Policy Recommendations and Implications

Based on the analysis conducted in this paper, the recommended policy option is for full disclosure of claim funding.

Full disclosure of claim funding received the highest rankings with no low score. This policy option would reveal the presence of funding by others who are speculating on potential highly-profitable claims. Removing confidentiality may dissuade funders from pursuing NAFTA's Chapter 11 claims that are without merit. Providing full disclosure of claim funding will also aid in preventing conflict of interest among arbitrators and legal counsel. Yet, if many conflicts arise, there may not be enough arbitrators to choose from established rosters. This could lead to the addition of new experts with no previous ties to funders. With legislated full disclosure of claim funding, and strict enforcement, this policy may impact the reduction of NAFTA Chapter 11 claims for Canada.

Remaining with the current Chapter 11, or status quo, is the next highest-ranking option. While the status quo will continue to provide a stable and predictable backdrop for foreign investment, Chapter 11 claims will not be reduced. Even though changes are currently being renegotiated, financial speculation is not being considered. This policy option will not deter claims from being brought against the Canadian government.

The option of capping recovery of awards together with the option of full disclosure is ranked third. This option could be seen as not allowing a fair profit to be made from an investment. Policy option 3 would be restrictive enough to reduce claims but would not receive the necessary acceptance of political actors or stakeholders.

The fourth policy option of prohibiting all financial speculation received the lowest ranking. Prohibiting funding, even under speculative conditions, will limit foreign investors from bringing a Chapter 11 claim. Meritorious claims deserving of the chance to seek redress must be allowed this opportunity. It is this very reason that international, and commercial, investment arbitration takes place.

Chapter 10. Conclusion

This paper has illustrated the changing intentions of entities seeking ISDS claims. From investors seeking compensation from expropriation to a new speculative financial industry, the government must consider appropriate policy measures in order to reduce the number of NAFTA claims brought against Canada that are based primarily on financial speculation. From the analysis of the policy options presented, the optimum choice is for full disclosure of claim funding to be included in current NAFTA renegotiations.

The benefits of full disclosure are more than just reducing NAFTA claims against Canada, this option provides protection to all parties. Full disclosure of claim funding offers complete transparency, addresses concerns of regulating in the public interest, reduces conflicts of interest, and allows meritorious claims to be brought forward while keeping all parties accountable. While this paper provides a viable policy option as a counter measure to current practices in ISDS claims, especially those brought through NAFTA's Chapter 11, due to data restrictions from the lack of transparency surrounding these very claims, analysis is as comprehensive as possible.

Full disclosure of claim funding is the next logical step in dispute settlement in the global trade environment. Future research should review past publicly available funded ISDS claims where disclosure has been required. Comparisons should include the type and size of investments, arbitration costs, awards, timeline of claim, and type of funding received. Similarly, domestic commercial funding should be reviewed in comparable cases as these claims have a lengthier history. Other factors to be monitored in ISDS claims are the rise in the number of third party financiers and evolving financially engineered instruments such as credit default swaps and the creation of new security packages (similar to the 2008 mortgage-backed securities). As such, new developments will continue the discussion of future policy options.

It is in the best interest of the government to pursue full disclosure of claim funding in current renegotiations of NAFTA. Full disclosure will facilitate the

monitoring of funding procedures, the ongoing effects on Chapter 11 claims, and award outcomes. With this policy in place, data collected will assist in formulating future options that may become necessary in the unpredictable world of international investment arbitration. As the changing trend in ISDS claims is likely to increase, full disclosure policies will need to emerge to reduce the number of claims being brought under NAFTA's Chapter 11.

References

- AFTINET. (2017). *Australian High Court rules against big tobacco on plain packaging*. Retrieved from <http://aftinet.org.au/cms/node/519>
- Barrera, E.B. (2017). *The Case for Removing the Fair and Equitable Treatment Standard from NAFTA*. Centre for International Governance Innovation. No. 128. Ontario: Canada
- Bernasconi-Osterwalder, N. (2014). State-State Dispute Settlement in Investment Treaties, Best Practice Series – October 2014. *International Institute for Sustainable Development*. Retrieved from <https://www.iisd.org/sites/default/files/publications/best-practices-state-state-dispute-settlement-investment-treaties.pdf>
- Bishop, R.D., Keenan, K.D. (2017). *Comparative Table of Rules of International Arbitral Regimes*. Retrieved from <https://www.yumpu.com/en/document/view/23975911/comparative-table-of-rules-of-international-king-spalding>
- Burford Capital. (2017). *International arbitration*. Retrieved from <http://www.burfordcapital.com/customers/international-arbitration/>
- Burford Capital. (2017a). *Burford Quarterly. A review of litigation and arbitration finance*. Retrieved from <http://www.burfordcapital.com/wp-content/uploads/2017/07/Burford-Quarterly-Summer-2017.pdf>
- Canada. Parliament, House of Commons. Standing Committee on International Trade. (2017, December). *Priorities of Canadian Stakeholders having an interest in bilateral and trilateral trade in North America, between Canada, the United States and Mexico*. 8th Report. 42nd Parliament, 1st Session. Retrieved from <http://www.ourcommons.ca/Content/Committee/421/CIIT/Reports/RP9326406/ciitrp08/ciitrp08-e.pdf>
- Chiasson, C., Parsons, H. (2013). Canada: Financing Disputes – Third -Party Funding Option. *Mondaq*. Retrieved from <http://www.mondaq.com/canada/x/280260/Arbitration+Dispute+Resolution/Dispute+Resolution+Newsletter+Fall+Edition+2013>
- Clayton/Bilcon v. Government of Canada. (2008). Procedural Order No. 24. *Permanent Court of Arbitration (PCA) Case No. 2009-04*. Retrieved from <http://www.pccases.com/web/sendAttach/2229>

- Dattu, R., Glossop, P., Pavic, S. & Anand, N. (2017). *Canada unveils its top priorities for NAFTA renegotiations*. Retrieved from <https://www.osler.com/en/resources/cross-border/2017/canada-unveils-its-top-priorities-for-nafta-renego>
- De Mestral, (2015). *Investor-State Arbitration between developed Democratic Countries. Investor-State Arbitration Series. Centre for International Governance Innovation. Paper No. 1*. Retrieved from
- Eberhardt, P. & Olivet, C. (2012). *Profiting from injustice. How law firms, arbitrators and financiers are fueling an investment arbitration boom*. Retrieved from <https://www.tni.org/en/briefing/profitting-injustice>
- European Commission. (2016). *CETA chapter by chapter. Article 8.26 third party funding*. Retrieved from <http://ec.europa.eu/trade/policy/in-focus/ceta/ceta-chapter-by-chapter/>
- Freeman, S. (2015). *NAFTA's Chapter 11 Makes Canada Most-Sued Country Under Free Trade Tribunals*. *The Huffington Post*. Retrieved from http://www.huffingtonpost.ca/2015/01/14/canada-sued-investor-state-dispute-ccpa_n_6471460.html
- Foreign Trade Information System. (2001). *Notes of Interpretation of Certain Chapter 11 Provisions*. Retrieved from http://www.sice.oas.org/tpd/nafta/Commission/CH11understanding_e.asp
- Fulbrook Management LLC. (2012). *Third Party Commercial Funding. Taking Stock Today, Looking at Tomorrow*. Retrieved from <http://fulbrookmanagement.com/wp-content/uploads/2017/07/Third-Party-Commercial-Funding.pdf>
- Gaukrodger, D. & Gordon, K. (2012). *Investor-State Dispute Settlement: A Scoping Paper for the Investment Policy Community. OECD Working Papers on International Investment*. Paris: France OECD Publishing.
- Gaukrodger, D. (2013). *Investment Treaties as Corporate Law: Shareholder Claims and Issues of Consistency. OECD Working Papers on International Investment, 2013/03*. Retrieved from http://www.oecd.org/investment/investment-policy/WP-2013_3.pdf
- Gaukrodger, D. (2014). *Investment Treaties and Shareholder Claims, Analysis of Treaty Practice. OECD Working Papers on International Investment*. Retrieved from www.oecd.org/daf/inv/investment-policy/working-papers.htm.

Gaukrodger, D. & Gordon, K. (2015). Inter-Governmental Evaluation of Investor-State Dispute Settlement: Recent Work at the OECD-Hosted Freedom of Investment Roundtable. In J.E. Kalicki and A. Joubin-Bret (Eds.), *Reshaping the Investor-State Dispute Settlement System: Journeys for the 21st Century* (pp.597-620). Retrieved from <https://ebookcentral-proquest-com.proxy.lib.sfu.ca/lib/sfu-ebooks/detail.action?docID=1956712>

Global Affairs Canada (GAC). (2013). *Investment*. Retrieved from <http://www.international.gc.ca/trade-agreements-accords-commerciaux/topics-domaines/invest/index.aspx?lang=eng>

Global Affairs Canada (GAC). (2013a). *North American Free Trade Agreement (NAFTA) Dispute Settlement. Notes of Interpretation of Certain Chapter 11 Provisions*. Retrieved from <http://www.international.gc.ca/trade-agreements-accords-commerciaux/topics-domaines/disp-diff/NAFTA-Interpr.aspx?lang=eng>

Global Affairs Canada (GAC). (2016). *Mesa Power Group v. Government of Canada*. Retrieved from <http://www.international.gc.ca/trade-agreements-accords-commerciaux/topics-domaines/disp-diff/mesa.aspx?lang=eng>

Global Affairs Canada (GAC). (2017). *NAFTA – Chapter 11. Cases Filed Against the Government of Canada*. Retrieved from <http://www.international.gc.ca/trade-agreements-accords-commerciaux/topics-domaines/disp-diff/gov.aspx?lang=eng>

Global Affairs Canada (GAC). (2017a). *AbitibiBowater Inc. and The Government of Canada*. Retrieved from <http://www.international.gc.ca/trade-agreements-accords-commerciaux/assets/pdfs/disp-diff/abitibi-03.pdf>

Global Affairs Canada (GAC). (2017b). *Pope & Talbot Inc. v. Government of Canada*. Retrieved from <http://www.international.gc.ca/trade-agreements-accords-commerciaux/topics-domaines/disp-diff/pope.aspx?lang=eng>

Global Affairs Canada (GAC). (2017c). *Eli Lilly and Company. v. Government of Canada*. Retrieved from <http://www.international.gc.ca/trade-agreements-accords-commerciaux/topics-domaines/disp-diff/eli.aspx?lang=eng>

Global Affairs Canada (GAC). (2017d). How does Chapter 11 benefit our communities? *NAFTA – Chapter 11 – Investment*. Retrieved from <http://www.international.gc.ca/trade-agreements-accords-commerciaux/topics-domaines/disp-diff/Mun-FAQs.aspx?lang=eng>

- Globerman, S., Shapiro, D.M. (1999). The Impact of Government Policies on Foreign Direct Investment: The Canadian Experience. *Journal of International Business Studies*, 3rd Quarter 1999, Vol 30 (3) pp. 513-32. Retrieved from The Impact of Government Policies on Foreign Direct Investment: The Canadian Experience
- Goldsmith, A., & Molchionda, L. (2016). The ICC's Guidance Note on Disclosure and Third-Party Funding: A Step in the Right Direction. *Kluwer Arbitration Blog*. (Blog post). Retrieved from <http://arbitrationblog.kluwerarbitration.com/2016/03/14/the-iccs-guidance-note-on-disclosure-and-third-party-funding-a-step-in-the-right-direction/>
- Gotanda, J.Y. (2007). *A Study of Interest. Working Paper No. 2007-10*. Retrieved from <http://ssrn.com/abstract=1027994>
- Government of Canada (GOC). (2017). *North American Free Trade Agreement (NAFTA) – Fast Facts*. Retrieved from <http://www.international.gc.ca/trade-commerce/trade-agreements-accords-commerciaux/agr-acc/nafta-alena/fta-ale/facts.aspx?lang=eng>
- Government of Canada (GOC). (2016). *North American Free Trade Agreement (NAFTA). Part Five: Investment, Services and Related Matters*. Retrieved from <http://international.gc.ca/trade-commerce/trade-agreements-accords-commerciaux/agr-acc/nafta-alena/fta-ale/11.aspx?lang=eng>
- Government of Canada (GOC). (2016a). *North American Free Trade Agreement (NAFTA). Part One: General Part. Chapter Two: General Definitions*. Retrieved from <http://international.gc.ca/trade-commerce/trade-agreements-accords-commerciaux/agr-acc/nafta-alena/fta-ale/02.aspx?lang=eng>
- Government of Canada (GOC). (2017a). *Trade and Investment Agreements*. Retrieved from <https://www.international.gc.ca/trade-commerce/trade-agreements-accords-commerciaux/agr-acc/index.aspx?lang=eng>
- Government of Canada (GOC). (2018). *Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP) – Frequently asked questions*. Retrieved from <http://www.international.gc.ca/trade-commerce/trade-agreements-accords-commerciaux/agr-acc/tpp-ptp/faq.aspx?lang=eng>
- Hodgson, M. (2014). *Counting the costs of investment treaty arbitration*. Retrieved from http://www.allenoverly.com/SiteCollectionDocuments/Counting_the_costs_of_investment_treaty.pdf

- Hodgson, M. (2015). Costs in Investment Treaty Arbitration: The Case for Reform. In J.E. Kalicki and A. Joubin-Bret (Eds.), *Reshaping the Investor-State Dispute Settlement System: Journeys for the 21st Century* (pp.748-759). Retrieved from <https://ebookcentral-proquest-com.proxy.lib.sfu.ca/lib/sfu-ebooks/detail.action?docID=1956712>
- International Arbitration Attorney Network. (n.d.). *Third Party Funders For International Arbitration*. Retrieved from <https://www.international-arbitration-attorney.com/third-party-funders-international-arbitration/>
- International Bar Association (IBA). (2014). *IBA Guidelines on Conflicts of Interest in International Arbitration*. London, United Kingdom.
- International Centre for Settlement of Investment Disputes (ICSID). (2006). *ICSID Convention, Regulations and Rules*. Retrieved from https://icsid.worldbank.org/en/Documents/resources/2006%20CRR_English-final.pdf
- International Centre for Settlement of Investment Disputes (ICSID). (2017). *ICSID Additional Facility Rules*. Retrieved from <https://icsid.worldbank.org/en/Pages/icsiddocs/ICSID-Additional-Facility-Rules.aspx>
- International Centre for Settlement of Investment Disputes (ICSID). (2017a). *Schedule or Fees*. Retrieved from <https://icsid.worldbank.org/en/Pages/icsiddocs/Schedule-of-Fees.aspx>
- International Centre for Settlement of Investment Disputes (ICSID). (2017b). *Arbitration Rules*. Retrieved from <http://icsidfiles.worldbank.org/icsid/icsid/staticfiles/basicdoc/partF-chap01.htm>
- International Council for Commercial Arbitration (ICCA). (2017). *The ICCA-Queen Mary Task Force on Third-Party Funding in International Arbitration, Draft Report*. Retrieved from [http://www.arbitration-icca.org/media/9/75899457734281/submission version for public comment draft.pdf](http://www.arbitration-icca.org/media/9/75899457734281/submission_version_for_public_comment_draft.pdf)
- Italaw. (2015). *Metalclad Corporation v. The United Mexican States, ICSID Case No. ARB(AF)/97/1*. Retrieved from <https://www.italaw.com/cases/671>
- Italaw. (2016). *South American Silver Limited v. The Plurinational State of Bolivia, UNCITRAL Procedural Order No. 10*. Retrieved from <https://www.italaw.com/sites/default/files/case-documents/italaw7176.pdf>

- Iyer, K.G., Rambaldi, A.N. & Tang, K.K. (2008). *Efficiency Externalities of Trade and Alternative Forms of Foreign Investment in OECD Countries*. Retrieved from http://www.jstor.org.proxy.lib.sfu.ca/stable/25144578?seq=1#page_scan_tab_contents
- Jackson, R. (2009). *Review of Civil Litigation Costs: Final Report*. Belfast, Ireland: The Stationary Office
- Johnson, L. & Bernasconi-Osterwalder, N. (2013). New UNCITRAL Arbitration Rules on Transparency: Application, Content and Next Steps. *Investment Treaty News*. 4(4). Retrieved from http://www.iisd.org/pdf/2013/iisd_itn_sept_2013_en.pdf
- Lawrence, R.C. & Rizzo, E.S. (n.d.). *Basic Conflict of Laws Principles*. Retrieved from http://apps.americanbar.org/abastore/products/books/abstracts/5430661_chap1_abstracts.pdf
- London Stock Exchange, (LSE). (2016). *Burford Capital Limited, Fundamentals*. Retrieved from <http://www.londonstockexchange.com/exchange/prices/stocks/summary/fundamentals.html?fourWayKey=GG00B4L84979GGGBXAMSM>
- London Stock Exchange, (LSE). (2016a). Favourable Investment Result. *Burford Capital Limited, News Analysis*. Retrieved from <http://www.londonstockexchange.com/exchange/news/market-news/market-news-detail/BUR/13304297.html>
- McDonald, H. (n.d.). *Third Party Litigation Funding: Plaintiff Identity and Other Vexing Issues*. Retrieved from http://www.cba.org/cba/cle/PDF/Heather_McDonald_paper.pdf
- McGregor, J. (2016). Canada-EU trade talks with Wallonia collapse as Freeland heads home. *CBC News*. Retrieved from <http://www.cbc.ca/news/politics/canada-eu-ceta-brussels-friday-1.3815332>
- Molot, J. T. (2010). Litigation Finance: A Market Solution to a Procedural Problem. *Georgetown Law Journal*. 99(11). Retrieved from https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1962677
- NAFTA Secretariat. (2017). *North American Free Trade Agreement*. Retrieved from <https://www.nafta-sec-alena.org/Home/Texts-of-the-Agreement/North-American-Free-Trade-Agreement?mvid=1&secid=539c50ef-51c1-489b-808b-9e20c9872d25#A1121>
- New York Convention Guide. (2017). *Article II*. Retrieved from http://newyorkconvention1958.org/index.php?lvl=cmspage&pageid=10&menu=618&opac_view=-1

- OECD. (2012). Government perspectives on investor-state dispute settlement: a progress report. *Freedom of Investment Roundtable*. Paris, France: Organisation for Economic Co-operation and Development Investment Division
- OECD. (2012a). Investor-State Dispute Settlement. *Public Consultation: 16 May – 9 July 2012*. Paris, France: Organisation for Economic Co-operation and Development Investment Division
- OECD. (2016). *OECD Business and Finance Outlook 2016*. OECD Publishing: Paris <http://dx.doi.org/10.1787/9789264257573-en>
- OECD. (2016a). FDI Flows. *OECD Data*. Retrieved from <https://data.oecd.org/fdi/fdi-flows.htm#indicator-chart>
- Office of the Commissioner of Lobbying of Canada (OCLC). (2017). *Subject Matter in Monthly Communication Reports – Trends*. Retrieved from <https://lobbycanada.gc.ca/app/secure/ocl/lrs/do/cmmLgSms?month1=11&year1=2008&month2=11&year2=2017&dsply=Display&tb3=1>
- Office of the Commissioner of Lobbying of Canada (OCLC). (2017a). *Subject Matter in Monthly Communication Reports – Trends*. Retrieved from <https://lobbycanada.gc.ca/app/secure/ocl/lrs/do/cmmLgSms?month1=11&year1=2013&month2=11&year2=2015&dsply=Display&tb3=1>
- Office of the Commissioner of Lobbying of Canada (OCLC). (2017b). *Subject Matter in Monthly Communication Reports – Trends*. Retrieved from <https://lobbycanada.gc.ca/app/secure/ocl/lrs/do/cmmLgSms?month1=11&year1=2015&month2=11&year2=2017&dsply=Display&tb3=1>
- Organization of American States (OAS). (2018). *Inter-American Convention on International Commercial Arbitration (B-35)*. Retrieved from http://www.oas.org/en/sla/dil/inter_american_treaties_B-35_international_commercial_arbitration.asp
- Pavey, B. & Williams, T. (2003). *The North American Free Trade Agreement: Chapter 11*. Retrieved from <http://publications.gc.ca/Collection-R/LoPBdP/inbrief/prb0254-e.htm#2end>
- Project on International Courts and Tribunals. (n.d.). *North American Free Trade Area Dispute Settlement Procedures*. Retrieved from <http://www.pict-pcti.org/courts/NAFTA.html>
- Rajoo, S. (n.d.). *Institutional and Ad hoc Arbitrations: Advantages and Disadvantages*. Retrieved from <http://sundrarajoo.com/wp-content/uploads/2016/01/Institutional-and-Ad-hoc-Arbitrations-Advantages-Disadvantages-by-Sundra-Rajoo.pdf>

- Ramsey, T. (2017). *Tracey pushes the government to reveal their priorities on NAFTA*. Retrieved from <http://traceyramsey.ndp.ca/tracey-pushes-the-government-to-reveal-their-priorities-on-nafta>
- Roberts, A. (2014). State-to-State Investment Treaty Arbitration: A Hybrid Theory of Interdependent Rights and Shared Interpretive Authority. *Harvard International Law Journal*, Vol. 55 (1). Retrieved from https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2315078
- Rosert, D. (2014). *The Stakes Are High: A review of the financial costs of investment treaty arbitration*. *International Institute for Sustainable Development*. Winnipeg, Manitoba: The International Institute for Sustainable Development
- Smith, M. (2012). Mechanics of Third-Party Funding Agreements: A Funder's Perspective. In L.B. Nieuwveld and V. Shannon (Eds.), *Third-Party Funding in International Arbitration* (pp. 19-37). Retrieved from [http://www.calunius.com/media/7098/mechanics%20of%20third-party%20funding%20agreements%20\(mick%20smith%20-%202012\).pdf](http://www.calunius.com/media/7098/mechanics%20of%20third-party%20funding%20agreements%20(mick%20smith%20-%202012).pdf)
- The Economic Times. (2018). *Definition of 'Derivatives'* Retrieved from <https://economictimes.indiatimes.com/definition/derivatives>
- Transnational Notes. (2011). *Applicable Law Under Article 42 of the ICSID Convention*. Retrieved from <http://blogs.law.nyu.edu/transnational/2011/10/applicable-law-under-article-42-of-the-icsid-convention/>
- United Nations Commission on International Trade Law (UNCITRAL). (2010). *UNCITRAL Arbitration Rules*. Retrieved from <http://www.uncitral.org/pdf/english/texts/arbitration/arb-rules-revised/arb-rules-revised-2010-e.pdf>
- United Nations Conference on Trade and Development (UNCTAD). (2011). *Scope and Definition*. *UNCTAD Series on Issues in International Investment Agreements II*. Switzerland: United Nations.
- United Nations Conference on Trade and Development (UNCTAD). (2013). *Investment Dispute Settlement*. *Investment Policy Hub*. Retrieved from <http://investmentpolicyhub.unctad.org/ISDS>
- United Nations Conference on Trade and Development (UNCTAD). (2013a). *Investment Dispute Settlement*. *Investment Policy Hub*. Retrieved from <http://investmentpolicyhub.unctad.org/ISDS/FilterByApplicableIa>
- United Nations Conference on Trade and Development (UNCTAD). (2013b). *Investment Dispute Settlement*. *Investment Policy Hub*. Retrieved from <http://investmentpolicyhub.unctad.org/ISDS/FilterByCaseName>

- United Nations Conference on Trade and Development (UNCTAD). (2013c). Investment Dispute Settlement. *Investment Policy Hub*. Retrieved from <http://investmentpolicyhub.unctad.org/ISDS/Details/421>
- United Nations Conference on Trade and Development (UNCTAD). (2013d). *Teinver v. Argentina*. *Investment Policy Hub*. Retrieved from <http://investmentpolicyhub.unctad.org/ISDS/Details/335>
- United Nations Conference on Trade and Development (UNCTAD). (2013e). Recent Developments in Investor-State Dispute Settlement. *IIA Issues Note*. Retrieved from http://unctad.org/en/PublicationsLibrary/webdiaepcb2013d3_en.pdf
- United Nations Conference on Trade and Development (UNCTAD). (2016). Investor-State Dispute Settlement: Review of Developments in 2016. *IIA Issues Note International Investment Agreements*. Retrieved from http://unctad.org/en/PublicationsLibrary/diaepcb2017d1_en.pdf
- United Nations Conference on Trade and Development (UNCTAD). (2017). Investment and the Digital Economy. *World Investment Report 2017*. United Nations: Geneva
- United Nations Conference on Trade and Development (UNCTAD). (2017a). Special Update on Investor-State Dispute Settlement: Facts and Figures. *International Investment Agreements*. Retrieved from http://unctad.org/en/PublicationsLibrary/diaepcb2017d7_en.pdf
- U.S. Department of State. (2014). *Major Money Laundering Countries*. Retrieved from <https://www.state.gov/j/inl/rls/nrcrpt/2014/vol2/222471.htm>
- Van Boom, W.H. (2011). *Third-Party Financing in Insertional Investment Arbitration*. Retrieved from https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2027114
- World Trade Organization (WTO). (2017). *Annual Report 2017*. Retrieved from https://www.wto.org/english/res_e/booksp_e/anrep_e/anrep17_e.pdf
- Wroughton, L. (2017). Poll shows popular support for NAFTA as talks head into third round. *Reuters*. Retrieved from <https://www.reuters.com/article/us-trade-nafta-poll-ipsos/poll-shows-popular-support-for-nafta-as-talks-head-into-third-round-idUSKCN1BW2N3?il=0>

Appendix

International Arbitration Framework

Institutional vs. Ad Hoc Arbitration Framework

The first international arbitration model is one in which a specialized institution administers the arbitration process between two disputing parties. These institutions provide administrative services to the settlement of disputes. Institutions provide a location in which to carry out arbitration and procedural rules for both parties and arbitrators to follow. Included in the institutional process are the terms on how to nominate arbitrators, suggest procedural safeguards, and review as well as annul awards (Van Boom, 2011). Institutional arbitration is facilitated by several international arbitration forums such as the ICC, SCC, the London Court of International Arbitration (LCIA), and the World Bank's International Centre for Settlement of Investment Disputes (ICSID).

There are a number of advantages and disadvantages to institutional arbitration. The establishment of a sophisticated framework is inherent in institutional arbitration bodies. The reputation of an institution can be an advantage, especially in terms of award enforcement. If there is a refusal to pay out an award, enforcement may be pursued through federal courts (International Centre for Settlement of Investment Disputes, 2006). It may be easier for courts to enforce awards from a credible institutional arbitration body due to its entrenched rules and regulations (Rajoo, n.d.).

Some disadvantages to this method are the considerable administrative fees for service and use of facilities. Such is the case with the use of the ICSID forum. Located in Washington, D.C., this institution assigns fees ranging from US\$10,000 to appoint arbitrators up to UD\$42,000 annually to begin arbitration (ICSID, 2017a). Another disadvantage is that each arbitral institution may not follow the same rules and regulations. When claims are made, parties must review rules of each institution before proceeding. As well, where a state refuses to arbitrate under the authority of an

institution, claims of sovereignty can delay dispute settlement through increased procedural orders (Rajoo, n.d.).

The second international arbitration model is ad hoc arbitration. Parties engaging in ad hoc arbitration are responsible for the selection of arbitration rules. Use of the ICSID Convention arbitration rules are reserved for those countries that are both members of the ICSID. The Additional Facility Rules of ICSID offers arbitration for disputes between a state and a foreign national where one party is not an ICSID member. UNICTRAL Arbitration Rules do not have any special requirements.

Ad hoc arbitration does have advantages. Generally, it is thought that this form of arbitration can be more cost effective as there are no institutional administrative and facilities costs. Arbitrator's fees may be negotiated directly between parties and arbitrators compared to fees being set by the institutional arbitration method. In other IIAs, parties may draw up their own dispute settlement clauses, although many disputing parties often adopt UNCITRAL's 2010 revised arbitration rules which are available specifically for this purpose (United Nations Commission on International Trade Law, 2017). Ad hoc proceedings can be quicker than institutional arbitration by setting shorter timelines. Lastly, ad hoc procedures are suitable for all types of claims, both large and small.

Some disadvantages to ad hoc arbitration in general include the burden of selecting an arbitral panel making sure that there is expertise in the noted field. In NAFTA's appointment of arbitrators, there is a roster of available expert panelists in the field of international investment based on the ICSID Convention and Additional Facility Rules (GOC, 2016). Failure by both parties to cooperate can add substantially to time and expense of the arbitration where parties may have to seek intercession of the courts. This would increase litigation costs, negating any cost-savings of the ad hoc method. A closer look at two of the disputes settlement forums will highlight the differences in international arbitration.

ISDS Forums: International Centre for Settlement of Investment Disputes vs. United Nations Commission on International Trade Law

Under NAFTA, the ISDS mechanism comes in to play under the rules of the ICSID Convention, ICSID Additional Facility, or UNCITRAL Arbitration Rules. As there is no dedicated facility to administer UNCITRAL Arbitration Rules, the bulk of the organizational duties falls to the tribunal and disputing parties. If both parties agree, NAFTA allows for the use of services of the ICSID to administer ad hoc tribunals under UNCITRAL Arbitration Rules (GOC, 2016). This section will detail a comparison of the ICSID and UNCITRAL arbitration forums used in NAFTA Chapter 11 ISDS claims.

UNCITRAL rules dictate that the number of arbitrators to sit in a tribunal panel is three. While both forums state the acceptability of having a sole arbitrator, an uneven number is noted with panels of either three or five members through ICSID rules. In the case of ICSID rules, if the parties do not agree with the number of arbitrators and method of appointment, the tribunal shall consist of three arbitrators with one arbitrator appointed by each party and the third, designated the president of the tribunal, by agreement of the parties (ICSID, 2017b). Generally, no more than three arbitrators are assigned to tribunal panels to avoid undue costs.

The neutrality of arbitrators is critical in conducting NAFTA arbitrations. When appointing a panel member, international arbitration rules state that arbitrators cannot be the same nationality of either of the parties involved. This provision is to ensure the appointment of an independent and impartial arbitrator (UNCITRAL, 2010; ICSID, 2017b). Once neutrality has been addressed, selection of arbitrators is much the same for both dispute settlement forums. If a third arbitrator cannot be agreed upon, the appointing authority under UNCITRAL shall make the appointment from a roster of qualified arbitrators and under ICSID, this duty falls to the Chairman of the Administrative Council (UNCITRAL, 2010; ICSID, 2017b).

Governance of arbitration tribunals varies between UNCITRAL and the ICSID forums. If the disputing parties have no designated law in their IIA defining rights and

responsibilities, each forum first applies the law determined by the Conflict of Laws. Conflict of Laws, also referred to as private international law, provides guidelines to determine which jurisdictional law to apply to international commercial transactions and disputes. In determining the suitable jurisdiction, the Conflict of Laws refers to procedural laws or matters of substance which pertain to the rights of the parties (Lawrence & Rizzo, n.d.). It is generally the substantive rights that are decided from the facts of the case to determine which jurisdiction has the most significant relationship to the dispute (Lawrence & Rizzo, n.d.). Once jurisdiction has been decided, an ad hoc tribunal under UNCITRAL will arbitrate under the applicable state laws. However, as the ICSID Convention rules also apply the appropriate jurisdictional laws, ICSID arbitrators may also refer to international law (ICSID, 2006). International law, also known as public international law, refers to international agreements between countries. Applying two sets of laws to ISDS cases can lengthen an already complicated arbitration even further.

The ICSID Convention adopted international law to more effectively resolve foreign investment disputes. This provision of international law was seen as a neutral forum that would reduce the concern of political risk which may deter the inflow of foreign capital (Transnational Notes, 2011). Arbitrators are now tasked with applying both state and international law to dispute settlements. According to the ICSID Convention, after ICSID tribunals apply state law, the outcomes of that application should be tested against international law to check for unfair results (Transnational Notes, 2011). If there are notable gaps, differences, or violations, the ICSID tribunal can refuse to use state law. If the tribunal rejects state law and switches to international law, there is a broad range of laws from which tribunals can select to settle the case. The impact of using international law in ISDS claims has been far-reaching. By cherry-picking the most suitable rules to resolve a case, while highlighting a state's non-conforming laws, ICSID arbitrators are bestowed with greater power over ISDS claims (Eberhardt, & Olivet, 2012).

As part of the UNCITRAL Arbitration Rules, tribunals are granted the right to make an interim award, or interim partial award, or take any necessary measures during

the arbitration process (UNCITRAL, 2010). These decisions are binding on the parties and can be an effective tool to control party behavior. However, tribunals in the ICSID forum can only make recommendations for these provisional measures. These requests are then directed to judicial or another authority for decision (ICSID, 2017b). While the timing of awards at the conclusion of a claim has no defined timeline through ad hoc UNCITRAL tribunals, the ICSID forum has a definite time line of 60 days from the end of the proceeding with a further 30 days extension if requested (Bishop & Keenan, 2017).

The allocation of costs varies between the ICSID and UNCITRAL arbitral forums. UNCITRAL administers the “loser pays” method which broadly states that all costs of arbitration, including legal fees, shall in principle be borne by the unsuccessful party (UNCITRAL, 2010). This approach takes the position that a party whose stance is upheld should be compensated (Hodgson, 2015). Ad hoc tribunals under UNCITRAL also have the flexibility to adjust cost apportionment. Adjusted costs orders are allotted where one party is ordered to pay the other side’s legal, expert, and witnesses costs, as well as tribunal costs (Hodgson, 2015). This cost shifting can be assigned fully or in part. Since 2006, 69 percent of the awards allocated through UNCITRAL Arbitration Rules have been adjusted costs orders (Hodgson, 2015). Alternatively, all costs assigned through ICSID are at the discretion of the arbitration tribunal (ICSID, 2017b).

As a final comparison, ISDS claims lack transparency under both ICSID and UNCITRAL forums. Details of disputes are not required to be disclosed unless there is consent from both parties. In NAFTA, Canada and the United States consent to making awards public, with Mexico abiding by the applicable rules unique to the chosen arbitral forum (GOC, 2016). Since April 1, 2014, UNCITRAL has developed Rules of Transparency. While these rules represent a shift to openness, parties still have the opportunity to opt-out if their treaty has been concluded after 2014. For those treaties concluded before April 1, 2014, these rules will not apply unless one or both parties officially “opt-in” to the rules (Johnson & Bernasconi-Osterwalder, 2013). These Rules of Transparency may also be used in conjunction with other rules including the ICSID Convention and ICSID Additional Facility.