ARBITRATION UNDER CHAPTER 11 OF THE NORTH AMERICAN FREE TRADE AGREEMENT AND UNCITRAL RULES OF ARBITRATION

TEMBEC INC. *et al. v.* UNITED STATES OF AMERICA
CANFOR CORP. *v.* UNITED STATES OF AMERICA
TERMINAL FOREST PRODUCTS LTD. *v.* UNITED STATES OF AMERICA

TEMBEC'S MOTION TO DISMISS

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I. RELIEF REQUESTED BY THIS MOTION

Claimants Tembec Inc., Tembec Investments Inc., and Tembec Industries Inc. (collectively "Tembec") hereby move that the Tribunal make a preliminary decision on whether the United States' request for consolidation should be dismissed for lack of jurisdiction pursuant to Rule 21(3) of the UNCITRAL Arbitration Rules, or in the alternative because of the ethical problems arising from Article 1126 of NAFTA in this particular proceeding that the motion for consolidation be denied for lack of jurisdiction before this Tribunal. Tembec requests that the Tribunal stay briefing on the merits of the United States' request for consolidation (currently scheduled for July 22 and August 8, 2005) pending resolution of this motion.

II. INTRODUCTION

Tembec requested the Tribunal, during the hearing on June 16, 2005, to rule preliminarily on whether the United States' request for consolidation should be denied because it was not raised in the *Canfor* or *Tembec* Statements of Defense as required by Article 21(3) of the UNCITRAL Rules. Tembec now moves the Tribunal to rule on this request. In the alternative, Tembec asks this Tribunal to decline jurisdiction because of the ethical problems raised by Article 1126 of NAFTA in this particular case.

The question of whether the United States' request for consolidation is barred by Article 21(3), like the issue of proper constitution of Article 1126 tribunals, are threshold questions that, were the Tribunal to decide in the affirmative, would preclude the need for further briefing on the merits of the United States' request for consolidation under Article 1126 as scheduled for July 22 and August 5, 2005. Briefing on the merits of the United States' request would be an additional, unnecessary expense that could be avoided were the Tribunal to grant this motion. Tembec, therefore, requests that the

Tribunal treat this motion regarding Article 21(3) of the UNCITRAL Rules and Article 1126 of NAFTA as a preliminary question and stay further briefing until deciding this motion. Should the Tribunal decide to continue with the July 22 and August 8 briefs, Tembec reserves the right to present its remaining arguments as to why the Article 1126 standard for consolidation is not met in these cases.

Tembec's motion is based upon the ordinary meaning of NAFTA Article 1126 and Article Rule 21(3) of the UNCITRAL Rules. Article 1126 (1) specifically provides that these proceedings shall be conducted in accordance with the UNCITRAL Rules. Tembec also chose the UNCITRAL Rules in its Statement of Claim under Article 1120, which was its right under NAFTA Article 1119. There is, thus, no doubt that the UNCITRAL Rules apply to both relevant proceedings.

Article 21(3) is unequivocal in providing that jurisdictional defenses must be asserted no later than the Statement of Defense, and both the *Tembec* and *Canfor* tribunals ordered the United States to assert all jurisdictional defenses in its Statements of Defense. The United States itself fully recognized this requirement.[1] Having failed in both cases to assert consolidation as a defense in a timely manner, the defense was waived. The petition for consolidation consequently must be denied.

UNCITRAL Rule 21(3) exists, in significant part, to prevent the costly and disruptive piecemeal litigation of jurisdiction. In this case, Tembec would lose its entire investment in its consensual tribunal were it involuntarily consolidated with Canfor and Terminal. Consolidation necessarily would mean the repudiation of Article 21(3).

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[1] *See* Letter from Mark A. Clodfelter to Jose Antonio Rivas (Oct. 1, 2004) at 1-2, at Exh. A.

This motion also identifies two unique problems in the procedural structure of Article 1126 Tribunals that create particular problems for this Tribunal. The lone question presented to this Tribunal is whether to consolidate any part of the claims of *Tembec*, *Canfor*, and *Terminal*. Were the Tribunal to consolidate these claims, the Tribunal would, according to Article 1126, assume jurisdiction over them. The first problem, then, is that Article 1126 gives the Tribunal members personal financial incentives to consolidate the claims because they would be paid by the parties to undertake what is expected to be a lengthy arbitration. This incentive is not unique to arbitration, but its configuration in Article 1126 is unique because a tribunal chosen without consensus of the parties imposes itself on the parties, must be paid by them, and assumes jurisdiction not otherwise conferred, all by a single decision taken by that tribunal.

The second and related problem, again unique and peculiar to Article 1126, is that an Article 1126 Tribunal necessarily includes one arbitrator selected from the Respondent's appointees to the ICSID list of arbitrators. The appointing authority consulted no comparable list of arbitrators nominated by Claimants. None of the arbitrators would have been selected by the Claimants, even though international arbitration derives its legitimacy from the consent and consensus of the parties. The Tribunal so formed is necessarily and inescapably unbalanced and unfair.

In the event that this Tribunal were to deny this motion as to Article 21(3), which relies on ordinary meaning with applicable authority acknowledged by the United States, Tembec asks that the Tribunal members recuse themselves from assuming jurisdiction and allow the parties to establish by consensus an alternate Article 1126

Tribunal, as was agreed to be done in the *High Fructose Corn Syrup* ("*HFCS*") cases.[2] There is no other practical way for the Tribunal members to avoid the continuing appearance of impartiality and self-interest.

III. THE UNITED STATES' REQUEST FOR CONSOLIDATION SHOULD BE BARRED AS WAIVED IN ACCORDANCE WITH ARTICLE 21(3) OF THE UNCITRAL RULES OF ARBITRATION

A. The Tribunal Should Apply The Vienna Convention On The Law Of Treaties To Interpret NAFTA And The UNCITRAL Rules

The Tribunal must interpret the language of NAFTA Article 1126 and Article 21(3) of the UNCITRAL Rules to determine whether the United States' request for consolidation should be dismissed. Article 31 of the Vienna Convention on the Law of Treaties requires the Tribunal to interpret these texts "in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose." None of the language at issue is ambiguous. Its ordinary meaning is plain on its face.

The NAFTA Parties established in the first section of Article 1126--before any other details were given about the procedures for determining whether and how cases should be consolidated—that the UNCITRAL Rules shall govern the establishment and conduct of Article 1126 proceedings:

> A Tribunal established under this Article shall be established under the UNCITRAL Arbitration Rules and shall conduct its proceedings in accordance with those Rules, except as modified by this Section.

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[2] The parties in those cases recognized the infirmity of the Article 1126 structure and agreed to a tribunal to decide on consolidation on condition that another, different tribunal would have to be chosen, by consent, to proceed with consolidated claims. *See Corn Products International, Inc. v. United Mexican States* and *Archer Daniels Midland Co., et. al. v. United Mexican States*, ICSID case No. ARB(AF)04/5 (May 20, 2005) at ¶ 2. The first tribunal then rejected consolidation despite facts and circumstances that would have made consolidation in those cases far more defensible than it would be here. *See id.* at ¶¶ 19-20.

Article 21(3) of the UNCITRAL Rules therefore applies to the United States' request for consolidation as to *Tembec, Canfor*, and *Terminal*.

Article 21(3) states, "A plea that the arbitral tribunal does not have jurisdiction shall be raised not later than in the statement of defence or, with respect to a counter-claim, in the reply to the counterclaim." There are two questions the Tribunal must answer in analyzing Article 21(3): (1) whether a request for consolidation is a "plea that the arbitral tribunal does not have jurisdiction" and, should the answer be affirmative, (2) what the legal consequence is for the United States' failure to raise that plea in the *Canfor* and *Tembec* Statements of Defense.

B. A Request For Consolidation Is A "Plea That The Tribunal Does Not Have Jurisdiction"

Tembec demonstrated in its June 10, 2005 pre-hearing brief that, according to the ordinary meaning of the text of NAFTA, a request for consolidation is a plea that the tribunal does not have jurisdiction.[3] Article 1126(2) states:

> Where a Tribunal established under this Article is satisfied that claims have been submitted to arbitration under Article 1120 that have a question of law or fact in common, the Tribunal may, in the interests of fair and efficient resolution of the claims, and after hearing the disputing parties, by order: (a) *assume jurisdiction over*, and hear and determine together, all or part of the claims; or (b) *assume jurisdiction over*, and hear and determine one or more of the claims, the determination of which it believes would assist in the resolution of the others. (emphasis added).

Article 1126(8) is consistent:

> A Tribunal established under Article 1120 shall not have *jurisdiction* to decide a claim, or a part of a claim, over which

[3] *See* Tembec June 10, 2005 Submission in Opposition to Consolidation at 25-26.

> a Tribunal established under this Article has *assumed jurisdiction*. (emphasis added).

The ordinary meaning of these sections in Article 1126 is that the *Tembec* and *Canfor* Tribunals would not have jurisdiction over any issues for which this Tribunal granted the United States' request, in whole or in part.

The United States' characterization of its request for consolidation as a "transfer of jurisdiction" is inconsistent with the text of Articles 1126(2) and (8).[4] According to the ordinary meaning, jurisdiction is not "transferred to" but may be "assumed" by the Article 1126 tribunal, which could be no other way because Article 1126 tribunals must be created and do not exist otherwise to receive a "transfer" of a claim. The United States' request, therefore, necessarily pleads that the Article 1120 tribunals must be denied and that they do not have jurisdiction over the issues the United States alleges should be consolidated.[5]

C. The Failure To Raise Consolidation In The Statements Of Defense Should Result In Dismissal Of The Request For Consolidation

The language of Article 21(3) is mandatory: "A plea that the arbitral tribunal does not have jurisdiction *shall be raised not later than* in the statement of

[4] *See Transcript of Hearing on U.S. Request for Consolidation, Canfor Corp. v. United States, Tembec et al. v. United States and Terminal Forest Products, Ltd. v. United States* (June 16, 2005) at 175 (hereinafter "Hearing Transcript").

[5] The forcible nature of an untimely request under Article 1126 is eliminated when disputing parties reach an agreement to form a Tribunal to decide the propriety of consolidation, stipulating that, should consolidation be ordered, parties then will agree on the composition of a consolidation Tribunal. This manner of proceeding not only accords with the consensual nature of arbitration and basic standards of fairness, but is also how the only other request for consolidation under Article 1126 did proceed. Such a process eliminates both the conflicts of interest arising when arbitrators decide whether they themselves should hear consolidated claims (see Section II, *infra*) and a situation where claimants are thrust before a Tribunal whose jurisdiction differs from that to which they originally consented. *See* Order of the Consolidation Tribunal, *Corn Products International, Inc. v. United Mexican States* and *Archer Daniels Midland Co., et. al. v. United Mexican States*, ICSID case No. ARB(AF)04/5 (May 20, 2005) at ¶ 2. Notably, the United States knew of this prior experience with Article 1126 but kept this information from the Claimants in this proceeding. *Id.* at ¶ 11.

defence or, with respect to a counter-claim, in the reply to the counterclaim." (emphasis added). Tribunals and courts interpreting Article 21(3) have found that parties who failed to raise a plea in the statement of defense that a tribunal does not have jurisdiction waived that plea.

In *CME Czech Republic B.V. v. Czech Republic*,[6] a case cited in the U.S. Submission to this Tribunal, a Dutch company brought a claim against the Czech Republic under the UNCITRAL Rules for violations of the Dutch-Czech Bilateral Investment Treaty ("BIT"). The Tribunal considered whether, by disregarding the Czech Republic's waiver of defense of jurisdiction, it was obligated to rule *ex officio* on a possible lack of its jurisdiction due to the possibility of *lis pendens/res judicata*. The Tribunal decided that, "[a]ccording to the UNCITRAL Rules, a defence of jurisdiction is deemed to be waived, if not raised in time. This concept derives from the assumption that defences on jurisdiction can be waived by the Parties, with the consequence that a Tribunal is not able to set aside or disregard a Party's waiver in respect to the defence of lack of jurisdiction."[7]

The Svea Court of Appeal in Stockholm, deciding on the Czech Republic's request for annulment of the Partial Award in *CME*, affirmed that the Czech Republic had waived objections as to the jurisdiction of the Tribunal by failing to raise the defense

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[6] Partial Award, *available at* 2001 WL 34786542 (Sept. 13, 2001) at Exh. B. The United States submitted two articles on the *CME* case, one of which was authored by the *CME* Tribunal's President. *See* Wolfgang Kühn, *How to Avoid Conflicting Awards: The* Lauder *and* CME *Cases*, 5:1 WORLD INV. & TRADE 7 (Feb. 2004) (Appendix to U.S. Submission, Tab 11); *see also* Thomas Wälde, *Introductory Note to Svea Court of Appeals: Czech Republic v. CME Czech Republic B.V.*, 42 I.L.M. 915 (July 2003) (Appendix to U.S. Submission, Tab 12).

[7] *CME*, Partial Award, at ¶ 380; *see also CME Czech Republic B.V. v. Czech Republic.* Final Award, *available at* 2003 WL 24070172 (Mar.14, 2003) at ¶ 431 at Exh. C ("As stated in the Partial Award the Respondent expressly and impliedly waived any lis pendens or res judicata defence. The Tribunal decided this question in the Partial Award in passing upon its jurisdiction pursuant to UNCITRAL-Rule Art. 21(3).").

of *lis pendens*. The court concluded that the waiver "strongly supports the view that the right to challenge the Stockholm award is barred with respect to the allegation that the Stockholm tribunal acted erroneously in failing to take into consideration the principles of *lis pendens* and *res judicata*."[8]

A Canadian federal court, reviewing the arbitral award in the NAFTA Chapter 11 arbitration *S.D. Myers v. Canada*, also considered the applicability of Article 21(3).[9] The Government of Canada argued before the court that the Chapter 11 Tribunal did not have jurisdiction over the dispute. S.D. Myers objected on the ground that Canada had not raised lack of jurisdiction in its statement of defense, as required by Article 21 of the UNCITRAL Rules. Canada claimed that its generalized denial of the facts as alleged by the claimant under the heading "Jurisdiction of this Tribunal" in the statement of claim was sufficient to meet the requirement of Article 21(3). The court found for S.D. Myers, holding that Canada had not made a "specific, express objection to jurisdiction" in its statement of defense.[10] The court concluded that "[t]o find otherwise would undermine the clear and express procedures incorporated in NAFTA for the resolution of disputes."[11]

The concept embodied in Article 21(3) is an important facet of procedural rules governing international arbitration. In both *Canfor* and *Tembec*, the United States deliberately segregated jurisdiction and received instruction to present all jurisdictional

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[8] Svea Court of Appeal, Stockholm, Sweden, Judgment of 15 May 2003, at 95-96 *in* Kühn, *supra* note 5, at 10.

[9] *See Attorney General of Canada v. S.D. Myers*, 2004 FC 38 (2004) at Exh. D.

[10] *Id.* at ¶ 49.

[11] *Id.* at ¶ 53.

defenses in a single statement. Those Tribunal orders were consistent with these principles.

The United States, like the respondents in the above cases, is barred from moving for consolidation. Pursuant to Article 21(3) of UNCITRAL and under order by *Tembec's* and *Canfor's* Article 1120 Tribunals, the United States was required to raise all objections to the Tribunals' jurisdiction in its Statements of Defense, including an objection based on Article 1126.[12] The United States submitted its Statements of Defense in *Canfor* and *Tembec* regarding its objections to the jurisdiction of the Article 1120 tribunals in each of those cases. Neither of the Statements of Defense contained any U.S. objection to the Article 1120 Tribunals' jurisdiction based on Article 1126, notwithstanding that the United States was aware of all three cases at the time those Statements of Defense were submitted.

The United States submitted its Statement of Defense in *Canfor* on February 27, 2004, with no argument that jurisdiction of Canfor's claim should be assumed by an Article 1126 consolidation tribunal.[13] Contemporaneous with the Statement of Defense, the United States submitted a letter to the *Canfor* Tribunal that read, in pertinent part:

> After considerable deliberation, the United States has determined not to seek consolidation at this time of the *Tembec* and *Canfor* cases, or portions thereof, pursuant to Article 1126 of the NAFTA. If circumstances change, however (if, for example, another

[12] *See* Letter from Jose Antonio Rivas to Tembec and the United States (Oct. 25, 2004), *and* Letter from Andrea J. Menaker to Jose Antonio Rivas (Oct. 27, 2004) at Exh. E; *see Canfor Corp v. United States*, Decision on the Place of Arbitration, Filing of a Statement of Defence and Bifurcation of the Proceedings (Jan. 23, 2004) at 12 at Exh. F ("The Tribunal could indeed be treating the parties without equality if it were to allow the respondent to make piecemeal objections to its jurisdiction. . . . The Respondent shall file a Statement of Defence limited to and setting forth all of its jurisdictional objections.").

[13] *See Canfor v. United States*, U.S. Statement of Defense at Exh. G.

> Canadian softwood lumber company submits a similar claim to arbitration under Chapter Eleven of the NAFTA), the United States will need to reconsider this issue.[14]

When the United States submitted those two documents on February 27, 2004, it already was in possession of Tembec's Statement of Claim (submitted on December 3, 2003) and Terminal's Notice of Intent to Arbitrate (submitted on June 12, 2003). Terminal submitted its Notice of Arbitration one month later on March 31, 2004, but the United States took no action in either *Canfor* or *Tembec* to request consolidation in response to that filing.

On September 27, 2004, Tembec proposed to its tribunal that Tembec and the United States should brief arguments on Article 1901(3) and present those arguments to the tribunal at its First Session on November 30, 2004. The United States objected that Tembec had no right to compel the United States to present its defenses in advance of the Statement of Defense, and even cited Article 21(3) of the UNCITRAL Rules in support of its position:

> Article 21(3) of the Rules provides that objections to jurisdiction "shall be raised not later than in the statement of defence." In this case, the Tribunal has not yet determined the time period for filing the statement of defense. Thus, the time by which, under the rules chosen by Claimant, Respondent must plead its defenses, including any jurisdictional defenses it might have, has not yet arisen."[15]

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[14] Letter from Barton Legum to Mark A. Cymrot (Feb. 27, 2004) at 1 (quoting the actual letter submitted to the *Canfor* Tribunal). Tembec would have provided the actual letter submitted to the Canfor Tribunal but it has no access to that letter, either through http://www.naftalaw.org or through the United States' website at http://www.state.gov/s/l/c7424.htm.

[15] Letter from Mark A. Clodfelter to Jose Antonio Rivas (Oct. 1, 2004) at 1-2, at Exh. A.

The *Tembec* Tribunal acceded to the United States' argument, set the schedule for the U.S. Statement of Defense to be due on December 15, 2004, and required the United States to provide its jurisdictional defenses in its Statement of Defense.[16]

The United States submitted its Statement of Defense on December 15, 2004, which did not contain any argument that the *Tembec* Tribunal's jurisdiction should be assumed by an Article 1126 consolidation tribunal, despite the United States' full knowledge of Canfor's Statement of Claim and Terminal's Notice of Arbitration.[17] The United States knew of the three claims for which it recently requested consolidation and the significance of Article 21(3) of the UNCITRAL Rules when it first submitted its Statements of Defense and did not dispute the Article 1120 Tribunals' jurisdiction in *Canfor* and *Tembec* based on Article 1126 until it was out of time. The United States requested consolidation under Article 1126 on March 7, 2005, thirteen months after its effective waiver for Canfor and three months after its complete Statement of Defense and, therefore, waiver for Tembec.[18]

D. The Policy Reasons For Article 21(3) Are Evident In This Proceeding

The United States argued at the hearing that "Article 1126 does not contain any time frame for bringing an application for consolidation."[19] Article 1126 needs not specify because it makes no modification of the requirement in Article 21(3)

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[16] *See* Letter from Jose Antonio Rivas to Tembec and the United States (Oct. 25, 2004), *and* Letter from Andrea J. Menaker to Jose Antonio Rivas (Oct. 27, 2004) at Exh. E.

[17] *See Tembec v. United States*, U.S. Statement of Defense on Jurisdiction (Dec. 15, 2004) at Exh. H.

[18] *See* U.S. Request for the Establishment of a Consolidation Tribunal, *Canfor Corp. v. United States, Tembec et al. v. United States and Terminal Forest Products, Ltd. v. United States* (Mar. 7, 2005).

[19] Hearing Transcript at 175.

as to when a party must raise a plea that the tribunal does not have jurisdiction, and the ordinary meaning of Article 21(3) therefore must be upheld.

Article 21(3) is designed to prevent what the United States currently is attempting to do by moving for consolidation. Like other rules of procedure, Article 21(3) aims to balance concerns for efficiency and fairness. The rule ensures a reasonable and sensible allocation of resources during the course of arbitration by enabling the claimant, and the tribunal, to address all threshold objections at one time, rather than in a piecemeal fashion. Article 21(3) also infuses predictability into the arbitral process and prevents a respondent from using jurisdictional objections late in the proceeding, and after considerable expenditure, to obstruct a possibly unfavorable decision.

The current Tribunal must deny the U.S. motion for consolidation, which directly contravenes Article 21(3)'s ordinary meaning and also its underlying policies. Tembec already has spent a large amount of time and money litigating before the original Article 1120 Tribunal. The United States, concerned about its chances of prevailing, and after a considerable delay, now asks for consolidation, in direct contravention of Article 21(3). The dictates of fairness and efficiency embodied in Article 21(3) require this Tribunal to refuse the U.S. request, and not permit answering this question to be prolonged, thereby compounding both unfairness and inefficiency.

IV. STRUCTURAL PROBLEMS INHERENT IN ARTICLE 1126 COUNSEL AGAINST THE TRIBUNAL FROM PROCEEDING AS CONSTITUTED

At the hearing on June 16, 2005, Mr. Clodfelter proclaimed on behalf of the United States that Article 1126 is a unique invention, and he argued that all the

parties had consented to its use.[20] The first statement is true, but the argument is overstated.

Article 1126 is unique. It is also largely untested. In its very first test, the parties all recognized there was something defective about it, and they collaborated to write around the defects. The United States knew of this concern as it was engaged as a third party, but the proceedings working around the Article 1126 defects were not known to the other parties in this proceeding, and the United States did not reveal them before they were posted on the website of the United States of México, which occurred only after briefs were due before this Tribunal.[21] The United States, alone among the parties in this proceeding knowledgeable of the Article 1126 defects because of its exposure to the case involving México (which was not open to the other parties), kept the information to itself and insisted on imposing a non-consensual Article 1126 tribunal on the private parties here as quickly as possible. ICSID obliged.

This Tribunal has asked the parties to address the *HFCS* case. It was not surprising that, at the hearing, the United States was prepared to comment at length on the subject and the private parties were unable to respond.[22] And when the private

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[20] *See* Hearing Transcript at 14-15. ("And they address this question in NAFTA Article 1126, which represents a breakthrough innovation in arbitration."); *see also* Hearing Transcript at 22 ("[T]hat claimants do not like the Article 1126 process, a process to which they consented when they submitted their claims to arbitration under Chapter 11, is not a ground for favoring separate proceedings.").

[21] Counsel to Canfor and Terminal also argued that information about the *HFCS* tribunal was not publicly available until the United States decided to rely on it. *See* Submission of Canfor Corp. Opposing Consolidation Request at ¶ 8. The source code metadata for the United States' webpage announcing the outcome of the *HFCS* cases suggests that the content of that page was loaded on June 2, 2005, one day before the United States relied on the material in its pre-hearing consolidation brief to this Tribunal. *See* Exh. I.

[22] *Compare* Hearing Transcript at 302–313 *with* Hearing Transcript 293-294, 296-297. The United States was present at the *HFCS* hearing on consolidation, but none of the Claimants had information about the hearing or opportunity to attend. *See* Order of the Consolidation Tribunal, *Corn Products International,*

(continue)

parties asked for all documentation and correspondence that might shed more light on the decision of the parties in the *HFCS* case to address the Article 1126 defects and work around them, the United States refused.[23]

When Tembec requested arbitration pursuant to Chapter 11 of NAFTA, it may implicitly have submitted to the possibility of Article 1126, but no more so than accepting that laws may be applicable even when they are unconstitutional until they are struck down. It is apparent from the experience in *HFCS* that México and the private parties recognized and understood that Article 1126 is defective unless applied in a manner consistent with the ethical rules applicable to the parties and the arbitrators. Forced and rushed into this proceeding, and ignorant of the *HFCS* case, Tembec only in the course of this proceeding has had an opportunity to reach the conclusion already reached by México and the *HFCS* parties, that Article 1126 has profound problems requiring correction. Tembec did not knowingly or willingly consent to a provision that would deny its rights, confer unfair advantage on the United States, and impose on arbitrators excruciating conflicts of interest that they should not have to bear and that compromise them ethically. The remainder of this brief in support of Tembec's motion for dismissal for lack of jurisdiction focuses on this last concern.

Article 1126(2) states that the tribunal convened to determine the question of consolidation may, by order, "assume jurisdiction over and hear and determine

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(continued)
Inc. v. United Mexican States and *Archer Daniels Midland Co., et. al. v. United Mexican States*, ICSID case No. ARB(AF)04/5 (May 20, 2005) at ¶ 11.

[23] *See* Hearing Transcript at 300-301. The Tribunal, perhaps not appreciating the gravity of this situation – that the United States was unique among the parties to this proceeding in having knowledge and documents pertinent to the critical questions about Article 1126 – declined to direct the United States to share the information. *See id.*

together, all or part of the claims." This structural component of Article 1126—allowing the same tribunal that decides the question of consolidation to then assume jurisdiction to hear the merits of the claim—raises two serious concerns: arbitrators convened under Article 1126 have personal pecuniary incentives to favor the consolidation of claims. These incentives are unlike those confronting arbitrators in more typical proceedings, and cross the ethical line.

The second peculiar concern is that a tribunal formed under Article 1126 has no one appointed by claimants among its members, yet in this particular case does have an arbitrator effectively appointed by the Respondent. The UNCITRAL Rules contemplate balances in tribunals effected by party selections. That balance has been disrupted here, and consequently infects the process with, at minimum, an appearance and a perception of bias.

A. Article 1126 Places Tribunal Members In The Position Of Deciding A Question In Which They Have A Direct Financial Interest

1. Article 1126 Presents Unique Conflicts For Arbitrators

All arbitrators make decisions to continue or stop a proceeding with the consequence that their employment and income is affected. Article 1126, however, places the members of a Tribunal in the uncomfortable and unique position of convening for the express and single purpose of deciding whether they will be employed and paid for a considerable period of time. Should the members of the Article 1126 Tribunal decide to consolidate Article 1120 cases and assume jurisdiction over them, they would be deciding to create a substantial source of compensation for themselves, thus raising difficult ethical questions about their impartiality in deciding the consolidation question.

The Non-Waivable Red List of Conflicts in the *IBA Guidelines on Conflicts of Interest in International Arbitration* includes:

> 1.3 The arbitrator has a significant financial interest in one of the parties or the outcome of the case.

Tribunals formed under Article 1126, unless modified, have a significant financial interest in the outcome of their determination whether to grant a request for consolidation. The significant remuneration that arbitrators receive raises concerns about the impartiality of their decisions even under normal circumstances:

> The issue of arbitrator fees has become a problematic aspect of the business of transborder arbitration. . . . The enormous fees that can be commanded by international arbitrators place [] pressure on the process. Arbitrators, unregulated except by contract, develop a monetary self-interest that can conflict with both the ethical and practical operation of the process.[24]

Scholars and practitioners both have recognized the problems in international arbitration created by perverse financial incentives:

> Presumably arbitrators will be more likely than courts to find jurisdiction, since arbitrators get paid if they hear a dispute.[25]

The only restraints on arbitrators' ability to exploit arbitration for personal profit is typically the control exercised by disputing parties through their consent to arbitrate, their selection of the arbitrators, and their ability to set by contract the terms and scope of arbitration. The direct personal financial interest of arbitrators in this Tribunal is uniquely unrestrained.

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[24] Thomas E. Carbonneau, *The Ballad of Transborder Arbitration*, 56 U. Miami L. Rev. 773, 800-01 (2002).

[25] *See* William W. Park, Bridging the Gap in Forum Selection: Harmonizing Arbitration and Court Selection, 8 Transnat'l L. & Contemp. Probs. 19, 50 (1999).

Any potential incentive for personal profit facing arbitrators in Article 1120 tribunals is mitigated by the consensual nature of the arbitration and the narrow and delineated scope of proceedings. In Article 1120 tribunals, the parties to the arbitration participate in selecting arbitrators pursuant to Article 1123. Claimants choose the rules under which to submit a claim, pursuant to Article 1120(1). Thus, an Article 1120 tribunal's jurisdiction flows directly from the parties' consent and consensus.

The tribunal members' financial interest in consolidation is especially problematic because the tribunal's potential jurisdiction to adjudicate the substance of the claims flows not from agreement among the parties but from the tribunal's own decision whether to consolidate. The Article 1126 tribunal determines its own jurisdiction by seizing it from Article 1120 tribunals. Article 1126 tribunals do not derive jurisdiction or legitimacy through consent of the parties.

2. The Parties In *HFCS* Recognized The Ethical Problems Of Article 1126

Based on publicly available information, the only other tribunal to consider consolidation pursuant to Article 1126 did not decide the propriety of consolidating claims with the possibility that the same tribunal would conduct the consolidated arbitration.[26] In the *HFCS*, the tribunal's jurisdiction to decide whether to consolidate claims arose from a consensus among parties, who reserved the right to decide the

[26] According to the United States' website at http://www.state.gov/s/l/c3439.htm, there are three groups of cases for which consolidation has been requested: the cases at issue here, the *High Fructose Corn Syrup* cases, and the *Cases Regarding the Border Closure Due to BSE Concerns*. The United States' website provides no information about the status of consolidation in the *BSE* case. *See* Exh. J. Tembec's counsel inquired about this case during the hearing, but the United States did not respond or inform. *See* Hearing Transcript at 300-301.

The website to which the Chairman referred, www.naftalaw.org, does not provide information about the status of any of the three known consolidation proceedings.

composition of a consolidation tribunal, should one be ordered.[27] Under this procedural framework, the arbitrators had no financial interest in consolidating, and the conflict of interest would have been avoided.

This Tribunal was formed rapidly, and forcibly. Only the United States was aware, among the parties, of the *HFCS* precedent. This Tribunal should yield to that precedent and avoid for itself the ethical dilemmas Article 1126 otherwise presents.

B. Consolidation Under Article 1126 Eliminates Claimant's Right To Select Even One Arbitrator To Review The Merits Of The Case

A second concern inherent in Article 1126 is the potential elimination of the claimant's right to appoint a member of the tribunal to decide the claimant's case on the merits. The concern is aggravated by the fact that the respondent NAFTA Party defending against the claims has a Tribunal appointee taken from the respondent's own predetermined list of acceptable arbitrators. In this case, the United States is represented by a Tribunal member selected from the list of individuals that the United States has presented to ICSID for appointments. In this particular case that Tribunal member was aggressively championed by the United States against the formal and active objections of all other parties.

Article 1126 does not provide for ICSID to appoint an additional tribunal member from any predetermined lists created by the claimants. Article 1126 allows ICSID to appoint an arbitrator from the claimant's home country, but that procedure does not protect the party autonomy of the claimants as evidenced by the fact that the

[27] *See* Order of the Consolidation Tribunal, *Corn Products International*, ICSID case No. ARB(AF)04/5 (May 20, 2005) at ¶ 2.

claimants' party-appointed arbitrators in *Canfor* and *Tembec* are American and British, respectively, rather than Canadian.

In the *HFCS* cases, the parties had seven months from the request for consolidation to recognize and address these structural defects in Article 1126. The solution reached by the parties was that, were the Article 1126 tribunal to decide that consolidation was necessary, the parties would appoint members of a new tribunal to hear the consolidated case on the merits of those issues that had been consolidated. The appointment process also allowed the claimants the opportunity to appoint a member of the consolidated tribunal to represent their interests.

The parties to subsequent free trade agreements ("FTAs") with the United States also seem to have recognized the structural defects in Article 1126, as indicated by changes to the consolidation procedures set out in those agreements. The Central America Free Trade Agreement ("CAFTA") and the U.S. FTAs with Chile, Morocco and Singapore recognize that different procedures should follow when a party seeks a consolidation order without the agreement of "all the disputing parties sought to be covered by the order."[28] Notably, unless all disputing parties agree otherwise, all parties named in a request to consolidate must participate in the selection of an arbitrator for the new tribunal:

> Unless all the disputing parties sought to be covered by the order agree otherwise, a tribunal established under this Article shall comprise three arbitrators: (a) one arbitrator appointed by agreement of the claimants; (b) one arbitrator appointed by the respondent; and (c) the presiding arbitrator appointed by the

[28] CAFTA Art. 10.25(1); U.S.-Chile FTA Art. 10.24(1); U.S.-Morocco FTA Art. 10.24(1); U.S.-Singapore FTA Art. 15.24(1); all at Exh. K.

> Secretary-General, provided, however, that the presiding arbitrator shall not be a national of either Party.[29]

That consolidation tribunal may decide to assume jurisdiction over all or part of the claims, or it may instruct a previously established tribunal to assume jurisdiction over all or part of the claims,[30] but in no event does a tribunal consolidate and assume jurisdiction without representation through consensual selection of the parties.[31]

The United States knew of these concerns. The private claimants did not. Arbitration, which must strive for fairness, cannot construct its institutions and procedures on biased foundations.

V. CONCLUSION

Consolidation is unmistakably a jurisdictional defense. This Tribunal should dismiss the United States' request for consolidation immediately because, pursuant to the ordinary meaning of Article 21(3) of the UNCITRAL Rules, unmodified by Article 1126 of NAFTA, the United States did not present the jurisdictional defense of consolidation when it provided its complete jurisdictional defenses in the *Canfor* and *Tembec* proceedings.

This Tribunal must recognize that it has no jurisdiction because of the United States' failure to plead consolidation when required by the Rules, which was no mere technicality and involves fundamental public policy concerns. It must also recognize that the hasty and controversial manner in which this Tribunal was created,

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[29] CAFTA Art. 10.25(4)(a-c); U.S.-Chile FTA Art. 10.24(4)(a-c); U.S.-Morocco FTA Art. 10.24(4)(a-c); U.S.-Singapore FTA Art. 15.24(4)(a-c).

[30] CAFTA Art. 10.25(6)(a-c); U.S.-Chile FTA Art. 10.24(6)(a-c); U.S.-Morocco FTA Art. 10.24(6)(a-c); U.S.-Singapore FTA Art. 15.24(6)(a-c).

[31] CAFTA Art. 10.25(6)(c)(i); U.S.-Chile FTA Art. 10.24(6)(c)(i); U.S.-Morocco FTA Art. 10.24(6)(c)(i); U.S.-Singapore FTA Art. 15.24(6)(c)(i).

and the inherent and profound defects of Article 1126, place the Tribunal members in an impossible ethical situation. Dismissal of the consolidation motion of the United States is the only way to enforce the UNCITRAL Rules, and to avoid continuing foundational problems.

Respectfully submitted,

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