School of International Arbitration, Queen Mary, University of London

# International Arbitration Case Law

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## THE UNITED MEXICAN STATES AND CARGILL, INCORPORATED (2011 ONCA 622) – COURT OF APPEAL FOR ONTARIO

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Court of Appeal for Ontario decision of 4 October 2011, dismissing the Unites Mexican States' appeal against a decision of the Ontario Superior Court refusing to set aside a NAFTA award in favor of U.S. investor Cargill: standards of judicial review of NAFTA awards in Canada; jurisdiction of arbitral tribunals to award damages stemming from losses suffered by a protected investor in its home country.

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| **Court of Appeal Opinion:** | Feldman J.A. |
| **Appellant's Counsel:** | Patrick Foy, Q.C. |
| **Respondent's Counsel:** | John Terry with the assistance of Jeffrey W. Sarles (Mayer Brown, Chicago) |
| **NAFTA Tribunal:** | Dr. Michael C. Pryles (President). Professor David Caron, Professor Donald M. McRae. |

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## 1. FACTS OF THE CASE

1.1 On 4 October 2011, the Court of Appeal for Ontario dismissed the United Mexican States' appeal to set aside a US$ 77,329,240 arbitral award rendered on 18 September 2009[1] in favor of Cargill, Incorporated.

### (a) The *Cargill v. United Mexican States* Arbitral Award

1.2 U.S. food company Cargill, Inc. successfully argued before a NAFTA arbitral tribunal constituted under Chapter 11 of the North American Free Trade Agreement ("NAFTA"), that Mexico had interfered with its investment. Cargill's business model in Mexico was to manufacture in the United States and export to Mexico high fructose corn syrup ("HFCS"). Cargill established a Mexican subsidiary, Cargill de Mexico ("CdM"), to distribute its HFCS in Mexico.

1.3 HFCS is a sweetener, particularly used in the soft drink industry. Being the "second largest *per capita* consumer of soft drinks in the world,"[2] Mexico sought to protect its cane sugar industry by enacting a number of measures targeted at the import of HFCS into Mexico. More specifically, in the face of growing difficulties in the Mexican sugar industry, Mexico introduced a 20% tax on the import of all products containing sweeteners other than cane sugar. In addition, even after the tax was removed, the Mexican government continuously denied Cargill import permits.

1.4 The arbitral tribunal found that, by imposing a tax on soft drinks containing HFCS, and failing to issue import permits, Mexico breached NAFTA Articles 1102 (discriminatory treatment), 1105 (unfair and inequitable treatment), and 1106(3) (performance requirement). The tribunal awarded Cargill US$77,329,240 in damages, of which a little over $36 million were "upstream damages" corresponding to "lost sales of products manufactured by Cargill in the United States."[3]

### (b) Mexico's Challenge of the Arbitral Award before the Ontario Superior Court

1.5 The seat of the arbitration being Toronto, Ontario, Mexico filed an application with the Superior Court of Ontario to set aside the arbitral award. Mexico argued that by awarding US$36,166,885 in upstream damages, the arbitral tribunal exceeded its jurisdiction. Mexico considered that while the tribunal had the authority to award damages stemming from losses suffered by CdM, it did not fall within its jurisdiction to award damages arising from Cargill's production activities in the United States, even when the goods produced were intended for

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1 *Cargill, Inc. v. United Mexican States,* ICSID ARB(AF)(05/02)("Cargill").

2 *United Mexican States v. Cargill, Incorporated,* 2011 ONCA 622, at §6

3 *Id.*,at §10.

distribution in Mexico through CdM. Mexico asked that the court apply" a correctness" rather than a "deference" standard of review. Mexico further contended that, because the arbitral tribunal afforded Cargill greater protection than investors that chose to establish production facilities in addition to distribution facilities, the arbitral tribunal's findings were inconsistent with the aims of NAFTA Chapter 11.

1.6 Judge Low of the Ontario Superior Court rejected Mexico's application to set aside the award[4] noting that all tribunal members were "distinguished experts".[5] The Superior Court went on to find that it should approach its review of Mexico's challenge with "restraint and deference" and apply a reasonableness test.[6] Judge Low considered that the arbitral tribunal was not unreasonable in finding that NAFTA's territoriality limitation did not cover the losses flowing from Mexico's breaches. Accordingly, the Superior Court found that the tribunal did not exceed its jurisdiction. The Ontario Superior Court also rejected the argument that the arbitral award created a result that was inconsistent with the objectives stated in the Treaty. Mexico appealed the decision and the United States and Canada intervened to support Mexico's interpretation of NAFTA Chapter 11 regarding damages suffered by the investor in its home state.

## 2. Legal Issues Discussed in the Decision

2.1 Judge Feldman of the Court of Appeal for Ontario upheld the lower court's decision. It identified two main legal issues arising out of Mexico's appeal. First, the Court sought to define the standards of review that should apply to a jurisdictional challenge of a NAFTA award (a). Second, the Court of Appeal examined, under the standard it has defined, whether the arbitral tribunal had the authority to remedy losses suffered by Cargill's plants in the United States (b). The Court's examination of this second issue led it to address whether the State Parties' interpretations of NAFTA's territoriality requirement in Chapter 11 should have altered the arbitral tribunal's determination of its jurisdiction to award upstream damages (c). Lastly, the Court of Appeal's definition of the standards of review in this case led it to dismiss Mexico's claim that the *Cargill* award is inconsistent with the objectives set forth in NAFTA Article 102(a). The Court held that under the applicable standards that issue is not subject to review.

### (a) Correctness as the Test to Review NAFTA Jurisdictional Decisions

2.2 In adjudicating Mexico's appeal, the Court was mindful of the criticisms raised against the review by Canadian courts of NAFTA awards and referred expressly[7]

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4 *United Mexican States v. Cargill*, 2010 ONSC 4656.

5 *Id.*, at §2.

6 *Id.*, at §55.

7 *United Mexican States v. Cargill, Incorporated*, 2011 ONCA 622, at §29.

to Henri Alvarez' publication[8] on the subject.[9] The Court of Appeal for Ontario recognized a "challenge for a reviewing court to navigate the tension that exists between discouragement to courts to intervene on the one hand, and on the other, the court's statutory mandate to review for jurisdictional excess."[10] While clearly seeking to introduce a more objective and predictable standard of review, the Court appeared reluctant to abandon terminologies such "excess of jurisdiction" or "jurisdictional error." Similar to previous Canadian review cases, the Court of Appeal started its analysis with Article 34(2) of the Model Law, and reaffirmed the Canadian courts' "high degree of deference" accorded to international arbitral tribunals.[11] In particular, the Court looked at Article 34(2)(a)(iii), which applies where "the award deals with a dispute … not falling within the terms of the submission to arbitration, or contains decisions on matters beyond the scope of the submission to arbitration … ."

2.3 To define a test for whether arbitrators have exceeded the scope of the agreement to arbitrate, the Court finds "instructive" the English decision of *Dallah v. Pakistan.*[12] The Court notes, in particular, that in *Dallah*, Lord Mance accorded no "legal or evidential" value to the arbitral tribunal's finding on its own jurisdiction, regardless of the eminence of the arbitral panel, and regardless of whether or not London was the seat of the of the arbitration. The *Dallah* court considered that it had to "reassess," "*de novo*,"[13] the arbitral tribunal's determination of its jurisdiction.

2.4 The Court of Appeal acknowledges a difference between the grounds for review in Article 34(2) of the UNCITRAL Model Law and Article V of the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, generally reflected in the 1996 English Arbitration Act. Nonetheless, the appellate judge parallels the Canadian administrative law test of correctness as a "variant" of the *Dallah* court's de novo review of an arbitral panel's determination of its

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8 Henri C. Alvarez, *Juicial Review of NAFTA Chapter 11 Arbitral Awards,* in *Fifteen Years of NAFTA Chapter 11 Arbitration,* IAI Series No.7, pp.103-171 ("Alvarez").

9 Alvarez' assessment of the Canadian courts review of NAFTA awards is severe. He considers that, except for the case of *United Mexican States v. Metalclad* (Alvarez, at 108-117), the Canadian courts have not, thus far, applied "a clearly articulated and appropriate standard of review."(*Id*., at p. 153). Henri Alvarez notes that the Canadian cases that followed Metalclad, including *Canada v. S.D. Myers (Id*., at p. 126), imported domestic judicial review standards that are not included in Article 34(2)(a)(iii) of the UNCITRAL Model Law ("Model Law"). Alvarez thus criticizes Judge Low's decision in Cargill for perpetuating "the confusion created by the courts' inconsistent approach to the standard of review of NAFTA arbitral awards." (*Id*., at p. 155). Henri Alvarez considers that like the British Columbia Supreme Court in Metalclad, the Canadian courts should avoid concepts of "jurisdictional error" and "excess of jurisdiction," used in the domestic law context, and limit their review to the grounds set forth in Articles 5 and 34 of the Model Law (*Id*., at p. 112).

10 *United Mexican State v. Cargill, Incorporated,* 2011 ONCA 622 at §48.

11 *Id*., at §33.

12 *Dallah Real Estate and Tourism Holding Co. v. Ministry of Religious Affairs of the Government of Pakistan,* [2011] 1 A.C. 763.

13 *United Mexican States v. Cargill, Incorporated,* 2011 ONCA 622, at §§37,38.

jurisdiction. The Court of Appeal in *Cargill* finds the correctness test appropriate and necessary in order to assess whether the arbitrators "expand[ed] [their] jurisdiction by incorrectly interpreting the submission or the NAFTA, even if [their] interpretation could be viewed as a reasonable one."[14] Departing from Henri Alvarez' analysis, the Court finds the correctness test consistent with both *Metalcald* and *S.D. Myers.*

2.5 It insists, however, that before it conducts a de novo correctness scrutiny of an arbitration panel's jurisdictional finding, a court must ascertain that the question under review is truly jurisdictional. The Court recognizes that distinguishing jurisdictional from non-jurisdictional questions constitutes a further challenge for reviewing courts. It thus suggests a three-step approach: first, circumscribe the nature of the arbitral decision before the review court; second, determine whether the issue adjudicated by the arbitrators falls within the submission to arbitration under Chapter 11; and third, establish whether there was "anything in the NAFTA, properly interpreted, that precluded the tribunal from making the award it made."[15]

**(b) The Court of Appeal's Review of the Award of Upstream Damages in Cargill**

2.6 Mexico's challenge involved principally the extent and consequences of the territorial limitation on protected investments under Chapter 11. Mexico, joined by Canada and the United States as interveners, considered that the *Cargill* tribunal had no basis for distinguishing from the tribunal's finding in *Archer Daniels Midland Company & Tate & Lyle Ingredients America, Inc. v. United Mexican States ("AMD").*[16] In *ADM,* the tribunal found that it had no jurisdiction to award the investors "lost profits on HFCS they would have produced in the United States and exported to Mexico … as these losses were not suffered in their capacity as investors."[17] Likewise, Mexico, Canada, and the United States, alleged that Chapter 11 jurisdictionally excluded losses suffered by Cargill U.S. production facilities from the scope of an arbitration award of damages resulting from Mexico's trade barriers.

2.7 The *Cargill* tribunal had rejected Mexico's position on the scope of the territorial limitation under Chapter 11. It found that unlike Arthur Daniels Midland and Tate & Lyle, which established HFCS production facilities in Mexico in addition to their distribution units, Cargill's investment was structured in such a way that CdM was solely a distribution facility. The tribunal considered that, in those circumstances, the analysis in *Pope & Talbot v. Canada*[18] was more pertinent to the

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14 *Id.*, at §41.

15 *Id.*, at §52.

16 *AMD v. United Mexican States,* ICSID Case Arb (AF)/04/05.

17 *AMD* at §274.

18 *Pope & Talbot Inc. v. The Government of Canada,* Interim Award, 26 June 2000.

definition of Cargill's investment than the tribunal's reasoning in *ADM.* In *Pope & Talbot,* the tribunal had considered that the "'true interests at stake are the Investment's asset base, the value of which is largely dependent on its export business.'"[19] The *Cargill* tribunal thus found that, consistent with the *Pope & Talbot* analysis, the business income of Cargill's U.S. production facilities was "so closely associated with a physical asset in the host country and not mere trade in goods," that it made Cargill U.S. plants' income both "an element of a larger investment and an investment in and of itself…"[20]

2.8 To assess Mexico's challenge and the significance of the *ADM* jurisdictional finding, the Court of Appeal first responds to the question of whether the issue under scrutiny is jurisdictional in nature. It agrees with the lower court judge "that Mexico's submission seeks to expand the jurisdictional question into issues that go the merits of the case." The Court notes that the territorial limitation under NAFTA Chapter 11 only applies to the definition of an investment, not to the investor's compensation. In the Court's analysis of Article 1139 of NAFTA, the only express requirement regarding compensation is causation: the tribunal can only award compensation for losses suffered by an investor as a result of Mexico's trade barrier breaches. Thus, the Court finds that the determination of whether "lost capacity in Cargill's U.S. plants constitutes damages by reason of, or arising out of, Mexico's breaches … is a quintessential question for the expertise of the tribunal, rather than an issue of jurisdiction."[21]

2.9 As a result, the Court considers that to review the *Cargill* tribunal's distinction of *ADM* amounts to an analysis of the merits of the arbitrators' decision, which the Court refuses to do. Under the Court's own definition of the standards of review of NAFTA awards, once the review court determines that the award of damages is not a jurisdictional issue under NAFTA, it should no longer assess, *de novo*, whether the arbitral tribunal was correct in its award of damages. The Court therefore limited its review to merely noting that the arbitral tribunal relied on expert testimony in order to determine whether the upstream losses did result from Mexico's breaches of Chapter 11. But because it recognized an obligation under NAFTA to interpret the Treaty in light of its purpose and context, the Court found that it also had to be satisfied that the *Cargill* tribunal's findings were correct in light of the NAFTA State Parties' interpretation of the terms of the Treaty.

### (c) The Correctness Test Applied in Light of the State Parties' Interpretations of the Territoriality Requirement under Chapter 11

2.10 The Court conducted its further inquiry into the arbitral tribunal's award of damages on the basis of Article 1131 of NAFTA. Article 1131 requires tribunals to

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19 Cited in *Cargill* at §356.

20 *Cargill,* at §522.

21 *United Mexican States v. Cargill, Incorporated,* 2011 ONCA 622, at §72.

decide NAFTA disputes in accordance with NAFTA and applicable rules of international law. The Court thus considered that in interpreting the provisions of NAFTA, the *Cargill* tribunal had to comply with the *Vienna Convention on the Law of Treaties* (the "Vienna Convention"), and give weight to both the express provisions of NAFTA and its context and purpose.

2.11 With regard to the territoriality requirement under Chapter 11, Canada and the United States submitted that they had agreed that the "only compensable damages are those suffered in the territory of the Party where the investment is located."[22] But, the Court found that such agreement is not "a clear, well understood, agreed, common position"[23] of the State Parties. By operation of Article 31 of the Vienna Convention, if there had been such a clear common position, the *Cargill* tribunal would have had to accept it as a limit on its jurisdiction to award damages to Cargill U.S. production facilities.

2.12 However, in the Court's view, the State Parties' established common position is that Chapter 11 must compensate an investor for losses that "affect it as an investor in the investment."[24] The Court found no clear common interpretation that would extend the territorial limitation on the definition of a protected investment, to compensation for losses caused to such protected investment. The Court found that the State Parties' positions on the issues of protected investment and compensation were well understood and applied by the *Cargill* arbitral tribunal. Accordingly, the Court held that, "no jurisdictional error was made."[25]

## 3. Decision

3.1 The Court of Appeal for Ontario upheld the lower Court's refusal to set aside the *Cargill* award. In doing so, it sought to clarify the standard of review that the lower court should have applied. The Court of Appeal found that, to reach its conclusion, the Superior Court of Ontario should have first examined whether the issue before it was truly jurisdictional, and if so, it should have applied a correctness test and not a reasonableness test. The Court further held that the *Cargill* arbitral tribunal was correct in finding that NAFTA imposes no territorial limit on the award of damages under Chapter 11, even in light of the State Parties' interpretation of NAFTA. The Court found, on the other hand, that the tribunal's determination of the upstream damages awarded to Cargill's U.S. production facilities did not constitute a jurisdictional challenge and was not, as such, subject to a de novo correctness review.

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22 *Id.*, at §79.

23 *Id.*, at §84.

24 *Id.*, at §82.

25 *Id.*, at §84.