

NAFTA Chapter 11 Arbitration: Deciding the Price of Free Trade

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In Metalclad Corp. v. United Mexican States, an arbitration panel found the Mexican government to have violated the North American Free Trade Agreement's (NAFTA) investor protection provisions. Concluding that a local government in Mexico wrongly blocked Metalclad, an American company, from opening a hazardous waste facility, the panel ordered Mexico to pay the company \$16.7 million as compensation for its lost investment. The arbitration panel's broad interpretations of NAFTA's investor protection provisions and its disregard of environmental factors elevate foreign investors' rights over the right of governments to protect human health and the environment. Metalclad's analysis may be especially regrettable if it is applied in future Chapter 11 cases or its policy of subverting environmental values is replicated in future international trade agreements.

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INTRODUCTION

A North American Free Trade Agreement (NAFTA)¹ arbitration panel's recent judgment against Mexico in *Metalclad Corp. v. United Mexican States*² confirmed environmentalists' fear that NAFTA's Chapter 11 investor protections could undermine legitimate environmental regulations. Chapter 11 affords private investors the right to directly challenge host-nations' actions and regulations through an arbitral mechanism.³ Although Chapter 11 was initially viewed as a measure to assure cautious investors that host governments would not nationalize their investments, *Metalclad* exemplifies the use of Chapter 11 to recover diminished profits resulting from environmental regulation.

Metalclad, an American company, sought a construction permit for a hazardous waste facility in the Mexican town of

1. North American Free Trade Agreement, Dec. 17, 1992, 32 I.L.M. 605, available at <http://www.sice.oas.org/tradee.asp> [hereinafter NAFTA] (entered into force Jan. 1, 1994).

2. ICSID Case No. ARB(AF)/97/1, 21 Award of Aug. 30, 2000, 40 I.L.M. 36 (2001).

3. NAFTA, *supra* note 1, Ch. 11.

Guadalcazar. However, a geological study of the area concluded that the site was unsuitable for hazardous waste due to its seismic instability and position over several aquifers. Local officials also expressed concerns about public health problems they feared would accompany the proposed facility. The municipality therefore declined to issue a permit to Metalclad, causing the company to invoke investor-state arbitration under Chapter 11. Without considering environmental concerns, and ignoring NAFTA provisions⁴ and an environmental side-agreement⁵ that expressly promote environmental values, a NAFTA tribunal ordered the Mexican government to pay Metalclad \$16.7 million compensation for Metalclad's lost investment.

The *Metalclad* tribunal's broad interpretation of investor protections and its failure to address environmental concerns perpetuates the aggressive use of Chapter 11 by businesses whose investments lose value due to legitimate environmental measures. It affords rights to foreign investors far beyond those of domestic companies and undermines efforts by local governments to protect human health and the environment.

I

BACKGROUND

A. *The Policies and Goals of NAFTA*

NAFTA seeks to eliminate barriers to the trade of capital, goods and services among the United States, Canada, and Mexico.⁶ The treaty is designed to promote fair competition⁷ and to increase and secure cross-border investment activities.⁸ NAFTA calls on party countries to interpret all aspects of the agreement in light of those stated objectives.⁹

4. *Id.* art. 1114 (stating that Chapter 11 should not be construed as limiting the rights of government to require that investment occurs in an "environmentally sensitive manner"); *id.* at preamble (parties resolve to pursue objectives in a manner "consistent with environmental protection and conservation," "promote sustainable development," and "strengthen the development and enforcement of environmental laws).

5. North American Agreement on Environmental Cooperation, Sept. 14, 1993, 32 I.L.M. 1482 (entered into force Jan. 1, 1994), *available at* <http://www.sice.oas.org/tradee.asp> [hereinafter NAAEC].

6. NAFTA, *supra* note 1, art. 1102(1)(a).

7. *Id.* art. 1102(1)(b).

8. *Id.* art. 1102(1)(c)-(d).

9. *Id.* art. 1102(2).

In the United States, the Clinton administration enacted NAFTA despite great criticism from environmental, human rights, and labor organizations. Political pressure from the 1992 presidential election and Congress's concern that the proposed agreement lacked labor and environmental safeguards led to the creation of two NAFTA side-agreements.¹⁰ The first, the North American Agreement on Labor Cooperation, responded to the fears of labor watchdogs that U.S. and Canadian companies investing in Mexico would not be subject to the same labor restrictions as they would be in their home countries.¹¹ The second side agreement, known as the North American Agreement on Environmental Cooperation (NAAEC),¹² was a conciliation to some major environmental organizations in return for their support of NAFTA.¹³ The NAAEC allows citizens of any party nation to file a submission for arbitration to complain that a government has failed to enforce its domestic environmental law.¹⁴ However, the agreement does not set any uniform environmental standards. It is also not significantly linked to main NAFTA provisions.¹⁵

B. Investor Protections under NAFTA

1. The Origin of NAFTA's Investor Protections

Although rules protecting investments are common in international trade agreements,¹⁶ NAFTA is one of the first such agreements to allow private investors to directly challenge host-

10. See Howard Mann, *NAFTA and the Environment, Lessons for the Future*, 13 TUL. ENVTL. L.J. 387, 392-93 (2000).

11. North American Agreement on Labor Cooperation, Sept. 14, 1993, 32 I.L.M. 1499 (entered into force Jan. 1, 1994), available at <http://www.sice.oas.org/tradee.asp>.

12. NAAEC, *supra* note 5.

13. John H. Knox, *A New Approach to Compliance with International Environmental Law: The Submissions Procedure of the NAFTA Environmental Commission*, 28 ECOLOGY L.Q. 1, 54-55 (2001).

14. NAAEC, *supra* note 5, arts. 14, 24.

15. See Mann, *supra* note 10, at 395-407 (providing a detailed discussion of the absence of linkages between NAFTA and the NAAEC). While there is a clear opportunity for constructive interaction, trade officials take the view that "[t]he trade agreement is the trade agreement and the environment agreement is the environment agreement, and there is little if any need for the environmental regime to address matters within the trade regime. In effect, the approach has been largely one of 'keep your environmental hands off our trade agreement.'" *Id.* at 400.

16. See Daniel Price, *Some Observations on Chapter Eleven of NAFTA*, 23 HASTINGS INT'L & COMP. L. REV. 421, 426-27 (2000).

nations through dispute resolution.¹⁷ The willingness of member states to waive sovereign immunity and open themselves up to this type of liability is one of NAFTA's most unique features.

This feature also influences investors' decisions. Would-be corporate investors in the United States and Canada are often reluctant to make investments in Latin states due to a fear of expropriation by governments or a lack of clear regulatory policies.¹⁸ When the Mexican government nationalized the oil industry in 1938, some U.S. corporations lost their entire investment.¹⁹ Even with increased protections provided by international law, foreign investors remain concerned about the security of their Mexican investments. The Heritage Foundation, a conservative, pro-business think tank, warns potential investors that "[t]he threat of expropriation [by the Mexican government] is low, but the judicial system suffers from corruption and inefficiency."²⁰

A tangible mechanism by which U.S. and Canadian corporations may directly protect their business interests investments independent of the Mexican judicial system is an important consideration for otherwise reluctant investors to conduct business in Mexico.²¹ Therefore, without Chapter 11, NAFTA's attempt at removing trade barriers with respect to foreign investment in Mexico is arguably illusory.²²

17. See *id.*; Rene Lettow Lerner, *International Pressure to Harmonize: The U.S. Civil Justice System in an Era of Global Trade*, 2001 B.Y.U. L. REV. 229, 244 (2001).

18. Lerner, *supra* note 17, at 245.

19. See *id.*

20. THE HERITAGE FOUNDATION & THE WALL STREET JOURNAL, THE 2002 INDEX OF ECONOMIC FREEDOM: MEXICO, at <http://cf.heritage.org/index/country.cfm?ID=97.0> (last visited on Feb. 23, 2002) (quoting the U.S. Dept. of State).

21. See Mann, *supra* note 10, at 402 ("For Canada and the United States, Chapter 11 was attractive because it would provide protection to investors in Mexico, where the judicial process was generally considered corrupt or at least compliant with the will of the state."); Robert M. Kossick, Jr. & Julian Fernandez Neckelmann, *Structuring Private Equity Transactions in Mexico*, 6 NAFTA L. & BUS. REV. AM. 105, 160 (2000) (Advising potential investors of the political risks of investing in Mexico, the authors note that in the past, "expropriations have been compensated, but not necessarily at the just and fair rate, nor in a rapid manner. Given NAFTA's clear and protective approach to the subject, it is unlikely that expropriation will be an issue going forward.").

22. In making investment decisions, companies closely evaluate countries' "property rights" regimes, even for countries with liberalized trade policies. See THE HERITAGE FOUNDATION & THE WALL STREET JOURNAL, *supra* note 20 (rating countries' investment potential according to their protection of "property rights" in addition to trade and fiscal policies). Investment analysts for the Heritage Institute stated that "[a] number of factors contribute to a U.S. firm's decision to invest overseas. One very important consideration is the security of property rights in a given country. . . . Therefore, one would expect U.S. firms to allocate their investments in those

While Chapter 11 gives security to U.S. and Canadian investors in Mexico, Mexico also sought to gain benefits through Chapter 11. It viewed NAFTA's investor protections as a tool to attract foreign investments that would benefit the Mexican economy.²³

However, the member States surely did not contemplate the affront to their sovereignty that occurs when they are found liable for investors' losses arising from state and municipal regulation.²⁴ This liability is especially threatening in light of the apparent eagerness of businesses to resort to Chapter 11's binding arbitration mechanism. As one commentator noted, "[i]t is increasingly apparent that the private rights of foreign investors are being used not as a defensive protection against government abuse because an investor is a foreign-owned company, but as a strategic offensive threat to be wielded against government decision-makers rendering or considering decisions adverse to the interests of the company involved."²⁵

2. *Investor Rights and Government Obligations under NAFTA's Chapter 11*

Chapter 11 governs protection of foreign investments within the member nations.²⁶ Chapter 11 is divided into two sections. Section A discusses the obligations of party governments and the rights of investors against those governments. Section B describes the arbitration process for resolving disputes between investors and states. It "establishes a mechanism for the settlement of investment disputes that assures both equal treatment among investors of the Parties in accordance with the principle of international reciprocity and due process before an impartial tribunal."²⁷

countries where property rights are secure and the threat of expropriation is low." Philip C. English II and William T. Moore, *Property Rights Ambiguity and Effect of Foreign Investment Decisions on Firm Value*, in THE HERITAGE FOUNDATION & THE WALL STREET JOURNAL, THE 2002 INDEX OF ECONOMIC FREEDOM: MEXICO, at <http://www.heritage.org/index/2002/> (last visited on Feb. 23, 2002).

23. See Mann, *supra* note 10, at 402; Frederick M. Abbott, *The Political Economy of NAFTA Chapter Eleven: Equality Before the Law and the Boundaries of North American Integration*, 23 HASTINGS INT'L & COMP. L. REV. 303, 306 (2000).

24. See Abbott, *supra* note 23, at 306. Chapter 11 creates liability in the national governments of member States for improper acts of local governments, even if the federal government played no role. There is no provision under which local governments are independently liable.

25. Mann, *supra* note 10, at 405.

26. NAFTA, *supra* note 1, art. 1101(1).

27. *Id.* art. 1115.

Two articles of special importance within Section A set standards for government actions. Article 1105(1) establishes a “minimum standard of treatment” of foreign investments.²⁸ “Each Party shall accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security.”²⁹

A separate, commonly invoked provision forbids government expropriation of foreign investments. Article 1110(1) provides that “[n]o party may directly or indirectly nationalize or expropriate an investment of an investor of another Party in its territory or take a measure tantamount to nationalization or expropriation of such an investment except: (a) for a public purpose; (b) on a non-discriminatory basis; (c) in accordance with due process of law and article 1105(1); and (d) on payment of compensation in accordance with paragraphs 2 through 6.”³⁰

Chapter 11 also includes a provision that demonstrates the drafting parties’ intent regarding the treatment of environmental regulations. Article 1114 states that Chapter 11 shall not “be construed to prevent a Party from adopting, maintaining or enforcing any measure otherwise consistent with this Chapter that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental concerns.”³¹

3. *Dispute Resolution under NAFTA’s Chapter 11*

Investors objecting to their treatment by host nations may submit their disputes to binding arbitration.³² Article 1120 provides that the arbitral procedure is determined by the petitioner’s choice of the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID Convention),³³ the Additional Facility Rules of the

28. *Id.* art. 1105.

29. *Id.* art. 1105(1).

30. *Id.* art. 1110(1).

31. *Id.* art. 1114(1).

32. *Id.* arts. 1116 (claims by investor on its own behalf), 1117 (claims by investor on behalf of an enterprise).

33. Convention on the Settlement of Investment Disputes between States and Nationals of Other States, Mar. 18, 1965, 17 U.S.T. 1270, 575 U.N.T.S. 159 (entered into force Oct. 14, 1966), *available at*

<http://www.worldbank.org/icsid/basicdoc/9.htm>. The ICSID is a product of the World Bank, established to “facilitate the settlement of investment disputes between governments and foreign investors. . . [and] help to promote increased flows of international investment.” THE WORLD BANK GROUP, ABOUT ICSID, *at* <http://www.worldbank.org/icsid/about/about.htm> (last visited Feb. 23, 2002).

ICSID Convention,³⁴ or the arbitral rules of the United Nations Commission on International Trade Law (UNCITRAL).³⁵

The arbitration panel is composed of three arbitrators, one chosen by each party and a third arbitrator agreed on by the parties to the dispute.³⁶ If the parties cannot agree on a third panel member within 90 days, the ICSID Secretary General appoints one.³⁷ The process typically involves submissions of briefs by the parties and limited discovery followed by one or more decisions by the panel.³⁸ The arbitration process does not contemplate appeals.³⁹ However, arbitral judgments may be challenged in the national court of the "seat country" of the tribunal.⁴⁰ Domestic courts may refuse to enforce judgments that are contrary to public policy or that violate the country's laws regarding arbitral awards.⁴¹

In order to bring a dispute to arbitration, the parties are not required to exhaust administrative remedies.⁴² However, the investor must waive its right to administrative or judicial proceedings under the law of the host country and any other settlement mechanisms with respect to the disputed matter.⁴³

NAFTA arbitration judgments are not binding precedent on future panels.⁴⁴ However, subsequent panels may employ prior decisions to support their own rationale. While Chapter 11 decisions generally include a smattering of references to prior

34. Rules Governing the Additional Facility for the Administration of Proceedings by the Secretariat of the International Center for Settlement of Investment Disputes, ICSID Doc. 11 (June 1979), available at <http://www.worldbank.org/icsid/facility/facility.htm>. The additional facility rules are used in place of the Convention rules when either the investor or the government is a party to the Convention, but not both. Because Canada and Mexico are not parties to the Convention, the ICSID rules cannot currently apply to NAFTA arbitrations, and the ICSID Additional Facility rules may only apply when the investor is from the U.S. or the host country is the U.S. David A. Gantz, *Reconciling Environmental Protection and Investor Rights Under Chapter 11 of NAFTA*, 31 ENVTL. L. REP. 10646, 10652 n.59 (2001).

35. UNCITRAL Arbitration Rules, G.A. Res. 31/98, Dec. 15, 1976, available at <http://uncitral.org/english/texts/arbconc/arbitrul.htm> (last visited Feb. 23, 2002).

36. NAFTA, *supra* note 1, art. 1123.

37. *Id.* art. 1124.

38. See Gantz, *supra* note 34, at 10652.

39. See *id.*

40. See *id.*

41. William T. Waren, *Paying to Regulate: A Guide to Methanex v. United States and NAFTA Investor Rights*, 31 ENVTL. L. REP. 10986, 10992 (2001).

42. Gantz, *supra* note 34, at 10653.

43. NAFTA, *supra* note 1, art. 1121.

44. *Id.* art. 1136(1). However, NAFTA tribunals are guided by international law, of which the arbitral decisions are a part. See *id.*, art. 1131(1); Gantz, *supra* note 34, at 10664-65.

cases, the general inconsistency of the standards employed in such cases allows tribunals to select “persuasive authority” retrospectively. That is, panels may come to a conclusion and then find a prior decision to support it.⁴⁵

C. *Metalclad Corp. v. United Mexican States*

Metalclad Corp v. United Mexican States is a recent investor-state dispute in which a NAFTA arbitration panel ordered Mexico to compensate an American company for the diminished value of its Mexican investment caused by government actions.

1. *Metalclad is Prevented from Opening the Landfill*

COTERIN, a Mexican firm, applied for a permit from the Mexican government to construct a hazardous waste landfill at the La Pedrera site in the City of Guadalcázar in the State of San Luis Potosí.⁴⁶ Mexico’s permitting agency, the National Ecological Institute (INE), issued the federal permit in January 1993.⁴⁷ The State of San Luis Potosí granted COTERIN a land use permit for the construction of the facility at La Pedrera in May of that year.⁴⁸ Soon thereafter, Metalclad, a United States corporation, entered into an option contract to purchase COTERIN along with its permits for the hazardous waste facility.⁴⁹ Metalclad was advised by INE that the only permit it still needed to obtain was a federal operating permit.⁵⁰ Once that permit was issued, Metalclad exercised its option to acquire COTERIN in September 1993.⁵¹

Local government officials, citizens, and non-governmental associations opposed the proposal to site the landfill at La Pedrera.⁵² Officials blamed the landfill that previously operated at the site for health problems of the local population, including

45. See Gantz, *supra* note 34, at 10658-62 (describing different standards employed by arbitral panels in interpreting Article 1105’s “minimum standard of treatment”). “[T]ribunals appear quite willing to interpret the broad language of NAFTA in accordance with the tribunal members’ view of the language and its intent.” *Id.* at 10667.

46. Lucien Dhooge, *The North American Free Trade Agreement and the Environment: The Lessons of Metalclad Corporation v. United Mexican States*, 10 MINN. J. GLOBAL TRADE 209, 209-10 (2001).

47. *Id.* at 210.

48. *Id.*

49. *Id.*

50. *Id.*

51. *Id.*

52. *Id.* at 237, 240, 269.

a high rate of birth defects and chronic breathing disorders.⁵³ Additionally, a study conducted by a professor at the Autonomous University of San Luis Potosi (AUSLP) concluded that La Pedrera was a geologically unsuitable site for the landfill due to the presence of numerous aquifers, recent seismic activity, and other problems.⁵⁴

Despite local opposition, Metalclad began constructing the landfill. Five months into construction, the City of Guadalcazar charged that Metalclad failed to obtain a municipal construction permit and halted the project.⁵⁵ Metalclad then applied for the permit and resumed construction in anticipation of approval.⁵⁶ The landfill was scheduled to open in March 1995, but local demonstrators blocked access to the site, preventing its operation until November 1995.⁵⁷ In an attempt to address some of the major environmental concerns, and in hopes of beginning operations at the site, Metalclad entered into an agreement with the federal government to take specific remediation measures at La Pedrera. The company set aside a portion of its property for a native species reserve and agreed to engage in several other environmental and community service activities.⁵⁸

Despite these concessions, the Guadalcazar city council finally denied Metalclad's request for a municipal construction permit and brought a lawsuit challenging the validity of Metalclad's agreement with the Mexican government.⁵⁹ The City eventually dismissed the action.⁶⁰ However, in September 1997, the Governor of San Luis Potosi issued a decree establishing an ecologically protected area that encompassed Metalclad's landfill. The decree prohibited all industrial activity in the protected region, including landfill operations.⁶¹

53. *Id.* at 240.

54. *Id.* at 232. Other studies, including one requested and financed by Metalclad, came to contrary conclusions. *Id.* Upon its publication, the Metalclad-backed study was immediately contested by Greenpeace Mexico and a local environmental group. PUBLIC CITIZEN & FRIENDS OF THE EARTH, NAFTA CHAPTER 11 INVESTOR-TO-STATE CASES: BANKRUPTING DEMOCRACY: LESSONS FOR FAST TRACK AND THE FREE TRADE AREA OF THE AMERICAS 11 (2001), available at <http://www.citizen.org/documents/ACF186.PDF>.

55. Dhooge, *supra* note 46, at 211.

56. *Id.*

57. *Id.*

58. *Id.* at 238.

59. *Id.* at 211-12.

60. *Id.* at 212.

61. *Id.* at 240-41.

2. *The Decision of the NAFTA Arbitration Panel*

Metalclad filed a Chapter 11 claim requesting arbitration with ICSID under the Additional Facility rules⁶² in January 1997.⁶³ The claim cited violations of two NAFTA provisions: 1) Article 1105's requirement of "fair and equitable treatment" of investments in accordance with international law, and 2) Article 1110's prohibition against direct or indirect expropriation of investments without compensation.⁶⁴ The initial claims were based on Guadalcazar's refusal to issue a construction permit to Metalclad.⁶⁵ After San Luis Potosi's governor issued the ecological decree in September 1997, Metalclad added the facts surrounding the decree to its claim, alleging them to be an independent violation of Article 1105.⁶⁶

After three years of arbitral proceedings in Canada⁶⁷ ending in August 2000, the tribunal ordered Mexico to pay Metalclad damages of \$16.7 million for violations of both the expropriation and the "fair and equitable treatment" provisions of Chapter 11.⁶⁸

The panel first stated that its position was based on the provisions of NAFTA and applicable rules of international law, interpreted through NAFTA's preamble and annexes, and the objectives stated in Article 102(1).⁶⁹ These objectives included achieving "transparency"⁷⁰ and the "substantial increase in investment opportunities in the territories of the Parties."⁷¹

The panel separately considered Guadalcazar's denial of Metalclad's municipal construction permit application and San Luis Potosi's ecological decree. First, the panel determined that Guadalcazar's actions with regard to the permit denial (and

62. See *supra* notes 33-35 and accompanying text.

63. *Metalclad v. United Mexican States*, ICSID Case No. ARB(AF)/97/1, 21 Award of Aug 30, 2000, 40 I.L.M. 36, 38, ¶ 8 (2001).

64. *Id.* at 37, ¶ 1.

65. *Id.* at 44, ¶ 58.

66. *Id.* at 44, ¶ 59.

67. *Id.* at 38, ¶ 11. "In accordance with Article 21 of the ICSID Arbitration (Additional Facility) Rules . . . , the Tribunal . . . determined that the place of arbitration would be Vancouver, British Columbia, Canada. The parties accepted that determination by the Tribunal." *Id.*

68. *Id.* at 54, ¶ 131.

69. *Id.* at 46, ¶ 70; see also *supra* notes 6-8 and accompanying text (describing the objectives).

70. The tribunal defined transparency as "the idea that all relevant legal requirements for the purpose of initiating, completing and successfully operating investments made, or intended to be made, under the Agreement should be capable of being readily known to all affected investors of another Party." *Metalclad*, 40 I.L.M. at 47, ¶ 76.

71. *Id.* at 46, ¶ 70.

Mexico's tolerance of the city's behavior) constituted a violation of both Article 1105 and 1110.⁷² To describe the lack of "fair and equitable treatment" in violation of Article 1105(1),⁷³ the panel provided a copious description of the municipal and federal governments' conduct pertaining to the various permit requirements.⁷⁴ The panel stated that, as a municipality, Guadalupe did not have the authority under Mexican law to deny Metalclad a permit based on environmental factors.⁷⁵ The panel also noted Guadalupe's delay in rejecting Metalclad's final permit application.⁷⁶ On these bases, the panel found that Mexico did not "ensure a transparent and predictable framework for Metalclad's business planning and investment."⁷⁷

The tribunal based its finding that Mexico expropriated Metalclad's investment in violation of NAFTA, Article 1110(1) on its earlier conclusion regarding fair and equitable treatment.⁷⁸ The panel defined expropriation to include "covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use of reasonably-to-be-expected economic benefit of property."⁷⁹ It stated that by "breaching Article 1105 and by thus participating or acquiescing in the denial to Metalclad of the right to operate the landfill, . . . Mexico must be held to have taken a measure tantamount to expropriation in violation of NAFTA Article 1110(1)."⁸⁰ The panel finally found that the ecological decree was an alternate ground for finding expropriation because it forever prohibited Metalclad from operating its hazardous waste facility.⁸¹

The panel awarded damages equaling Metalclad's actual investment in reliance on federal permits and assurances.⁸² The sum was offset by the presumed remediation costs that would be borne by the Mexican government.⁸³ In total, Mexico was ordered to pay \$16.7 million in damages to Metalclad.⁸⁴

72. *Id.* at 50-51.

73. *Id.*

74. *Id.* at 47-9, ¶¶ 73-97.

75. *Id.* at 48, ¶¶ 81-84.

76. *Id.* at 49, ¶ 90.

77. *Id.* at 50, ¶ 99.

78. *Id.* at 50, ¶ 104.

79. *Id.* at 50, ¶ 103.

80. *Id.* at 50, ¶ 104.

81. *Id.* at 51, ¶ 111.

82. *Id.* at 52, ¶ 122.

83. *Id.*

84. *Id.* at 54, ¶ 131.

3. Appeal to the Supreme Court of British Columbia

Mexico appealed to the Supreme Court of British Columbia to have the award set aside.⁸⁵ The Canadian court found that the NAFTA tribunal inappropriately focused its Article 1105 analysis on the notion of transparency.⁸⁶ The court stated that transparency was merely an objective of the agreement, not the test for “fair and equitable treatment.”⁸⁷ The court further concluded that the tribunal wrongly based its finding of Article 1110 expropriation with regard to the permit denial on the improper transparency analysis of fair and equitable treatment, and was therefore also invalid.⁸⁸ However, the court did not set aside the award of damages to Metalclad because it did not find the tribunals’ finding of expropriation with regard to the ecological decree “patently unreasonable.”⁸⁹

II

ANALYSIS

Metalclad sends a signal to regulators and the regulated community about the supremacy of foreign investment. First, *Metalclad’s* definition of expropriation is overbroad in that it is more protective of private investments than the domestic laws of NAFTA party nations, it secures for foreign investors rights above and beyond those afforded to domestic companies, and it provides certainty to foreign investors at the expense of certainty

85. United Mexican States v. Metalclad Corp., [2001] B.C.S.C. 664 (Can.), available at <http://www.courts.gov.bc.ca/jdb-text/sc/01/06/2001BCSC0664.htm>.

86. *Id.* at 16-17. The British Columbia court noted that the NAFTA tribunal based its finding of an Article 1105 violation on Mexico’s perceived failure to “ensure a transparent and predictable framework for Metalclad’s business planning and investment.” *Id.* at 17. See also *supra* note 70 and accompanying text.

87. *United Mexican States*, [2001] B.C.S.C. 664, at 17, ¶¶ 72-76.

88. *Id.* at 18, ¶¶ 78-80. The court found that the tribunal grounded its determination that Mexico expropriated Metalclad’s investment in its failure to “ensure a transparent and predictable framework” and “the absence of a timely, orderly and substantive basis for the denial of the construction permit by the Municipality.” *Id.* The court viewed this statement as a clear reference to a lack of transparency. *Id.*

89. *Id.* at 21-23. In order to set aside the award, the court was required to find that all three of the tribunal’s findings of Chapter 11 violations “involved decisions beyond the scope of the submission to arbitration.” *Id.* at 29. The award was reduced, however, to \$15.6 million to remove from the original award interest that would have accrued prior to the issuance of the decree (since the court determined no violation occurred prior to the decree.) *Id.* at 29. Mexico appealed the court’s refusal to set aside the award, but later dropped the challenge and agreed to pay Metalclad the \$15.6 million. See Evelyn Iritani, *Metalclad NAFTA Dispute is Settled: The Impact of the Pending Resolution is Unclear for Future Investor Claims Under a NAFTA Provision*, L.A. TIMES, June 14, 2001, at C1.

for regulating entities. Second, the tribunal's decision undermines Chapter 11's goal of benefiting local communities by ignoring their concerns. *Metalclad* further reveals the illusory nature of NAFTA's environmental provisions. The arbitration panel's misguided analysis is especially disconcerting because it may be applied in future Chapter 11 cases or replicated in the Free Trade Area of the Americas (FTAA) agreement.

A. *Metalclad's Overbroad Interpretation of Expropriation*

1. *Metalclad Compensates Investors Where the Domestic Laws of Member States Would Not*

The tribunal's interpretation of NAFTA's expropriation provision provides broader protection for private investors than do the domestic laws of member states.⁹⁰ Mexico's constitution provides that "[p]rivate property shall not be expropriated except for reasons of public use and subject to payment of indemnity."⁹¹ However, the Mexican government is free to restrict the use of private property by both Mexican citizens and foreign nationals as long as it does not deprive the owner of title.⁹²

Canada's government has even more freedom to regulate use of private property. Under Canadian law, property owners cannot receive compensation from the government for losses resulting from regulation unless the regulation directly transfers a benefit from the property owner to the government.⁹³ Canadian courts only find a compensable taking in the event that the government actually seizes the property for its own use or destruction.⁹⁴ This is true even if regulation results in effective total loss of use of the property.⁹⁵

U.S. takings law is more generous to private property owners than both Mexican and Canadian law but still shows

90. Cf. Dhooge, *supra* note 53, at 261. The author concludes that the *Metalclad* tribunal elevated private property rights over their position in Mexican and Canadian law. *Id.*

91. CONSTITUCION POLITICA DE LOS ESTADOS UNIDOS MEXICANOS, tit. I, art. 27.

92. See Dhooge, *supra* note 53, at 261.

93. *Id.*

94. *Id.* (citing *A & L Invs., Ltd. v. Ontario*, 152 D.L.R. 4th 692, 702 (1997) ("the jurisprudence that has developed under the Charter [of Rights and Freedoms] has made clear that economic rights as generally encompassed by the term 'property' and the economic right to carry on a business, to earn a particular livelihood, or to engage in a particular professional activity all fall outside the... 'guarantee' against governmental takings)).

95. *Id.* (citing *Hartel Holdings Co. v. Council of the City of Calgary*, 8 D.L.R.4th 321, 324 (1984)).

considerable deference to regulators. Under U.S. takings jurisprudence, regulatory actions are found to be takings where they deprive property owners of all “economically beneficial or productive use” of the land.⁹⁶ Absent a total loss of economic value, regulatory takings claims are evaluated by balancing the public need and character of the regulation against the actual economic impact on the property owner and the reasonableness of a property owner’s “investment-backed expectations.”⁹⁷ In reality, U.S. courts generally have not found compensable takings even when very large economic losses have resulted from a regulation.⁹⁸ Courts have even rejected takings claims by property owners seeking to recover the value of their initial investment.⁹⁹

The *Metalclad* tribunal did not follow the standards set out by domestic courts in any of the member states in finding expropriation of Metalclad’s investment. Article 1110’s reference to “indirect” expropriation suggests the possibility of a valid claim when an investor suffers an economic loss caused by a regulation.¹⁰⁰ On its face, indirect expropriation is similar to a regulatory taking in U.S. law. However, the *Metalclad* tribunal stated that expropriation includes government actions that have “the effect of depriving the owner, in whole or in significant part, of the use of reasonably-to-be-expected economic benefit of property.”¹⁰¹ The *Metalclad* tribunal’s characterization of expropriation therefore incorporates the notion of compensation based solely on “significant” diminution in value, a standard much lower than that employed by the courts of the U.S.,

96. *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003, 1015 (1992). There is a “nuisance exception” to this rule, as explained in *Lucas*. Governments may enact regulations that prohibit all economically beneficial use of a property owner’s land when such regulation “does not proscribe a productive use that was previously permissible under relevant property and nuisance principles.” *Id.* at 1029-30.

97. See *Penn Cent. Trans. Co. v. New York*, 438 U.S. 104, 123 (1978).

98. The Supreme Court stated in *Penn Central* that “decisions sustaining other land-use regulations . . . uniformly reject the proposition that *diminution in property value, standing alone*, can establish a ‘taking’ . . .” *Id.* at 131 (emphasis added). See *Hadacheck v. Sebastian*, 239 U.S. 394 (1915) (court did not find a taking even where regulation caused value of property to decrease from \$800,000 to \$60,000). “[O]ur cases have long established that mere diminution in the value of property, however serious, is insufficient to demonstrate a taking.” *Concrete Pipe & Prods. of California v. Constr. Laborers Pension Trust for S. California*, 508 U.S. 602, 645 (1993).

99. *William C. Haas v. City & County of San Francisco*, 605 F.2d 1117, 1120-1121 (9th Cir. 1979).

100. NAFTA, *supra* note 1, art. 1110(1).

101. *Metalclad v. United Mexican States*, ICSID Case No. ARB(AF)/97/1, 21 Award of Aug 30, 2000, 40 I.L.M. 36, 28 (2001).

Canada, or Mexico.¹⁰² Indeed, the Canadian court recognized this anomaly on appeal, stating that the tribunal's "extremely broad definition of expropriation" would include even "legitimate rezoning of property."¹⁰³

A closer look at the tribunal's analysis reveals an even broader standard for expropriation than it claimed to apply. The tribunal based its finding of expropriation on its determination of a lack of "fair and equitable treatment" under Article 1105.¹⁰⁴ Therefore, the finding was rooted almost entirely in the lack of transparency in the government's actions.¹⁰⁵ The actual interference with the economic value of the property, a consideration inherent in almost all takings analyses, was hardly considered in *Metalclad*.

2. *Metalclad Does Not Comport with U.S. Takings Law*

Specific application of U.S. takings jurisprudence to the facts of *Metalclad* reveals the significance of the tribunal's deficient analysis. As stated above, the U.S. recognizes greater private property rights than does Canada or Mexico, yet even a U.S. court would not have concluded that Mexico effected a taking of *Metalclad's* investment without considering both the propriety of the government action and its effect on the value of *Metalclad's* property.¹⁰⁶ A U.S. court would first inquire whether *Metalclad* lost *all* economically beneficial use of its land.¹⁰⁷ Guadalcazar's refusal to issue a construction permit and the subsequent ecological decree probably eliminated the most profitable use of

102. See *supra* note 90; see also Lerner, *supra* note 17, at 246 (predicting that the regulatory takings claims heretofore brought under Chapter 11 "would have little chance of success under domestic U.S. takings law").

103. United Mexican States v. *Metalclad Corp.*, [2001] B.C.S.C. 664, 21, ¶ 99 (Can.), available at <http://www.courts.gov.bc.ca/jdb-text/sc/01/06/2001BCSC0664.htm>. However, the court concluded that it could not interfere with this question of law under the rules of international law. *Id.*

104. See *supra* note 88 and accompanying text.

105. *Id.*

106. Courts evaluate three factors set forth in *Penn Central* to determine whether a regulation results in a taking. Those factors are: economic impact of the regulation, its interference with reasonable investment backed expectations, and the character of the government action. *Penn Cent. Trans. Co. v. New York*, 438 U.S. 104, 124-25 (1978). For examples of the application of these factors, see *Keystone Bituminous Coal Ass'n v. DeBenedictis*, 480 U.S. 470, 495 (1987), and *Dist. Intown Props. Ltd. P'ship v. District of Columbia*, 198 F.3d 874, 883 (D.C.Cir. 1999). Accordingly, in U.S. courts, questions about both the economic effect of the action on *Metalclad's* property and the nature of the action would be indispensable inquiries.

107. See *supra* note 96 and accompanying text.

the land, but the NAFTA tribunal did not consider whether the property still has value for non-industrial uses such as tourism. While a U.S. court might not find the remaining uses of the property substantial enough to defeat a takings claim, it would consider enduring uses in order to determine the actual diminution of the property's value.¹⁰⁸

Under U.S. takings law, a fact-finder would weigh the public interest in Guadalcazar's actions to protect public health and the environment against the diminution in value of the land and the interference with Metalclad's investment-backed expectations.¹⁰⁹ The NAFTA tribunal failed to consider the public health justifications or ecological merits of the permit denial and decree. Additionally, the tribunal avoided discussion of actual diminution in property value and the degree to which Metalclad was on notice of such regulations.¹¹⁰

Had the tribunal conducted this more scrutinizing inquiry, it might not have so readily labeled Guadalcazar's actions, and the Mexican government's acquiescence, expropriation. In assessing the public benefit of the actions, the tribunal might have concluded that the permit denial had merit based on the 1991 geological study that found the La Pedrera site unsuitable and the claims of local officials that the landfill was responsible for serious health problems in the local community.¹¹¹ Furthermore, the tribunal might have determined that Metalclad was on notice of Guadalcazar's position prior to making a substantial investment based on Guadalcazar's refusal to issue the permit from the very beginning and consistent public opposition to the project.¹¹² On balance, these factors might lead a court to find that the public interest in the permit denial outweighed

108. See *supra* note 106.

109. See *supra* note 97 and accompanying text.

110. The issue of whether Metalclad had notice relates to whether its "investment-backed expectations" were reasonable. It is relevant that Metalclad engaged in a "heavily regulated" industry - hazardous waste. U.S. courts deem participants in heavily-regulated industries to be on notice of possible changes in the regulatory scheme that would affect their profits. See, e.g., *Golden Pacific Bancorp v. U.S.*, 25 Cl. Ct. 768, 771 (1992) ("plaintiff's reasonable investment-backed expectations could not possibly have been interfered with given the highly regulated nature of the banking industry which pre-existed their investment"); *Transohio Sav. Bank v. Director, Office of Thrift Supervision*, 1991 WL 201178, *10 (D.D.C. 1991) ("Plaintiffs, by virtue of their participation in a comprehensively regulated industry, can hardly claim 'distinct investment-backed expectations.'").

111. See *supra* note 54 and accompanying text.

112. See *supra* note 110 and accompanying text.

Metalclad's investment-backed expectations and could thus cause the court to decline to find a taking.¹¹³

Comparison of Chapter 11's protections to domestic laws illustrates the potential for overcompensation for legitimate regulation and reveals an unfair competitive advantage of foreign investors over nationals in the domestic market. Chapter 11 provides no protection for domestic investments.¹¹⁴ Because all of the Parties' domestic laws give more deference to regulators than NAFTA's Chapter 11, foreign investors might be compensated for the effect of regulations that domestic companies must accept.¹¹⁵ Similarly, one can imagine that the potential for NAFTA claims to be judged by the loose *Metalclad* standards could lead to comparative under-regulation of multi-national corporations relative to regulation of domestic industry.¹¹⁶ This analysis is not to suggest that domestic investors *should* be subject to less stringent regulation. It rather illustrates the absurdity of the disparity between Chapter 11 and domestic laws.

3. Metalclad's *Elevation of Foreign Investment over the Democratic Process*

The broad protections of foreign investment under NAFTA undermine the democratic processes that spawn challenged regulations. Chapter 11 gives international tribunals power to pass judgment on environmental regulations enacted by democratically elected bodies without the judicial doctrines of substantial deference to lawmakers and administrative agencies that constrains U.S. courts.¹¹⁷ Instead, *Metalclad* expresses a

113. See *supra* note 97 and accompanying text.

114. NAFTA, *supra* note 1, art. 1116, 1117 (providing that only *foreign* investors may request binding arbitration against their host nations.).

115. See Lucien J. Dhooge, *The Revenge of the Trail Smelter: Environmental Regulation as Expropriation Pursuant to the North American Free Trade Agreement*, 38 AM. BUS. L. J. 475, 547 (2001). ("NAFTA's creation of a right for foreign investors to seek damages arising from the adoption of measures, including environmental laws and regulations, by a host state raises the issue of equivalent rights for domestic investors.").

116. The potential for liability might create a chilling affect on regulations affecting foreign investments. See *id.* at 549-50 (stating that the potential for Chapter 11 claims dissuades governments from enacting environmental regulation by increasing the cost of the regulatory process). However, because domestic businesses lack the arbitration mechanism and broad protections of NAFTA, there is no similar disincentive to their regulation.

117. In the United States, courts afford a high level of deference to agencies that promulgate regulations pursuant to statutes. Under the Administrative Procedure Act, Ch. 324, 60 Stat. 237 (1946) (current version codified in 5 U.S.C. §§ 551-59, 701-06, 1305, 3105, 3344, 5372, 7521 (1982)), courts review agency action using the

policy that values industry profits over the right of states to regulate in the public's interest.

Commentators have noted the impropriety of requiring the public to pay private investors for profits lost due to environmental regulation.¹¹⁸ Yet that was the exact result of the *Metalclad* decision. It transferred the costs associated with investment risks from the company to the government.¹¹⁹ The *Metalclad* tribunal ignored the duty of governments to protect their citizens and improperly limited its focus to the duty imposed by NAFTA to protect foreign investment.

B. *Metalclad's Subversion of the Interests of the Affected Community*

Foreign investment is promoted as a tool for invigorating local economies. Indeed, included in NAFTA's preamble is the resolution to "create new employment opportunities and improve working conditions and living standards in [the member states'] respective territories."¹²⁰ The *Metalclad* tribunal did not recognize this community-oriented objective of foreign investment and failed even to address the validity of local concerns regarding the landfill.¹²¹ On the day of *Metalclad's* inaugural celebration, hundreds of local protestors prevented the opening of the facility. The governor of San Luis Potosi, who enjoyed widespread support from his constituents, also opposed construction of the

"substantial evidence" standard, which is applied deferentially. See Alfred C. Aman, Jr., *Administrative Law in a Global Era: Progress, Deregulatory Change, and the Rise of the Administrative Presidency*, 73 CORNELL L. REV. 1101, 1110 n.28 (1988). U.S. courts also express reluctance to overturn actions taken by democratically-elected legislatures.

In areas of social and economic policy, it is not for the courts to judge the propriety of the Legislature's decisions. "The Constitution presumes that, absent some reason to infer antipathy, even improvident decisions will eventually be rectified by the democratic process and that judicial intervention is generally unwarranted no matter how unwisely we may think a political branch has acted."

U.S. v. Sage, 906 F.Supp. 84, 87 (D.Conn. 1995) (citation omitted); see also Fisher Scientific Co. v. City of New York, 812 F. Supp. 22, 25 n.3 (S.D.N.Y. 1993) ("[T]he courts' foray into ongoing legislative activity should . . . be restrained by a healthy respect for separation of powers.").

118. See, e.g., *Dhooge*, *supra* note 55, at 548-49. Chapter 11 turns the "polluter pays principle" on its head by requiring the government (effectively, the public) to pay for the right to regulate for a healthy environment rather than requiring those who pollute the environment to compensate the general public for the injury. *Id.*

119. S. Benton Cantey, Note, *International Arbitration to Resolve Disputes under NAFTA Chapter 11: Investment*, 9 TULSA J. COMP. & INT'L L. 285, 302 (2001).

120. NAFTA, *supra* note 1, at preamble.

121. See *Dhooge*, *supra* note 46, at 263.

facility. It is significant that the community that would gain the most economic benefit from the landfill vehemently opposed it.¹²² The panel should have weighed these considerations in determining the validity of the government's actions that kept the landfill from operating.¹²³

C. *Metalclad Illustrating NAFTA's Lip Service to Environmental Protection*

The *Metalclad* tribunal's dismissive treatment of environmental concerns controverts express language in NAFTA that seeks to promote environmental protection. It is clear after the *Metalclad* award that NAFTA's promise to protect the environment is illusory when matched against protection of private industry investment. Indeed, the *Metalclad* tribunal devoted only one paragraph to explicit consideration of environmental values.¹²⁴

Tribunals are required to proceed in a manner consistent with NAFTA as a whole, considering more than just the provision governing the disputed activity.¹²⁵ Tribunals should therefore be guided by the Preamble, which states the Parties' resolution to pursue the objectives of the Agreement "in a manner consistent with environmental protection and conservation," to "promote sustainable development," and to "strengthen the development

122. See *supra* notes 52-57 and accompanying text.

123. Tribunals must consider all of NAFTA's provisions, not just those directly relevant to the controversy. NAFTA, *supra* note 1, at art. 1131. See Jason L. Gudofsky, *Shedding Light on Article 1110 of the North American Free Trade Agreement (NAFTA) Concerning Expropriations: An Environmental Case Study*, 21 NW. J. INT'L L. & BUS. 243, 249-50 (2000). Indeed, the *Metalclad* tribunal claimed to interpret NAFTA's purpose through the preamble and in fact incorporated a portion of the preamble into its discussion of "applicable law." See NAFTA, *supra* note 1, at 46, ¶ 70; *Metalclad v. United Mexican States*, ICSID Case No. ARB(AF)/97/1, 21 Award of Aug 30, 2000, 40 I.L.M. 36, at 46, ¶ 71 (2001) (noting that the "Parties to NAFTA specifically agreed to 'ENSURE a predictable commercial framework for business planning and investment'").

124. *Metalclad*, 40 I.L.M. at 49, ¶ 98. Even that limited discussion was egregiously dismissive of environmental concerns. *Id.* The finding of a violation of the fair and equitable treatment standard is not affected by NAFTA Article 1114, which permits a Party to ensure that investment activity is undertaken in a manner sensitive to environmental concerns. The conclusion of the Convenio and the issuance of the federal permits show clearly that Mexico was satisfied that this project was consistent with, and sensitive to, its environmental concerns. *Id.* The tribunal declined to consider environmental concerns raised by Mexico in its submissions. See Dhooge, *supra* note 46, at 263.

125. NAFTA, *supra* note 1, at art. 1131. See Jason L. Gudofsky, *Shedding Light on Article 1110 of the North American Free Trade Agreement (NAFTA) Concerning Expropriations: An Environmental Case Study*, 21 NW. J. INT'L L. & BUS. 243, 249-50 (2000).

and enforcement of environmental laws and regulations.”¹²⁶ Arbitral tribunals should also be guided by the environmental side agreement, which preserves the right of each Party to establish its own level of environmental protection.¹²⁷ The *Metalclad* tribunal averred that its decision was guided by “any agreement relating to the treaty which was made between all the parties in connection with the conclusion of the treaty.”¹²⁸ This language directly implicates the environmental side agreement, yet the tribunal failed to cite the agreement or even incorporate its values into its analysis.

Rather than respect these environmental provisions, the *Metalclad* tribunal baldly asserted that the issuance of federal permits and the agreement between Metalclad and the Mexican government requiring mitigation of certain environmental harm evidenced Mexico’s satisfaction with environmental concerns.¹²⁹ The tribunal did not provide support for its determination that the Mexican government’s environmental assessment was more valid than that of the municipality. The tribunal did not even mention the study that concluded that the La Pedrera site was geologically unsuitable for the landfill.¹³⁰ The inconsistency of the Mexican government’s and the municipality’s actions notwithstanding, the tribunal should have given some deference to the right of the local government to consider environmental factors in its permitting decisions.¹³¹

D. Implications for the Future

1. *Methanex Corp. v. United States*

The extent of the impact of *Metalclad*’s interpretation of NAFTA’s investor protection provisions will soon be revealed in *Methanex Corp. v. United States*, a pending Chapter 11 arbitration. Methanex is a Canadian producer and marketer of methanol, the main ingredient in the gasoline additive methyl

126. NAFTA, *supra* note 1, at preamble; see also *supra* note 123.

127. NAEEC, *supra* note 5, art. 3

128. *Metalclad*, 40 I.L.M. at 46, ¶ 70.

129. *Id.* at 49, ¶ 98.

130. See *supra* note 54 and accompanying text.

131. Environmental regulation falls within a local government’s police power to protect “the health, safety and welfare of the local citizenry.” Dhooge, *supra* note 46, at 263; see also *supra* note 117; Waren, *supra* note 41, at 10987 (characterizing NAFTA challenges to public health and environmental regulation as challenges to “core governmental functions”).

tertiary butyl ether (MTBE).¹³² After a University of California at Davis study concluded that MTBE poses a significant risk to water quality,¹³³ the state of California ordered the removal of MTBE from gasoline sold in the state by December 31, 2002.¹³⁴

Methanex does not dispute the merits of the Davis study or the accuracy of its conclusion.¹³⁵ Rather, the corporation states that there is no study documenting MTBE's effect on human health.¹³⁶ Methanex claims that California's action therefore constitutes an unreasonable and substantial interference with Methanex's investment and requests \$970 million in damages.¹³⁷

If the *Methanex* tribunal uses the *Metalclad* decision as a guide, the United States could be forced to pay the company compensation for its lost profits from the sale of methanol. While a U.S. corporation would probably not be entitled to compensation under domestic law,¹³⁸ a broad definition of expropriation that includes interference with "reasonably-to-be-expected economic benefit" could lead a NAFTA tribunal to the opposite conclusion.¹³⁹

The *Methanex* arbitration panel has not yet issued a decision. The case's mere existence, however, is troubling. First, the case illustrates the problem of an expropriation analysis that is divorced from any traditional notion of property rights. The claim is entirely based on diminished consumer economic activity, and all aspects of production are based in the investor's home state.¹⁴⁰

Second, Methanex illustrates the privileged status of foreign investors over domestic market participants.¹⁴¹ Unlike Methanex, domestic producers of Methanol do not have access to claims for compensation under NAFTA Chapter 11.¹⁴²

Finally, even if *Methanex* is unsuccessful in obtaining compensation for its lost profits, the existence of the case demonstrates the risk to states enacting environmental

132. See Dhooge, *supra* note 115, at 492.

133. See Waren, *supra* note 41, at 10988.

134. Exec. Order No. D-5-00 of the State of California, (Mar. 25, 1999).

135. Gantz, *supra* note 34, at 10656.

136. See Dhooge, *supra* note 115 at 513; see also *id.* at 513-19 (fully discussing Methanex's claim).

137. See *id.* at 519.

138. See *supra* notes 96-99 and accompanying text.

139. See *supra* notes 101-102 and accompanying text.

140. See Gantz, *supra* note 34, at 10656 (Methanex claims that the Executive order will "effectively end Methanex's methanol sales in California.").

141. See *supra* notes 114-116 and accompanying text.

142. See Dhooge, *supra* note 115, at 545.

protections. Governments are forced to invest resources to defend valid and important regulatory actions whenever such actions incidentally reduce the profits of a company from a NAFTA member nation. The potential for liability, indeed the mere prospect of defending an action, could have a chilling effect on environmental regulation.¹⁴³

2. *The Free Trade Area of the Americas Agreement*

The Free Trade Area of the Americas (FTAA) agreement could replicate the problems with NAFTA illustrated by *Metalclad* on a larger scale. The FTAA will establish NAFTA-style trade liberalization among 34 nations in the Americas.¹⁴⁴ The FTAA negotiators are using NAFTA as a model for removing trade restrictions and promoting the movement of goods and capital in the hemisphere.¹⁴⁵ Unless the FTAA drafters more specifically state their intent with regard to expropriation and environmental values, FTAA could replicate the problems with NAFTA illustrated by *Metalclad* on a larger scale.¹⁴⁶

CONCLUSION

NAFTA's investor protections, as illustrated by *Metalclad*, serve their original purpose too well – to the exclusion of other important values. Chapter 11 subjects local, state, and federal lawmakers to the constant worry that legitimate environmental regulations will result in liability. The result is over-

143. See R.C. Longworth, *Laws Skirted Using NAFTA: Clause Lets Firms Sidestep Labor, Environment Rules*, CHICAGO TRIBUNE, July 5, 2001, at N1; see also Dhooge, *supra* note 115, at 545-46 (“[F]oreign investors may now bring the threat of damages awarded in the context of a Chapter Eleven proceeding to bear upon their host governments during crucial stages of the public policy process.”). One commentator has even suggested that “[s]tate legislatures may want to repeal some state laws that appear to conflict with international agreements or they may want to amend laws to minimize the conflict . . . Committee reports and drafts of new legislation, similarly, can be adapted to reduce the risk of international challenges.” Waren, *supra* note 41, at 10999. The U.S. Supreme Court expressed a similar concern eighty years ago in *Pennsylvania Coal*, stating that “[g]overnment hardly could go on if to some extent values incident to property could not be diminished without paying for every such change in the general law.” *Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393, 413 (1922).

144. Sheryl Dickey, *The Free Trade Area of the Americas and Human Rights Concerns*, 8 HUM. RTS. BRIEF 26, 26 (2001). The free trade area will encompass all the nations of the Americas except Cuba. *Id.*

145. *Id.* at 26.

146. *Cf. id.* at 28 (noting NAFTA's failures in the labor arena and the implications replicating such failures in FTAA).

empowerment and under-regulation of private, foreign economic interests.

NAFTA party nations should seek to reclaim their sovereignty by clarifying and narrowing the definition of "expropriation" and "fair and equitable treatment." The parties should also give clearer guidance to tribunals regarding environmental protection by strengthening Article 1114 to mandate express consideration of environmental values in arbitral decision making.