NAFTA CHAPTER 11 TRIBUNALS AND THEIR IMPACT ON SIGNATORY STATES: A PARALLEL JUDICIAL SYSTEM AND ITS MANY POTENTIAL DANGERS

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Abstract

NAFTA's Chapter 11 tribunals were created to protect foreign investors from undue interference by host States. These tribunals have considerable adjudicative power in their own right, power that is international in nature. Consequently, Chapter 11 tribunals allow private entities, even relatively small ones, to have a voice in the international legal forum. This Note uses a few major tribunal decisions as case studies to illustrate the potential problems arising from the NAFTA Chapter 11 tribunals and then points out that this leaves open significant opportunities for international expansion by foreign investors in the NAFTA bloc.

I. INTRODUCTION

Globalization is an ongoing process that is heavily promoted by some people, reviled by others, and misunderstood by many. It can be roughly defined as the increasingly free movement goods and services globablly.[1]

In the United States, the North American Free Trade Agreement ("NAFTA") has been perhaps the greatest symbol of globalization and its attendant "negative" effects, encapsulated most memorably by Ross Perot's "giant sucking sound" description.[2] While organizations like the World Trade Organization have done considerably more to promote the interests of globalization and international economic efficiency, NAFTA is a much nearer phenomenon and therefore occupies more of the American public's

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[1] DANIEL C.K. CHOW & THOMAS J. SCHOENBAUM, INTERNATIONAL BUSINESS TRANSACTIONS 24 (Aspen Publishers 2005).

[2] ROSS PEROT WITH PAT CHOATE, SAVE YOUR JOB, SAVE OUR COUNTRY: WHY NAFTA MUST BE STOPPED – NOW! 41 (Hyperion Books 1993).

attention. Furthermore, since it directly affects the United States and its two neighbors, the politics of NAFTA also hit closer to home.

NAFTA has had clear effects on the American economy. Naturally, NAFTA has also affected the legal systems of the U.S. and its NAFTA trading partners, Canada and Mexico. Free trade agreements ("FTAs"), such as NAFTA, are particularly important to consider because they "internationalize" the scope of the value judgments made by domestic judges, giving greater scope and power to courts that rule in cases concerning FTAs.[3] As an example, the Fifth Circuit had no problem finding jurisdiction over a dispute between two Mexican companies when the only real tie to the U.S. was the cargo being given over from one company to the other; this indirectly resulted from the growth in trade between the U.S. and Mexico thanks to NAFTA.[4] This example illustrates how NAFTA indirectly has expanded the jurisdiction of U.S. courts (and opened similar reciprocal expansion by Mexican and Canadian courts over U.S. persons).

This Note is concerned with the power that NAFTA has arguably carved out in its own right, independent of the signatory States;[5] this power is then more directly passed on to private, legal entities. The most obvious way to explore this phenomenon is through the vehicle of NAFTA's Chapter 11, a provision meant to protect investors against expropriation by foreign governments by creating security and predictability.[6] Despite the fact that NAFTA is just one of approximately two thousand investment treaties that are currently in effect, it is subject to a disproportionate amount of scholarship, and much of that attention is focused squarely on NAFTA's controversial Chapter 11 and the potentially powerful tribunals it creates.[7] This controversial provision has been derided by both sides of the political spectrum with "the political right wary of its intrusion on sovereignty" and "the political left concerned that it favors investor rights over public welfare and chills appropriate environmental regulation that happens to interfere with investment."[8] Depending on the article, the journal and the intended

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[3] Andrew J. Walker, *Conflict of Laws Analyses for the Era of Free Trade*, 20 AM. U. INT'L L. REV. 1147, 1148 (2005).

[4] *Id.* at 1164-67.

[5] In this article, the term "State" is capitalized to signify that it refers to an international State, as opposed to a state within the United States.

[6] Howard Mann & Konrad von Moltke, NAFTA's Chapter 11 and the Environment: Addressing the Impacts of the Investor-State Process on the Environment 6 (1999) (working paper, *available at* http://www.iisd.org/pdf/nafta.pdf).

[7] Catherine M. Amirfar & Elyse M. Dreyer, *Thirteen Years of NAFTA's Chapter 11: The Criticisms, the United States's Responses, and Lessons Learned*, 20 N.Y. INT'L L. REV. 39, 39 (2007).

[8] John B. Fowles, *Swords Into Plowshares: Softening the Edge of NAFTA's Chapter 11 Regulatory Expropriations Provisions*, 36 CUMB. L. REV. 83, 84 (2006). Interestingly, NAFTA is the product of a Democratic Congress and Republican President, though

audience of a journal, commentators (be they scholars, practitioners, or students) often take on a single issue and deal with it in a very precise manner. While this method of study is informative and interesting, it usually fails to achieve a more "macro" perspective or derive any broader understanding which can more easily be applied to real practice.[9]

What gets lost in the academic to-and-fro are the long-term effects on the U.S. legal system, i.e., how NAFTA is expanding the power of the legal systems of the U.S., Canada, and Mexico, and what NAFTA is taking away from those legal systems. Of even greater concern, perhaps, is what power is being apportioned to none of the three NAFTA States but is instead devolving upon private entities.

This Note attempts to examine that dynamic by first briefly describing NAFTA generally and Chapter 11 specifically in Section II, then examining and analyzing a few of the major arbitrations involving Chapter 11 in Section III. Finally, in Section IV, the author hopes to point out the potential power that Chapter 11 has created for individuals in the international domain (confined currently to the NAFTA countries, although a major expansion of that domain is possible) and how much potential this opens up to smaller businesses.

II. NAFTA AND CHAPTER 11 – A BRIEF OVERVIEW

A. *NAFTA Generally*

For the purposes of this paper, it is important to keep in mind the goals of NAFTA. NAFTA seeks to employ principles such as national treatment, most-favored nation, and transparency in order to: 1) promote the elimination of trade barriers to facilitate trade in the concerned territories, 2) substantially increase the investment opportunities in the territories of the signatory States, 3) protect intellectual property rights, 4) create or enhance effective enforcement mechanisms, and 5) generally promote free trade and

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President Bush's endorsement received considerable support and a few improvements from his successor, President Clinton.

[9] This is not to say that such articles do not exist—they do—however, so much of the scholarship is disjointed and narrowly focused that it becomes difficult for those who are not immersed in this area to gain a broad perspective without at least partially immersing themselves. For good general overviews of the mechanics of NAFTA's Chapter 11 and broader impact outlooks, see also Amirfar & Dreyer, *supra* note 7, and Jessica S. Wiltse, Comment, *An Investor-State Dispute Mechanism in the Free Trade Area of the Americas: Lessons from NAFTA Chapter Eleven*, 51 BUFF. L. REV. 1145 (2003).

amity between the signatory States.[10] As the guiding forces, these objectives drive much of the implementation and interpretation of NAFTA.

NAFTA creates relatively few substantive legal standards, preferring that signatory States harmonize their legal systems via negotiation and cooperation.[11] However, this broad rule is qualified by the obvious provision that signatory States must conform their legal systems to NAFTA standards, when and where necessary.[12] NAFTA members must also avoid anti-competitive practices, although the provision proscribing this behavior is not enforceable and therefore non-binding.[13] NAFTA negotiators were uncomfortable in creating binding standards regarding non-trade matters.[14]

1. *Procedure*

While NAFTA does not dictate the creation of substantive laws, it does create basic standards for domestic legislative procedure.[15] Certain provisions of NAFTA essentially create due process by requiring that there be advance publication of guidelines concerning governmental procurement of goods and services as well as advance notice of any economically-related measure that may be adopted, and that a reasonable amount of time is allowed so that interested parties can comment upon the proposed measure.[16] The reasoning for this was simple: if the signatory States were expected under NAFTA to harmonize their domestic laws, then all three States would require transparent legislative procedure in order to assure other governments and their citizens that the legislative process was fair and open.[17] Otherwise, interested parties, foreign or otherwise, would have no ability to comment on the legislative process, let alone influence it.[18]

This is not necessarily nefarious, however; it is only fair that under a free trade agreement all parties involved should at least be able to see the

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[10] Carvana Hicks, *The NAFTA Aftermath: Analyzing a Free Trade Agreement Defectively Designed to Perpetuate Poverty and Defendency in Rural Mexico*, 13-SUM CURRENTS: INT'L TRADE L.J. 49, 51 (2004).

[11] Stephen Zamora, *NAFTA and the Harmonization of Domestic Legal Systems: The Side Effects of Free Trade*, 12 ARIZ. J. INT'L & COMP. L. 401, 402 (1995).

[12] *Id.* at 409.

[13] *Id.* at 409, 411-14. Negotiators were so uncomfortable with non-trade issues, nothing was included in NAFTA to deal with the illegal immigration issue that was of serious concern in the early 1990s and is now a headlining political issue in the United States. *See also,* Kevin R. Johnson, *Free Trade and Closed Borders: NAFTA and Mexican Immigration to the United States*, 27 U.C. DAVIS L. REV. 937, 959-60 (1994).

[14] Johnson, *supra* note 13, at 959-60.

[15] Zamora, *supra* note 11, at 410.

[16] *Id.*

[17] *Id.*

[18] *Id.*

rules of operation in other signatory States so that foreign economic entities enter those States forewarned of potential dangers.

2. *Enforcement*

NAFTA does not create specific enforcement mechanisms across the board; instead, it creates general standards and requires only that certain minimum requirements be fulfilled.[19] The minimum standards require of signatory States that at least proper notice be given to potential defendants, that these defendants be allowed the opportunity to present evidence in their defense, and that there generally be available civil and criminal remedies for claimants.[20]

Aside from these basics, however, Mexico has also had to adopt supplementary agreements, meant to ensure that the Mexican government will enforce certain kinds of domestic laws, such as environmental and labor laws.[21] Generally, there are concerns that Mexico's judicial system, though traditionally weak (although there has been reform in recent years), should not necessarily be reformed in the image of the American judicial system, which is litigious and therefore expensive.[22]

3. *Thoughts on General Framework of NAFTA*

Essentially, NAFTA, by creating legal requirements and standards, has given Canadian and American entities the ability to penetrate and strongly influence the Mexican legal system, although this is not the intended outcome.

Ideally, Mexican laws would not be substantively affected by the increased pressures applied by the United States and Canada as the economies of the NAFTA signatory States become more and more integrated. Even when seeking to attract investment, Mexico is still sovereign within its territory and can theoretically dictate laws to both domestic and foreign entities.

Realistically, however, Mexican laws will be influenced by the legal systems of their northern neighbors. Using the broader example of securities law, the United States has a very well developed securities regulation system, thanks to creation of the Securities and Exchange Commission and a powerful adjudication process.[23] Consequently, rather

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[19] *Id.* at 412.
[20] *Id.*
[21] Zamora, *supra* note 11, at 411-12.
[22] *Id.*
[23] James A. Kehoe, *Exporting Insider Trading Laws: The Enforcement of U.S. Insider Trading Laws Internationally*, 9 EMORY INT'L L. REV. 345, 348-51 (1995). Apparently, the SEC has no problem accepting a leadership role in this area and is fairly aggressive

than develop these laws from scratch, other States simply pattern their securities regulations on those of the U.S., albeit making them a bit weaker in the process.[24] Essentially, the U.S., as it expands its economic and commercial domain, is able to bring its own laws with it and virtually impose them on foreign systems, since those systems benefit so much from U.S. investment and the attendant economic benefits. Of course, if the purpose of the foreign legislature is to attract foreign investment, then this loss of legislative independence may seem a small price to pay.

Procedurally, NAFTA creates many avenues for the American legal influence. While it is fair for entities who may invest in a NAFTA State to have some say in the legislative process, it is not realistic to assume that this influence will be equal for all parties involved. A large U.S. corporation seeking to influence a Mexican law could conceivably be more influential because, relative to the overall economy, it is quite large and represents a significant amount of money. By contrast, consider a large Mexican corporation trying to do the same thing in the U.S. While it may be possible that this Mexican corporation would have enough money to be worth considering, more than likely, and relative to the overall American economy, that Mexican corporation would have little or no influence. In effect, by virtue of the larger economy from which they originate, American corporations have greater potential for impact in the Mexican political arena than a Mexican corporation will likely have in the American political arena. This power imbalance is facilitated by NAFTA, since the Mexican government has effectively signed on to allow this disparity to exist.

Even if the Mexican legislature could be relied on to operate impartially, or at least not be unduly influenced by American corporations, the Mexican judicial system is susceptible to improper influences and needs, in the eyes of the U.S. and Canada, to be reformed.[25] This susceptibility to "improper influences" cuts both ways: not only can foreign corporations take advantage of this looseness (though American corporations would be bound within the confines of the Foreign Corrupt Practices Act), but domestic corporations or claimants who are seeking to attack a foreign corporation could secure a victory in their court system using "improper practices." This instability is of serious concern to many foreign corporations for obvious reasons. To cure this, some scholars argue

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in trying to regulate insider trading internationally by working with foreign states in developing or more rigorously implementing securities regulations.

[24] Hannah L. Buxbaum, *Conflict of Economic Laws: From Sovereignty to Substance*, 42 VA. J. INT'L L. 931, 948-49 (2002). For other examples of similar trends, see Jurgen Basedow, *International Antitrust: From Extraterritorial Application to Harmonization*, 60 LA. L. REV. 1037 (2000); Thomas M. Gaa, *Harmonization of International Bankruptcy Law and Practice: Is It Necessary? Is It Possible?*, 27 INT'L LAW 881 (1993); and Robert W. Hillman, *Cross-Border Investment, Conflict of Laws and the Privatization of Securities Laws*, 55 LAW & CONTEMP. PROBS. 331 (1992).

[25] Zamora, *supra* note 11.

that if the Mexican system is reformed and modeled after the American or Canadian system—systems heavily influenced by Western Europe—it would be more acceptable, and, therefore, accessible and trustworthy to foreign multinational corporations ("MNCs") by virtue of being more familiar.[26] In turn, American courts would not need to necessarily interfere to protect the rights of American MNCs because the now-acceptable Mexican courts would be able to adjudicate the matter fairly by American standards.

The procedural and enforcement requirements written into NAFTA are powerful and create the potential for a lot of American or Canadian influence within Mexico. However, if these requirements do not allow indirect American or Canadian influence, like necessary reform or appropriate remedies, American or Canadian courts may be encouraged to keep legal disputes in the American or Canadian judicial systems in order to protect the interests of the American or Canadian corporations rather than leaving them in the Mexican domestic courts. In other words, if American and Canadian judges feel like natural or legal persons from their State may not receive fair treatment in the Mexican legal system, they may keep the dispute in the more sophisticated American or Canadian courts and thereby effectively expand their jurisdiction. On the other hand, a stronger and more acceptable Mexican legal system (both legislatively and judicially) would quell this concern and perhaps discourage American and Canadian courts from expanding their influence.

B. *NAFTA Chapter 11*

The previous discussion should have made clear that the mechanics of free trade are not simple, even within the relatively small geopolitical confines of the NAFTA bloc. There are legitimate concerns that foreign investors operating under the auspices of NAFTA will not receive fair treatment in a domestic court, potentially causing problems. Adjudicating disputes fairly within this bloc is of great concern and NAFTA's mechanism for adjudication outside of domestic courts is the tribunal system, created under Chapter 11 of the Treaty.

NAFTA's Chapter 11, the more specific focus of this Note, is unusual insofar as it breaks with the traditions of international law. Previously, when one State expropriated the property of another State's investor, the two States would resolve the conflict without directly involving the aggrieved individual.[27] NAFTA Chapter 11, on the other hand, allows the investor to resort to direct actions against a State,

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[26] *Id.*

[27] Chow & Schoenbaum, *supra* note 1, at 36. As Professors Chow and Schoenbaum note, the realm of public international law has considerably expanded of late and now encompasses public rights and governs commercial activities. *Id.*

regardless of what a negotiated investment contract or concession says about arbitration.[28] NAFTA Chapter 11 is the first time such an agreement was signed by two States with developed economies, and the implications of this were not appreciated at the time for it has yielded considerable litigation for both sides.[29]

NAFTA Chapter 11 applies to "measures adopted or maintained by a [p]arty" and how they apply to investors from the U.S., Canada and Mexico and their investments.[30] Foreign investors operating within the NAFTA bloc are granted "National Treatment" (treatment no less favorable than treatment given to domestic investors) and "Most-Favored-Nation" status (treatment no less favorable than treatment given to similar parties from other States). This creates a minimum standard of treatment for all natural and legal persons within the NAFTA bloc within any given State, though one's status as a domestic or foreign investor may create fewer or greater advantages, as we shall see.[31] States are also expected to accord the same "fair and equitable treatment and full protection and security" to all persons within NAFTA by engaging in no discriminatory behavior (with some exceptions).[32]

The most crucial article for the purposes of this Note is Article 1110: Expropriation and Compensation. This article was intended to protect investors, and has created the most chatter among commentators. Article 1110 forbids direct or indirect nationalization or expropriation of another Party's investment, or an investment made by a citizen of a Party.[33] Naturally, there are exceptions to this rule: a government may nationalize or expropriate where the action is undertaken for a public purpose, is

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[28] Guillermo Aguilar Alvarez & William W. Park, *The New Face of Investment Arbitration: NAFTA Chapter 11*, 28 YALE J. INT'L L. 365, 368 (2003).

[29] William S. Dodge, *Investor-State Dispute Settlement Between Devloped Coutnries: Reflections on the Australia-United States Free Trade Agreement*, 39 VAND. J. TRANSNAT'L L. 1, 15 (2006). Developed countries who sign bilateral investment treaties ("BITs") with developing countries usually include provisions similar to NAFTA Chapter 11 in order to protect themselves from the urges of developing countries to swallow up their investments. Since the investment tends to be a one-way street, the developed country rarely, if ever, faces litigation from their BIT partner. Since both Canada and the U.S. are developed and heavily invested in each others' economies, Chapter 11 was bound to be used as a more effective way (potentially) for foreign investors to recover money from the host State should an environmental or public health regulation come into effect. This has proven to be the case. *Id.*

[30] North American Free Trade Agreement, U.S.-Canada-Mexico, pt. 5, ch. 11, art. 1101, Dec. 17, 1992, 32 I.L.M. 605, 639.

[31] *Id.* at art. 1102-03, p. 639.

[32] *Id.* at art. 1105, p. 640. The analysis for "national treatment" (Art. 1102) is similar to "minimum standard of treatment" (Art. 1105) and both strongly inform the claim for a violation of Art. 1110. *See also* 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, 248 (2001).

[33] NAFTA, *supra* note 30 at art. 1110, p. 641-42.

nondiscriminatory, and employs adequate due process and provides compensation.[34] Compensation is to be the fair market value just prior to the expropriation and must be paid promptly.[35]

NAFTA Chapter 11 also does not seek to impinge upon environmental regulations that a Party may find necessary for the protection of the environment or public health.[36]

The rest of the NAFTA Chapter 11 provisions are largely procedural and will be referenced as necessary.

III. CASE STUDIES

A. *Introduction*

The first four cases examined in this section all have commonalities. First, each seeks to recoup losses allegedly caused by governmental regulatory measures, as opposed to more straightforward transfer of property rights to the government.[37] All of the regulatory measures involved were purportedly undertaken for the betterment of the public (a "public purpose").[38] Each of these claims also argues that the interferences with the property rights of the claimants had substantial economic effects, so much so that compensation is required.[39] The last case concerns water disputes, an area which will likely become more and more contentious in the coming years, and may become more vulnerable to NAFTA Chapter 11 tribunals.

Each case will be briefly outlined, with relevant case facts and holdings emphasized, and then will be briefly analyzed, highlighting the major implication of each holding.[40]

B. *The Metalclad Case*

Metalclad Corporation was a U.S. waste disposal company operating a Mexican subsidiary ("COTERIN") that sought a municipal

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[34] *Id.*

[35] *Id.*

[36] *Id.* at art. 1114.

[37] Kevin Banks, *NAFTA's Article 1110—Can Regulation Be Expropriation?*, 5 NAFTA: L. & BUS. REV. AM. 499, 503 (1999).

[38] *Id.* at 504.

[39] *Id.*

[40] The major criticisms of NAFTA Chapter 11 tribunals were brilliantly dealt with in Catherine M. Amirfar & Elyse M. Dreyer's article, *supra* note 7, which in many ways mirrors this article, and does so more eloquently. As noted therein, the major criticisms of NAFTA Chapter 11 tribunals are that they threaten finality of judgment in domestic courts, potentially offset environmental and health regulations and create a competitive advantage for foreign investors. *Id.* at 41.

license to operate a hazardous waste treatment facility near Guadalcazar, Mexico.[41] The license was rejected, although Metalclad did acquire three permits from Mexican state and federal authorities.[42] Metalclad, upon the assurances of federal and local regulators that no license was needed, began to build its facility without a municipal license, although it chose to apply for this permit, having already been rejected once.[43] After Metalclad had already invested considerable sums in the project and completed construction, but before any permit was issued, the state government declared the entire area an ecological zone, effectively closing down Metalclad's operation and rendering its investment worthless.[44] Metalclad then sought the protection of NAFTA Chapter 11 by filing claims against Mexico for violating Articles 1105 and 1110.[45] The tribunal made history by ruling against a State and in favor of the foreign investor, going so far as to award damages because Mexico had violated Articles 1105 and 1110(1).[46]

On appeal, Mexico argued that "[t]he tribunal committed two acts in excess of jurisdiction in connection with Article 1105."[47] Mexico first argued that "the Tribunal used NAFTA's transparency provisions as a basis for finding a breach of Article 1105."[48] Second, Mexico contended that the Tribunal then created essentially new transparency obligations that have no basis in the text of NAFTA.[49] Furthermore, Mexico argued that the tribunal inappropriately interpreted Mexican domestic law.[50] The Supreme Court of British Columbia, the appellate court, found these arguments compelling enough to warrant a partial reversal of the tribunal's decision (a first).[51] The tribunal had construed expropriation in Article 1110 too broadly, making even incidental interference with an investment compensable even when the host State derived no benefit from the interference.[52] The appeals

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[41] United Mexican States v. Metalclad Corp., 2001 BCSC 664, ¶¶ 3, 6-7, 13 (2001), *available at* http://naftaclaims.com/Disputes/Mexico/Metalclad/MetalcladJudgement.pdf.

[42] *Id.*

[43] Fowles, *supra* note 8, at 95.

[44] United Mexican States v. Metalclad, *supra* note 41, at ¶¶ 9, 11, 17.

[45] Jennifer Trousdale, Comment and Casenotes, *The International Investor's Guide to Retaining a Successful NAFTA Chapter 11 Award on Appeal*, 13 L. & BUS. REV. AM. 217, 221 (2007).

[46] Chris Tollefson, *Metalclad v. United Mexican States Revisited: Judicial Oversight of NAFTA's Chapter 11 Investor-State Claim Process*, 11 MINN. J. GLOBAL TRADE 183, 194 (2002). *See also* Metalclad Corp. v. United Mexican States, ICSID (W. Bank) Case No. ARB(AF)/97/1, 40 I.L.M. 36, 54 (Arb. Trib., Vancouver, B.C., Can. 2001).

[47] United Mexican States v. Metalclad Corp., *supra* note 41, at ¶ 66

[48] *Id.*

[49] *Id.*

[50] *Id.*

[51] *Id.* at ¶¶ 133-37.

[52] Metalclad Corp. v. United Mexican States, *supra* note 46, at 50.

court did not explicitly reject this broad expropriation idea but used a different line of reasoning, one less nebulous and more tailor-made to this particular case, thereby "dulling the edge of the proverbial sword" by approaching the issue more cautiously.[53]

The *Metalclad* case, when considered in conjunction with the *Methanex* case (discussed *infra*) creates serious concerns about problems of overly broad and too-narrow interpretations and generally inconsistent rulings from NAFTA Chapter 11 tribunals. Because these NAFTA tribunals only bind the parties to the arbitration and have no precedential value, the decisions made by one tribunal technically have no effect on any future arbitrations. It is probably naïve, however, to think that later tribunals never look back on the prior holdings for help and support.[54]

C. The S.D. Myers Case

S.D. Myers, Inc., a U.S. corporation, operated a Canadian subsidiary that exported polychlorinated biphenyls (PCBs) to the U.S. for disposal.[55] Canada passed a neutral regulation that banned PCB exportation because of environmental and human health safety concerns, which caused S.D. Myers to bring a Chapter 11 claim against Canada for violation of Articles 1102, 1105, 1106, and 1110.[56] S.D. Myers claimed that Canada prepared the measure with full knowledge of their business in Canada and acted specifically against a U.S. investor.[57] The tribunal found that both Articles 1102 and 1105 had been violated because the Canadian government had denied S.D. Myers treatment as favorable as other similarly situated Canadian companies and because the Canadian exportation ban "blatantly preferred domestic investors over foreign investors."[58] The Article 1106 and 1110 claims were denied.[59]

The *S.D. Myers* case essentially undermined Canada's environmental regulations and "obligations under international law to

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[53] Fowles, *supra* note 8, at 97-98.

[54] Jessica C. Lawrence, Note, *Chicken Little Revisited: NAFTA Regulatory Expropriations After Methanex*, 41 GA. L. REV. 261, 264 (2006). In the *Metalclad* appeals decision, for example, Judge Tysoe of the British Columbia Supreme Court references the reasoning of other NAFTA tribunal cases, choosing to reject at least the reasoning of *S.D. Myers* (discussed *infra*). *See* Metalclad, *supra* note 46, ¶¶ 61-65.

[55] Jessica S. Wiltse, Note, *An Investor-State Dispute Mechanism in the Free Trade Area of the Americas: Lessons from NAFTA Chapter 11*, 51 BUFF. L. REV. 1145, 1166 (2003). The PCBs were exported with the special permission of the Environmental Protection Agency. *Id.*

[56] Partial Award on the Merits, S.D. Meyers Inc. and Gov't of Canada, at 28-31, ¶¶ 130-143 (Nov. 13, 2000), *available at* http://www.naftaclaims.com/Disputes/Canada/SDMyers/SDMyersMeritsAward.pdf.

[57] *Id.* at 29, ¶ 132.

[58] Trousdale, *supra* note 45, at 223.

[59] Partial Award, *supra* note 56, at 80, ¶¶ 322-23.

prohibit the transboundary movement of hazardous wastes" using NAFTA Chapter 11, a provision meant to protect investors against takings by a foreign government.[60] Canada's motives may not have been purely environmental when passing the regulation, but the fact remains that an environmental regulation, a matter of sovereign control, was nullified quickly and effectively by a tribunal because of a single complaint brought by a lone foreign company.[61]

S.D. Myers points to the strong ability of foreign investors to circumvent environmental regulations that post-date the investment in the host State; those investors can then exit a problematic situation with cash in hand. Perhaps of even greater concern is the fact that domestic entities may not be able to get similar treatment because they are limited to domestic courts and do not have NAFTA Chapter 11 provisions to protect their interests as strongly. This creates a strong competitive advantage for any foreign entity in comparison to their domestic rivals, since foreign companies do not have to "just live with" environmental regulations. This advantage is particularly pronounced in chemical-related businesses, where a business is just one high-profile study away from being dismantled.

D. The Loewen Case

The *Loewen* case was brought by a competitor of Loewen Group, Inc., a Canadian funeral home company, in a Mississippi state court where a questionable trial over a commercial dispute resulted in Loewen being ordered to pay $500 million damages. An appeal required posting of a bond in the amount of 125% of the judgment, making an appeal in Mississippi virtually impossible for Loewen.[62] Loewen settled and then promptly filed suit against the U.S. in a NAFTA Chapter 11 tribunal, alleging violations of Articles 1102 (because of discrimination against a foreign investor), 1105 (because of a failure to adhere to even a minimum standard of treatment) and 1110 (because of the excessive verdict and an inability to reasonably appeal).[63] Despite this dramatic fact scenario, Loewen was denied remedy

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[60] Brian Trevor Hodges, *Where the Grass is Always Greener: Foreign Investor Actions Against Environmental Regulations Under NAFTA's Chapter 11, S.D. Myers, Inc. v. Canada*, 14 GEO. INT'L ENVTL. L. REV. 367, 369 (2003).

[61] *Id.* Canada sought judicial review of the case but was denied essentially because of the broad powers granted under NAFTA Chapter 11. *See* Judgment, S.D. Myers Inc. and Gov't of Canada, ¶ 76 (Jan. 13 2004), *available at* http://www.naftaclaims.com/Disputes/Canada/SDMyers/SDMyers-Canada-JRT-FCTDJudgment.pdf.

[62] Loewen Group, Inc. v. United States, ICSID (W. Bank) Case No. ARB(AF)/98/3, 42 I.L.M. 811, 812, ¶¶ 3-5 (Arb. Trib., Washington, D.C. 2003).

[63] *Id.* at ¶¶ 7-8, and 816, ¶¶ 39-40 (the appeal was reasonable because the bond requirement was a percentage of the staggering verdict).

due to a lack of jurisdiction.[64] The tribunal's disgust with the Mississippi court proceedings was obvious throughout the decision and dicta seem to imply that given adequate jurisdiction, a case similar to this one could be considered an expropriation.[65]

A case like this calls into question the criticisms of those who complain that NAFTA tribunals are a convenient way for foreign investors to circumvent the local judicial process and get out without having to "exhaust all local remedies" because, despite the egregious case facts, the tribunal declined to get involved, essentially punting the case back to the U.S. court system.[66] However, the dicta of the *Loewen* tribunal again displays strong sentiments in favor of the investor, even if it is hard to feel any other way when reading the case facts; the acid criticism leveled by the tribunal towards the Mississippi judge essentially laid blame, from an international law standpoint, at the door of the U.S. federal government.[67] Some critics take this as a sign that other aggressive foreign investors may be able to contest decisions by state supreme courts as well as the Supreme Court of the United States in a Chapter 11 tribunal.[68] Foreign investors would thereby gain another tool not available to the domestic investor, whose ability to challenge a court decision must end domestically.[69] Concerned critics call it an "all-out attack on democracy" because it would thwart the purpose of the jury system.[70]

These critics probably overstate the issue here, as the Loewen's tribunal can be more accurately described as saying that a court (be it American, Canadian, or Mexican) can be considered to have expropriated where it has imposed a decision that discriminates against the foreign investor on the basis of their status as foreigner.[71]

Loewen displays the opposite problem to the one seen in the *S.D. Myers* case because here the foreign investors are villainized and put through a grueling trial process. Worse, they can neither find an appeal domestically (due to the high value of the bond required in this case), nor

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[64] *Id.* at ¶ 1.

[65] *Id.*, at 817, ¶ 44 ("grossly excessive verdict"); at 819, ¶ 54 ("Having read the transcript...we have reached the firm conclusion that the conduct of the trial judge was so flawed that it constituted a miscarriage of justice amounting to a manifest injustice as that expression is understood in international law.").

[66] *Id.* at 819, ¶¶ 54-55.

[67] Amy K. Anderson, Note, *Individual Rights and Investor Protections in a Trade Regime: NAFTA and CAFTA*, 63 WASH. & LEE L. REV. 1057, 1069 (2006); *see also* Loewen, *supra* note 62, at 820, ¶¶ 57-61; 821, ¶¶ 65-69. The tribunal also made special note that Loewen's counsel failed to object to the prejudicial conduct. *Id.* at 823, ¶¶ 71-76.

[68] Anderson, *supra* note 67.

[69] *Id.*

[70] NAFTA: Public Citizen Calls NAFTA Suit Attack on Democracy, Jury System, 15 INT'L TRADE REP. (BNA) 2007 (Dec. 2, 1998).

[71] *Id.*

with a NAFTA Chapter 11 tribunal (the tribunal held off from engaging the merits because Loewen had not yet exhausted all local remedies). Even if a tribunal were used to overturn a state court decision, the opposite problem would emerge, where NAFTA would be seen to directly interfere and overturn a court decision and thereby blatantly violate the sovereignty and sanctity of that State's courtroom. Xenophobic citizens would have a field day, no matter the true circumstances of the case.

Loewen is, of course, also an excellent example of why the NAFTA tribunals are beneficial as they provide a parallel structure for the acquisition of justice if the rights of the foreign investor are dealt with unfairly in domestic courts.[72]

E. The Methanex Case

Methanex v. United States arose from a legislative ban in California of methyl tertiary-butyl ether (MBTE), a gasoline additive used to increase octane ratings and reduce tailpipe emissions.[73] The California legislature sought to ban MBTE because of concerns that it would seep into the groundwater and therefore pose a public health and environmental danger.[74]

Methanex Corporation is a Canadian corporation that produces methanol (a major component of MBTE) and because of the California ban lost a large market for its product. Within ten days of the ban, Methanex had lost some $150 million in market capitalization.[75] Methanex brought a complaint against the U.S. in a NAFTA Chapter 11 tribunal, alleging violations of Articles 1102, 1105 and 1110, all of which combined to create an expropriation.[76] According to the tribunal, however, the law was not tantamount to an expropriation because it "was made for a public purpose, was non-discriminatory and was accomplished with due process...[and] Methanex's claim under Article 1110(1) of expropriation...fails".[77]

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[72] Amirfar & Dreyer, *supra* note 7, at 42.

[73] Methanex Corp. v. United States (NAFTA/UNCITRAL Aug. 3, 2005), *available at* http://www.state.gov/documents/organization/15035.pdf. *See* Kara Dougherty, Comment, *Methanex v. United States: The Realignment of NAFTA Chapter 11 with Environmental Regulation*, 27 NW. J. INT'L L. & BUS. 735, 736 (2007).

[74] U.S. Envtl. Prot. Agency (EPA), Rep. No. 420-R-99-021, Achieving Clean Air and Clean Water: The Report of the Blue Ribbon Panel on Oxygenates in Gasoline 76 (1999), *available at* http://www.epa.gov/otaq/consumer/fuels/oxypanel/r99021.pdf ((MBTE is highly soluble and relatively small amounts can render large amounts of water unusable due to potential side effects; MBTE is not as biodegradable as other fuel components).

[75] Dougherty, *supra* note 73, at 739.

[76] Methanex Corp. v. United States, Claimant Methanex Corp.'s Second Amended State of Claim, Methanex Corp. v. U.S., ¶¶ 219-320 (Arb. Trib. 2003), *available at* http://www.state.gov/documents/organization/15035.pdf (last visited Mar. 25, 2008).

[77] Methanex Corp. v. United States, pt. IV, ch. D, ¶ 15 (NAFTA/UNCITRAL Aug. 3, 2005), *available at*

The *Methanex* tribunal's analysis chose not to follow the broader reading of the *Metalclad* tribunal, and instead opted for a narrower reading.[78] However, the decision once again highlighted the uncertainty inherent in NAFTA Chapter 11 tribunal. In addition, the debate over which way the *Methanex* tribunal would rule underscores the tension arising from this uncertainty and the more general uncertainty inherent in the vague language of Chapter 11.[79]

As noted earlier, *Methanex*, when looked at in conjunction with *Metalclad*, presents an odd picture: because of the lack of precedent in the NAFTA Chapter 11 tribunal system, the decisions would appear at odds with each other. This sort of unpredictability is disliked by businesspeople and, therefore, confounds the fundamental goal of NAFTA: to promote free trade.

F. Water Disputes

The allocation of fresh water in the NAFTA bloc is also a cause for concern as water is used more heavily by more people and sources begin to dry up due to overuse.[80] Because of this scarcity, NAFTA States are beginning to squabble over when water becomes a good or commodity, and therefore becomes subject to the demands of NAFTA. Since that initial definition is not clear, there is a much higher risk of litigation going against the States, thereby depriving them of water rights within their own territory.[81]

This uncertainty has forced Canada to implement a bulk export ban for water—the fear is that once water from Canada becomes a commodity on the open market and a "good" as defined by NAFTA, the Canadian government will be unable to regulate water export, even during droughts.[82] This ban will hold for now, but as water scarcity becomes a larger problem abroad and in the NAFTA bloc particularly, there will be greater pressure for Canada to lift the ban and expose itself to international commercial interests and litigation.[83]

One reason for Canada's trepidation may be because it watched the Texas water dispute unfold. This dispute arises from the 1944 International Boundary Waters Treaty signed by the U.S. and Mexico, which laid out

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http://naftaclaims.com/Disputes/USA/Methanex/Methanex_Final_Award.pdf. See also Lawrence, *supra* note 54, for excellent discussion of Methanex generally.

[78] Lawrence, *supra* note 54, at 263.

[79] Dougherty, *supra* note 73, at 744.

[80] Gregory F. Szydlowski, *The Commoditization of Water: A Look at Canadian Bulk Water Exports, the Texas Water Dispute and the Ongoing Battle Under NAFTA for Control of Water Resources*, 18 COLO. J. INT'L ENVTL. L. & POL'Y 665, 665-69 (2007).

[81] *Id.*

[82] *Id.* at 675-77.

[83] *Id.* at 677.

rules for apportioning water that flowed in and out of both States.[84] Beginning in 1992 and until early 2005, Mexico did not send the required amounts of water to the U.S., thus causing damage to the agriculture in the U.S. due to an inadequate water supply from Mexico. Mexico, it seems, was redirecting the water to certain regions where more water-consumptive (and lucrative) crops were being grown.[85] It would seem, then, that the Mexican government redirected those waters to advantage domestic investors at the expense of foreign investors, i.e., the investors in the U.S. who had been relying on that water, which is a violation of Articles 1102 and 1105; the investors brought a claim under Article 1110 as well.[86] Consequently, those U.S. investors are now suing for damages, alleging that they would have reaped greater rewards had the water had been sent as it should have been, and their harm amounts to an expropriation under NAFTA Chapter 11.[87]

Mexico naturally denies these claims, asserting that water is not a tradable commodity and therefore cannot be litigated under NAFTA, and that there is no violation of private rights here since the water rights belong to the U.S. government, not the investors.[88] This argument could have carried the day since the Mexican government accumulated water debt following the procedure laid out in the 1944 Water Treaty and then repaid it also according to the correct procedures.[89] Given that the investors' water rights, if they even exist, stem directly from a treaty to which they are not party, as long as the Mexican government does not violate the treaty, there can be no problem.[90] Also, given that the 1944 Water Treaty creates no private rights, its provisions operate between two sovereign States and is therefore really only challengeable between those two entities.[91]

The tribunal, in its recently rendered decision, made several pronouncements and essentially upheld the above assertions of the Mexican government. First, NAFTA Chapter 11 is not triggered when enterprises wholly in one State are affected by actions taken in another State.[92] The tribunal goes on with a discussion explaining that NAFTA Chapter 11 was

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[84] *Id.* at 679.

[85] David M. Quealy, Comment, *Bayview Irrigation District, et. al v. United Mexican States: NAFTA, Foreign Investment and International Trade in Water—A Hard Pill to Swallow*, 17 MINN. J. INT'L L. 99, 111 (2008).

[86] Paul Stanton Kible & Jonathan R. Schulz, *Rio Grande Designs: Texans' NAFTA Water Claim Against Mexico*, 25 BERKELEY J. INT'L L. 228, 257-58 (2007).

[87] *Id.*

[88] Szydlowski, *supra* note 80, at 681.

[89] Kible & Schulz, *supra* note 86, at 257-58.

[90] *Id.*

[91] *Id.*

[92] Bayview Irrigation District, et al. v. United Mexican States, ICSID (W. Bank) Case No. Arb.(AF)/05/01 23 ¶ 101 (Arb. Trib. Washington, D.C. 2007), *available at* http://www.naftaclaims.org/Disputes/Mexico/Texas/Bayview_Jurisdictional_Award_19-05-07.pdf.

not meant to be wielded broadly and should be construed fairly narrowly to avoid "unintended results" such as giving domestic investors an ability to interfere with foreign measures affecting their investment.[93] The Texan investors' assertion of ownership of water in Mexico and having "water rights" was likewise rejected by the tribunal as being conceptually problematic. The tribunal then asserted that the water rights of the Texan investors derived only from the Texan government and, therefore, existed only in Texas.[94] The tribunal concluded that unless the investors made an investment in Mexico, they could not raise a claim under NAFTA Chapter 11.[95] While this is an encouraging ruling, it should be remembered that NAFTA Chapter 11 tribunal findings are not binding—theoretically, there is nothing to prevent a future tribunal from finding differently from a prior tribunal.

The Texas water disputes and the Canadian ban on bulk water exports highlight the potential for private individuals from the NAFTA bloc to directly interfere with the relations of sovereign States, thereby circumventing the democratic process generally. This last case study ended well enough (from a sovereignty standpoint), but the reverberations have been strong enough for Canada to be completely unwilling to expose itself to liability, despite the opportunity for great profits. Even though the Texas case was resolved favorably to the interests of State actors, as opposed to private actors, Canada may still be unwilling to enter the fray because of the unpredictability of the NAFTA tribunal system due to the lack of a uniform body of law to interpret and a lack of precedent.

IV. CONCLUSIONS

Thus far this Note has briefly surveyed some of the major disputes that have been brought before a NAFTA Chapter 11 tribunal. This Note is meant to provide a solid surface from which to make some observations about how these tribunals are affecting the legal system of the U.S. and likely also those of Canada and Mexico. Each case study, though brief, was meant to highlight a different problem and potential effects on a NAFTA Party's legal system.

NAFTA Chapter 11 tribunals, as they stand, can be capricious and arbitrary, meddlesome in the laws of States, damaging to the finality of judicial awards and potentially can have ramifications even between the relations of two sovereign States. This Note does not intend to be partisan and demand either a repeal or a massive overhaul of NAFTA Chapter 11.

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[93] *Id.* at ¶¶ 103-08.

[94] *Id.* at ¶¶ 113-19.

[95] *Id.* at ¶ 122.

Instead, this Note merely seeks to make the potential pitfalls more noticeable and urge some stronger, more coherent and less nebulous boundaries to NAFTA Chapter 11 tribunals so that they can operate within well-defined limits and not tempt the avarice of investors at the expense of the environment, public health and the autonomy of States and their legal systems.

In the meantime, enterprising individuals should take advantage of a system that is so loose and inconsistent. For the small- or medium-sized business owner, expanding into a foreign market within the NAFTA bloc potentially creates a number of advantages. First, concerns about denial of justice in the domestic system are considerably allayed because of the parallel tribunal system that NAFTA has created. Second, this parallel system creates an inherent advantage for foreign businesses since they not only have an extra level of appeals, but also can effectively circumvent environmental and health regulations that are more stringently applied to domestic entities. Last, the uncertainty inherent in this system creates another advantage as it is likely to result in tentativeness in most other businesses, opening up opportunities for the bold. Naturally, the risks involved are increased due to the inherent uncertainty surrounding the system, but then larger rewards tend to be reaped in riskier situations.

Another avenue of potential profit will arise when the FTAA is finalized. The FTAA is based at least partially on NAFTA and the tribunal process of the FTAA may become more refined. Therefore, studying the lessons of NAFTA Chapter 11 tribunals may give enterprising individuals an advantage when and if the FTAA is eventually implemented, allowing quicker entry into a newer market with (hopefully) fewer complications.