

TRADE PACTS' "INVESTOR-STATE" SYSTEMS: PRIVATE CORPORATE TRIBUNALS USED TO ATTACK COUNTRIES' COURTS

"Loewen" NAFTA Case: Foreign Corporations Unhappy with Domestic Jury Awards in Private Contract Disputes Can Demand Bailout from Taxpayers

SUMMARY

The Loewen Group, a Canadian firm, initiated a case against the U.S. government in July 1998 at the World Bank's International Centre for Settlement of Investment Disputes (ICSID) demanding \$725 million in damages. This was the first NAFTA Chapter 11 investor-state case challenging a domestic court ruling. In this claim, the Canadian funeral home conglomerate challenged a Mississippi state court jury's damage award in a private contract dispute and various rules of civil procedure relating to posting bond for appeal. The underlying civil court case involved a suit initiated by a local Mississippi funeral home owner that claimed Loewen had engaged in anti-competitive and predatory business practices in breach of contract. Loewen lost the domestic civil court case. It then decided to appeal and, under normal rules of civil procedure, Loewen was required to post a bond covering the lower court's damages award. (This is also a similar requirement for appeal under U.S. federal civil procedure, which is designed to safeguard against a losing party reorganizing its assets to avoid the lower court judgment.)

In 2001 and 2003 rulings, the **ICSID tribunal held that the functions of a domestic court hearing a private contract dispute qualified as a government action covered by NAFTA's Chapter 11 investor rules, and thus was subject to a NAFTA investor-state claim.** The panel also discussed the merits of the case in some detail, blaming the U.S. for a "miscarriage of justice" in the function of the civil court. (The case was dismissed on a technical standing matter: in 2002, Loewen's lawyers had reorganized what had been a Canadian firm as a U.S. corporation under bankruptcy protection, thus terminating the firm's standing as a *foreign* investor.) However, the case shows the perils of NAFTA's privatized system of dual track "justice." U.S. individuals and firms rely on our domestic judicial system, one of the finest in the world. But foreign corporations not only can attack our domestic judicial system writ large, but can do so in a parallel "court" where only they can initiate cases and where the private litigants in the underlying domestic case have no standing or rights.

NAFTA'S FOREIGN INVESTOR PROTECTIONS AND THEIR PRIVATE ENFORCEMENT

The North American Free Trade Agreement (NAFTA) included an array of new corporate investment rights and protections that were unprecedented in scope and power. NAFTA's extreme rules have been replicated in various U.S. "free trade agreements" (FTAs), including CAFTA, the Peru FTA, and the recently passed deals with Korea, Panama and Colombia.

These special privileges provide foreign investors new rights to own and control other countries' natural resources and land, establish or acquire local firms, and to operate them under privileged terms relative to domestic enterprises. The scope of the "investments" covered by these rules is vast, including derivatives and other financial instruments, intellectual property rights, government licenses and permits, and procurement and natural resource contracts with the national government, as well as more traditional forms of investment.

The pacts provide foreign firms with a way to attack domestic public interest, land use, regulatory and other laws if they feel that a domestic policy or government decision has undermined the firms' new trade pact privileges, such as threatening their "expected future profits." These firms have access under the trade deals to an investor-state enforcement system, which allows them to skirt national court systems and privately enforce their extraordinary new investor privileges by directly suing national governments. These "investor-state" cases are litigated outside the U.S. court system in special international arbitration bodies of the World Bank and the United Nations. A three-person panel composed of arbitrators listens to arguments in the case. Most of the lawyers who serve on tribunals also represent corporations as plaintiffs, meaning the "judge" deciding a case brought by Lawyer A may well be the lawyer bringing a case to be decided to a future tribunal on which Lawyer A is now serving as a "judge." This system creates inherent conflicts of interest. These tribunals are empowered to award an unlimited amount of taxpayer dollars to corporations. Because the mechanism elevates private firms and investors to the same status as sovereign governments, it amounts to a privatization of the justice system – and a privatization in which lawyers often representing corporations attacking government also serve as the judges.

If a corporation wins its private enforcement case, the taxpayers of the "losing" country must foot the bill – with the losing country's Treasury paying cash compensation to the winning corporation. Specialized private equity firms have sprung up to finance this system of raiding public treasury funds. Over \$350 million in compensation has already been paid out to corporations in a series of NAFTA investor-state cases. This includes attacks on natural resource policies, environmental protection and health and safety measures, and more. In fact, of the over \$12.5 billion in pending claims, all relate to environmental, public health and transportation policy – not traditional trade issues.

The investor-state system has numerous worrying implications. Many worry that it promotes the offshoring of jobs by providing special protections and rights for firms that relocate, removing the risk of foreign investors having to use local court systems. And the bipartisan National Conference of State Legislatures (the national association of U.S. state parliamentary bodies) has strongly opposed this system for its negative impact on federalism. States whose laws are challenged have no standing in the cases and must rely on the federal government to defend state policies which the federal government may or may not support.

THE LOEWEN NAFTA INVESTOR-STATE CASE

The Loewen Group was a Canadian-based funeral conglomerate that aggressively acquired more than 1,100 funeral homes across Canada and the United States.¹ The Loewen NAFTA case arose in the context of increasing consolidation in the U.S. funeral home market, as a handful of conglomerates acquired or pushed out of business small, independent firms. This phenomenon drew public attention because of subsequent consumer abuses and several high-profile investigations of anticompetitive business practices. A 1996 *Time Magazine* investigation into the funeral industry charged that "... the Loewen Group and a handful of other large death-care companies are racing to buy up as many independent funeral homes as possible – not out of any desire to share the resulting economies of scale and cut the cost of funerals – but rather to boost prices still higher."²

In 1994, Loewen Group was sued in Mississippi state court by a Biloxi businessman named Jeremiah O'Keefe. O'Keefe alleged that Loewen, as part of a strategy to dominate the local funeral market, had committed various unlawful, anti-competitive and predatory acts designed to drive O'Keefe's local funeral and insurance companies out of business, in violation of state law.³ This was not the last time Loewen would land in U.S. court. In 1996, Loewen settled a similar breach of contract case for \$30 million.⁴ The Massachusetts Attorney General became so concerned about Loewen's near monopoly status in the Cape Cod area that it ordered the company to divest itself of a number of funeral homes.⁵

After a trial reviewing O'Keefe's claims, a Mississippi jury agreed with O'Keefe. Angered by Loewen's behavior, the jury came back with a verdict of \$500 million.⁶ According to one juror, "The Loewen group...clearly violated every contract it ever had with O'Keefe... If there was ever an indefensible case, I believe this was it."⁷ Ironically, O'Keefe's attorney's had attempted to settle the case even before the trial began; \$5 million was the number they had in mind, but they were authorized to go even lower.⁸

Loewen decided to appeal the jury verdict. Before proceeding with the appeal, the company asked the trial court to be exempted from a long-standing rule of civil court procedure. The state rule (which is similar to the U.S. federal and other nations' rules of civil procedure⁹) requires that losing defendants who wish to pursue an appeal without beginning to pay damages to the plaintiff must buy a bond securing the damages owed. The purpose of the rule is to prevent defendants from using the lengthy appeals process to hide assets or otherwise evade liability.¹⁰ Loewen requested that the amount of the bond be reduced to \$125 million – a motion that the trial court denied.¹¹ Loewen appealed the issue to the Mississippi Supreme Court. On January 24, 1996, the Mississippi Supreme Court rejected Loewen's demand to reduce the amount of the bond.¹² Rather than post the full bond or pursue other legal avenues, Loewen decided to settle the case with O'Keefe, and on January 29, 1996, the company settled for approximately \$85 million, 17 percent of the jury verdict and 17 times what the company could have settled for when the case began.¹³

The settlement was not the end of the story, however. In July 1998, Loewen initiated a suit against the United States before a tribunal of the World Bank's International Centre for Settlement of Investment Disputes (ICSID) under NAFTA's investment chapter.¹⁴ Although Loewen only paid out a fraction of the original jury award, the company demanded \$725 million

in compensation from U.S. taxpayers, arguing that the jury verdict, the punitive damages and the Mississippi bond requirement all violated its new investor rights guaranteed under NAFTA.¹⁵

Specifically, the company claimed that the judge allowed the plaintiff's attorney to appeal to the "anti-Canadian, racial and class biases" of a Mississippi jury in violation of national treatment rules in NAFTA Article 1102.¹⁶ The company also claimed that the verdict amount, allegedly racially charged comments and the bond requirement denied justice and effectively forced a settlement, thus denying Loewen its right to appeal. The company claimed this violated Article 1105 (which requires "fair and equitable treatment").¹⁷ Finally, Loewen argued that "the excessive verdict, denial of appeal, and coerced settlement were tantamount to an uncompensated expropriation in violation of Article 1110 of NAFTA."¹⁸

"The absolute frightening part of this thing is that in this particular instance, the United States government has surrendered its sovereignty over a matter of fraud and tort and predatory and illegal practices within its own boundaries."

- Michael S. Allred, Attorney for O'Keefe,
Los Angeles Times, 2/28/99

In response to these allegations, the U.S. government argued that the judgments of domestic courts in purely private disputes are not "measures" covered by NAFTA rules;¹⁹ that in any case the trial-related incidents could not be attributed to the U.S. because Loewen had chosen to not exhaust its appeal options; that its settlement defeated their NAFTA claim; that the complained of features of the legal system were common internationally; that Loewen had not established that bias had occurred; that many of Loewen's problems in courts were the result of its own counsel's failed courtroom strategies (for instance, Loewen never raised many of these concerns during the trial); and that Loewen had not come even close to establishing grounds for expropriation.²⁰

The Loewen case represented the first instance in which a jury ruling has been challenged under NAFTA. In March 1999, ICSID formed a NAFTA panel to hear the case consisting of Anthony Mason (Australia), L. Yves Fortier (Canada), and former Congressman and U.S. federal court judge Abner J. Mikva.²¹ On January 5, 2001, the panel issued its initial ruling, rejecting the U.S. arguments that a jury decision in private contract litigation did not constitute a governmental measure under NAFTA.²² Instead, the tribunal allowed the case to proceed, surprising many observers. Further, the panel placed no limits on what types of court action or decision it considers covered by NAFTA rules. This ruling thereby opened up the possibility that all court decisions, even those of the U.S. Supreme Court, are now open to review by unaccountable NAFTA tribunals.²³

However, in June 26, 2003, the arbitral tribunal issued its final ruling, holding that, due to changed circumstances, it no longer had jurisdiction to proceed with the claim.²⁴ In December 2001, courts in Canada and Delaware approved a request from the Loewen Group to file for bankruptcy. A month later, the firm emerged from bankruptcy, and its lawyers had reorganized the majority of the Canadian firm's assets to form a new U.S. corporation called the Alderwoods Group Inc. The rights to any proceeds from the NAFTA claim (and the power of attorney for the case), however, were transferred to another new Canada-registered company called Nafcanco. Nafcanco, however, was itself owned and controlled by the Alderwoods Group.²⁵ The tribunal held that this had terminated the required "diversity of nationalities" –

that a case brought against the U.S. government under NAFTA Chapter 11 be brought by a foreign investor or about a foreign investment.²⁶

However, the tribunal's comments on the merits of the case in its ruling raised many worries with respect to the prospect of investor-state cases inappropriately invading the realm of domestic civil court systems' functions:

- The tribunal second guessed the jury award, despite it having resulted from the decision by Loewen's lawyers to reject the settlement offer and to opt for the damages stage of the case to be heard by the jury. The tribunal delved into reviewing the merits of the domestic civil court case to conclude that Loewen "had very strong prospects of successfully appealing the damages awarded on the grounds that they were excessive".²⁷
- The tribunal concluded that the decision not to relax the bonding requirement was "an act for which Respondent is responsible in international law."²⁸ However, the tribunal concluded that the court decisions refusing to relax the bonding requirement were not violations of Article 1105 because they did "not transgress the minimum standard of treatment mandated" by this provision and were "at worst ... erroneous or mistaken."²⁹
- The panel noted injustices suffered by the company (and its founder Raymond Loewen), including that the judge had allowed the trial lawyer to make inflammatory statements about the firm and its intentions. "...[T]he conduct of the trial judge was so flawed as to constituted a miscarriage of justice amounting to a manifest injustice as that expression is understood in international law."³⁰ The panel declared that the United States "is responsible for any failure on the part of the trial judge in failing to take control of the trial so as to ensure that it was fairly conducted...."³¹
- It is worth noting that the tribunal also concluded that the firm had failed to pursue its domestic remedies, and therefore "had not shown a violation of customary international law."³² However, after recounting its findings, (as noted above) the tribunal noted that its decision to dismiss the claims was ultimately based on a lack of jurisdiction given the firm had reorganized as a U.S. corporation under Chapter 11 protection of the U.S. Bankruptcy Code.
- But as the U.S. had noted in its defense, the trial judge had repeatedly urged Loewen to object when they saw fit. (In the U.S. adversarial legal system, initiating procedural or other objections is not a role for a judge to undertake.)³³ Moreover, the judge admonished O'Keefe's lawyers for perceived racially insensitive remarks,³⁴ and instructed the jury to not be "influenced by bias, sympathy or prejudice."³⁵ The judge also advised Loewen on ways to get a lower jury award.³⁶ In its NAFTA case filings, the U.S. also noted that while all the discussion of race may seem distasteful, racial distinctions are perhaps the most pertinent market segmenting distinction in the funeral home business, as religious denominations in the U.S. often break down on racial lines.³⁷ Perhaps for this reason, an academic review of the NAFTA ruling concluded that the tribunal in the Loewen case failed to consider many of the facts and that "significant parts of its argumentation are incomplete, incoherent, and even contradictory."³⁸

IMPLICATIONS OF THE LOEWEN CASE

1. Using NAFTA to Evade Liability, A Special Right of Appeal: The Loewen case sends the powerful message to foreign businesses that they can evade justice by challenging the workings of state, local and federal courts in NAFTA tribunals. Foreign corporations that lose tort cases in the United States can use NAFTA to attempt to evade liability by shifting the cost of their court damages to U.S. taxpayers. In contrast, U.S. citizens and businesses must comply with the rulings of U.S. courts.

2. Advancing a Rear-Guard Attack on the U.S. Legal System: The U.S. justice system guarantees a strong role for citizen juries. A jury trial is broadly viewed as an important safeguard for equalizing the imbalance between citizens and more powerful or wealthy interests. In addition to attacking the principle of a jury trial, the Loewen case attacks the U.S. civil justice system, which allows juries to send strong messages to defendants who abuse their power and resources to rip off consumers, pollute the environment or evade the law by assessing damages. In sum, Loewen Group argued that the U.S. civil justice system has the possibility of being NAFTA-illegal because of its structural features – jury trials, requirements to post bonds on appeal and the like.

3. Forum Shopping: It is ironic that Loewen ended up paying \$85 million when it could have settled for less than \$5 million early in the civil suit and saved itself years of costly litigation. Loewen sought to use NAFTA to force U.S. taxpayers to pay for its legal missteps, failed courtroom strategy and financial problems that led to its inability to post a bond for appeal. The fact that Loewen had another avenue of appeal in the NAFTA dispute resolution system may have relieved the corporation of the pressure it might normally feel to settle the case quickly and easily in the U.S. court system.

4. A Politically Charged System: An interesting twist to this case is that one of the tribunalists was former U.S. Congressman Abner Mikva. In its final award document, the tribunal intriguingly notes: “What clearer case than the present could there be for the ideals of NAFTA to be given some teeth?”³⁹ It then proceeds to explain its political logic – that in deciding this case, it was necessary to be “on guard against” this “human reaction” because “[t]oo great a readiness to step from outside into the domestic arena, attributing the shape of an international wrong to what is really a local error (however serious), will damage both the integrity of the domestic judicial system and the viability of NAFTA itself.”⁴⁰ International investor arbitral tribunals are not bound to the common law notion of *stare decisis* - binding precedents. Thus, an interesting consideration is what a future panel faced with a similar claim and a similar “human reaction” would do, or for that matter how this panel would have ruled had Mikva not been present to raise the broader implications of a ruling in favor of Loewen torpedoing NAFTA.

For more information on NAFTA Investor-State cases, see: Public Citizen, NAFTA Chapter II Investor-to-State Cases: Bankrupting Democracy” Available at: <http://www.citizen.org/documents/AGF186.PDF>. You can also contact Public Citizen’s Global Trade Watch, blopez@citizen.org /-202-546-4996.

ENDNOTES

- ¹ "Canadian Funeral Home Firm Battles \$150 Million Biloxi Judgment," *Miami Herald*, Nov. 25, 1998.
- ² Erik Larson, "Fight to the Death: A Battle Between Rival Funeral Homes Dynasties Puts the Spotlight on a Vast But Quiet Transformation in the Way We Bury our Dead," *Time Magazine*, Dec. 9, 1996.
- ³ Second Amended Complaint, May 16, 1994, at 6-19, *O'Keefe v. Loewen Group, Inc.*, No. 91-67-423 (Miss. Circ. Ct. 1st Jud. Dist., Hinds County 1995).
- ⁴ *Provident American Corporation v. The Loewen Group Inc* (U.S.D.C. Ed. Pa. CA. No. CIV. A. 92-1964). (Mar. 10, 1995). Settlement amount known from personal communication between Mary Bottari, Public Citizen, and Provident attorney Bret Flaherty, Aug. 21, 2001.
- ⁵ "Fight to the Death: A Battle Between Rival Funeral Homes Dynasties Puts the Spotlight on a Vast But Quiet Transformation in the Way We Bury our Dead," *Time Magazine*, Dec. 9, 1996.
- ⁶ This included \$100 million in compensatory damages and \$160 million in punitive damages. However, these two stages were meant to be separate. In the punitive damages phase, the jury returned a corrected award of \$400 million, for a total of \$500 million. See *The Loewen Group, Inc. and Raymond L. Loewen v. United States of America*, ICSID Case No. ARB(AF)/98/3, Award (June 26, 2003), at paras. 96 and 101. (Henceforth "Final Award") Available at: <http://www.state.gov/documents/organization/22094.pdf>
- ⁷ Communication from juror Robert Bruce to John Corlew, attorney, Nov. 24, 1995, on file with Public Citizen.
- ⁸ Personal communication between Mary Bottari, Public Citizen, and Michael S. Allred, attorney for O'Keefe Aug. 17, 2001.
- ⁹ Counter-Memorial of the United States of America, *Loewen Group v. the United States* (Mar. 30, 2001), at 144-152. Available at: <http://www.state.gov/documents/organization/7387.pdf> [Henceforth "Counter-Memorial"]
- ¹⁰ *Ibid.*
- ¹¹ Counter-Memorial, at 57-59.
- ¹² Counter-Memorial, at 63.
- ¹³ Counter-Memorial, at 64. "Although Loewen values the settlement at \$175 million for present purposes, that amount does not reflect the deferral of payment and tax benefits that Loewen received from the settlement. In statements to the U.S. Securities and Exchange Commission (a federal agency that regulates the securities markets) and in its press releases at the time, Loewen estimated the aftertax, net present value of the settlement to be approximately \$85 million."
- ¹⁴ Notice of Claim, *Loewen Group Inc. v. the United States* (Oct. 30, 1998), at para. 20. [Henceforth "Notice of Claim"] Available at: <http://www.state.gov/documents/organization/3922.pdf>
- ¹⁵ Notice of Claim, at paras. 139, 162 and 187.
- ¹⁶ Notice of Claim, at paras. 4 and 139.
- ¹⁷ Notice of Claim, at paras. 151, 158, and 161.
- ¹⁸ Notice of Claim, at para. 162.
- ¹⁹ Decision on the Arbitral Tribunal on Hearing of Respondent's Objection to Competence and Jurisdiction, *Loewen Group Inc. v. the United States* (Jan. 5, 2001), at para. 32. [Henceforth "Decision on Jurisdiction"] Available at: <http://www.state.gov/documents/organization/3921.pdf>
- ²⁰ Counter-Memorial, at 65-186.
- ²¹ Decision on Jurisdiction, at para. 17.
- ²² Decision on Jurisdiction, at para. 60.
- ²³ Decision on Jurisdiction, at paras. 45 and 54.
- ²⁴ Memorial of the United States of America on Matters of Jurisdiction and Competence Arising From The Restructuring of The Loewen Group, Inc., *Loewen Group Inc. v. the United States*, (March 1, 2002), at 3-9. Available at: <http://www.state.gov/documents/organization/8744.pdf>
- ²⁵ Final Award, at para. 29.
- ²⁶ Final Award, at para. 240.
- ²⁷ Final Award, at para. 114.
- ²⁸ Final Award, at para. 212.
- ²⁹ Final Award, at para. 189.
- ³⁰ Final Award, at para. 54.
- ³¹ Final Award, at para. 53.
- ³² Final Award, at para. 217.
- ³³ Counter-Memorial, at 66-69.
- ³⁴ Counter-Memorial, at 20.
- ³⁵ Counter-Memorial, at 49.
- ³⁶ Counter-Memorial, at 53.
- ³⁷ Counter-Memorial, at 25-26.
- ³⁸ Dirk Pulkowski, "The Final Award in *Loewen v. United States*," in W.M. Reisman, G. Aguilar Alvarez (eds.), *The Reasons Requirement in International Investment Arbitration: Critical Case Studies* (2008), at 321.
- ³⁹ Final Award, at para. 241.
- ⁴⁰ Final Award, at para. 242.