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## NOTES

# KEEPING NAFTA “GREEN” FOR INVESTORS AND THE ENVIRONMENT

TERRI L. LILLEY\*

### INTRODUCTION

The signing of the North American Free Trade Agreement<sup>1</sup> (“NAFTA”) and its environmental side agreement, the North American Agreement on Environmental Cooperation<sup>2</sup> (“NAAEC”) was hailed as a landmark in providing for environmental protection within a free-trade agreement.<sup>3</sup> A series of controversies, however, has called into question the effectiveness of the intended protections for the environment and admits concern that the ability of the Parties to enact and enforce environmental regulation could be seriously undermined. Central to the controversy is NAFTA, Chapter XI, Article 1110.<sup>4</sup> It was designed to protect foreign investors from expropriation of their investments by the

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\* Class of 2002, University of Southern California Law School; B.A. 1988, The University of Texas at Austin. Warmest appreciation to Professor Chris Stone, whose assistance has made this Note and so many opportunities possible. Deepest love and gratitude to my spouse and partner, Dee Ann Fujioka, who tirelessly encourages and supports me in all my endeavors.

1. North American Free Trade Agreement, Dec. 17, 1992, Can.-Mex.-U.S., Parts One–Three, 32 I.L.M. 289, Part Four–Eight & Annexes, 32 I.L.M. 605 (1993) (entered into force Jan. 1, 1994) [hereinafter NAFTA].

2. North American Agreement on Environmental Cooperation, Sep. 14, 1993, Can.-Mex.-U.S., 32 I.L.M. 1480 (1993) (entered into force Jan. 1, 1994) [hereinafter NAAEC].

3. See, e.g., Daniel Magraw, *NAFTA & the Environment: Substance and Process*, in *NAFTA & THE ENVIRONMENT: SUBSTANCE AND PROCESS 1* (Daniel Magraw ed., 1995) (noting that “the NAFTA package came to include many environmental components, most of which were unprecedented”).

4. NAFTA, *supra* note 1, art. 1110 at 641–42. Interestingly, the NAAEC has little role in this controversy. For a discussion of the NAFTA-NAAEC relationship, see Howard Mann, *NAFTA and the Environment: Lessons for the Future*, 13 TUL. ENVTL. L.J. 387 (2000).

host country. In several instances, foreign investors have had the value of their investments impaired by environmental regulation in the host country. Asserting that their investments had been effectively expropriated, the investors filed for arbitration, demanding that the host government provide compensation for the losses. Although Article 1110 was intended to stimulate foreign direct investment by assuring investors that they would be protected against the host government “directly or indirectly nationaliz[ing] or expropriat[ing] an investment . . . or tak[ing] a measure tantamount to nationalization or expropriation of such an investment,”<sup>5</sup> the claims raise the specter of an unforeseen and unwelcome consequence: Parties who choose not to compensate domestic companies for regulatory losses or regulatory “takings” may be required to compensate foreign investors, advantaging them over domestic companies.<sup>6</sup>

Widespread concern has been expressed that the risk of crushing liability for regulatory action will hamstring environmental regulation and curtail national sovereignty.<sup>7</sup> This Note will argue, however, that, in reality, the hazard to national sovereignty over the environment is exaggerated. The text of the treaty, international legal norms, legal systems of the Parties, and a series of resolved claims would suggest that concern for the unraveling of environmental regulation is an unnecessarily alarmist reaction to the Chapter XI claims. Indeed, this Note concludes that simply applying the language of Chapter XI as an incorporation of United States regulatory takings law provides a reasonable mechanism through which extremist results can be easily avoided. Such an application provides adequate protection for NAFTA investors while permitting Parties to exercise autonomy in their efforts to protect the environment. Although it is true that compensation under Article 1110, as informed by United States regulatory takings jurisprudence, probably results in higher levels of protection for NAFTA investors in Canada and Mexico than would be

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5. NAFTA, *supra* note 1, art. 1110(1) at 641.

6. Logically, governments could exempt NAFTA investors from regulations that would otherwise give rise to compensation requirements, but this would reduce the effectiveness of the environmental protection while nonetheless disadvantaging domestic companies that would be required to meet the regulations. Such exemptions, however, may not be permissible under NAFTA. See NAFTA, *supra* note 1, art. 1114(2) at 642 (stating that relaxation of environmental standards in order to encourage investment is inappropriate).

7. See, e.g., Samrat Ganguly, Note, *The Investor-State Dispute Mechanism (ISDM) and a Sovereign's Power to Protect Public Health*, 38 COLUM. J. TRANSNAT'L L. 113, 116–17 (1999); Robert W. Benson, *Constitution? Forget It! NAFTA Rules: MTBE Ban Can Be Challenged Under Trade Agreement, Where Trade Invariably Wins*, L.A. TIMES, Jun. 24, 1999, at B9; Anthony DePalma, *NAFTA's Powerful Little Secret: Obscure Tribunals Settle Disputes, but Go Too Far, Critics Say*, N.Y. TIMES, Mar. 11, 2001, § 3, at 1.

available to domestic businesses, this is not inconsistent with other uncontroversial provisions of the treaty.<sup>8</sup>

Part I provides an overview of four claims that are at the heart of this issue and which illustrate the degree to which trade and environmental regulation are often intertwined. Part II describes the challenges frequently encountered when balancing the goals of trade and environmental protection, identifying parameters for the protection of both interests. Part III examines the concept of regulatory expropriation under the domestic laws<sup>9</sup> of Canada, Mexico, and the United States, and argues that application of the United States' legal norms provides the best compromise between the excessively trade-restrictive regimes of Canadian or Mexican law on the one hand, and the untenable restrictions on the ability of NAFTA countries to regulate for environmental protection that would result from a literal textualist approach on the other. Part IV analyzes the four claims discussed in Part I, applying Article 1110 as informed by U. S. law, and compares the results with the actual results thus far and with the goal of balancing trade and environmental concerns in ways that preserve the integrity of both.

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8. For example, Articles 1104 and 1204 each require that NAFTA trading partners be given *the more favorable* of National Treatment or Most Favored Nation Treatment if there is a disparity. NAFTA, *supra* note 1, at 639, 649. Thus, it is at least theoretically possible that whenever Most Favored Nation Treatment is the more favorable, NAFTA trading partners would receive better treatment or better protection than would domestic businesses. *Id.* Similarly, Article 1105 provides for a minimum standard of treatment in conformity with international standards of fairness of treatment and protection of investments. *Id.* at 639–40. Presumably, this requirement would be of importance only if National Treatment, required under Article 1102, provided protection that was inferior to international standards under Article 1105.

9. Even though NAFTA instructs arbitration tribunals to apply international law, this Note does not examine regulatory takings under international law because international law remains undeveloped in this area. Julie A. Soloway, *Environmental Trade Barriers Under NAFTA: The MMT Fuel Additives Controversy*, 8 MINN. J. GLOBAL TRADE 55, 87 (1999). See also Jan Paulsson, *Dispute Resolution*, in ECONOMIC DEVELOPMENT, FOREIGN INVESTMENT AND THE LAW 209, 229 (Robert Pritchard ed., 1996) (asserting that general principles of law "are better used in conjunction with a defined system of national law"); M. SORNARAJAH, *THE INTERNATIONAL LAW ON FOREIGN INVESTMENT* 77–79 (1994) (observing that international law in this area is so broad and general as to supply only useful "fodder for arguments," not rules for decision); J. Martin Wagner, *International Investment, Expropriation and Environmental Protection*, 29 GOLDEN GATE U.L. REV. 465, 519 (1999) (noting a "general lack of . . . authoritative sources addressing the limits of indirect expropriation" in international law). Furthermore, the international decisions that have addressed related issues were not interpreting trade treaty provisions equivalent to Article 1110. Kevin Banks, *NAFTA's Article 1110—Can Regulation Be Expropriation?*, 5 NAFTA L. & BUS. REV. AM. 499, 515 (1999); Wagner, *supra*, at 519–27. Cf. *infra* notes 121–130 and accompanying text (addressing the differences between trade treaties and other international agreements).

## I. OVERVIEW OF CLAIMS

Four claims have been filed<sup>10</sup> that have particular relevance to the tension between environmental protection and open trade.<sup>11</sup> Each alleges inter alia violation of Article 1110. One, between Ethyl Corporation and the Government of Canada (“Ethyl”), settled prior to the completion of the arbitration process. Two others, between Metalclad Corp. and the United Mexican States (“Metalclad”) and between S. D. Myers, Inc. and the Government of Canada (“Myers”), have resulted in arbitration awards. Both awards were appealed.<sup>12</sup> The Metalclad award was appealed to the Supreme Court of British Columbia.<sup>13</sup> Ultimately, Mexico settled the claim after the Canadian court’s ruling.<sup>14</sup> The appeal in the Myers claim is still pending. The merits of the fourth claim, between Methanex Corporation and the United States of America (“Methanex”) have not yet been argued before the arbitration panel. These claims provide a practical framework for examination of the issues addressed in this Note.

### A. THE ETHYL CLAIM

When the Canadian government settled the Ethyl claim by rescinding the offending regulation and agreeing to pay some \$19.3 million (Canadian) to the claimant, the action outraged environmental protection proponents.<sup>15</sup> The basis of the claim was that a Canadian ban on the import and interprovincial shipment of Methylcyclopentadienyl Manganese Tricarbonyl (“MMT”), a fuel additive produced by Ethyl Corporation in the United States, violated Article 1102: National Treatment; Article 1106:

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10. NAFTA Chapter XI provides investors with the option to file for arbitration with either the International Centre for Settlement of Investment Disputes (“ICSID”) or the United Nations Commission on International Trade Law (“UNCITRAL”). NAFTA, *supra* note 1, art. 1120 at 643. The mechanisms are not identical. See DENIS LEMIEUX & ANA STUHEC, REVIEW OF ADMINISTRATIVE ACTION UNDER NAFTA 87–89 (1999). The differences, however, are beyond the scope of this Note. Ethyl, Myers, and Methanex were filed with UNCITRAL. Metalclad was filed with ICSID.

11. In total there have been roughly 20 claims filed under Chapter XI. The exact number of claims is uncertain because there is no requirement under NAFTA that claims be made public. For an exceptionally comprehensive listing of the claims, including links to download available documents, see <http://www.naftalaw.org> (last visited Jan. 4, 2002).

12. See *Canada Intervenes to Set Aside NAFTA Hazardous Waste Case Rulings*, SOLID WASTE REP., Mar. 1, 2001, at 66 [hereinafter *Canada Intervenes*].

13. See *id.*, *Metalclad Gets Full NAFTA Settlement*, WASTE TREATMENT TECH. NEWS, November 2001; *Mexico Pays U.S. Waste Management Firm \$16 Million on NAFTA Claim*, HAZARDOUS WASTE LITIG. REP., Nov. 9, 2001, at 13 [hereinafter *Mexico Pays*].

14. See *Metalclad Gets Full NAFTA Settlement*, *supra* note 13; *Mexico Pays*, *supra* note 13.

15. See, e.g., Timothy Ross Wilson, *Trade Rules: Ethyl Corporation v. Canada (NAFTA Chapter 11): Part I: Claim and Award on Jurisdiction*, 6 NAFTA L. & BUS. REV. AM. 52, 54 (2000); Soloway, *supra* note 9, at 88; DePalma, *supra* note 7.

Performance Requirements; and Article 1110: Expropriation and Compensation.<sup>16</sup> Because MMT was not produced domestically, the regulation prohibiting importation had the effect of banning the use of MMT as a fuel additive in Canada.<sup>17</sup> Ethyl Corp., the only producer of MMT in North America, was in the business of exporting MMT to Canada, blending MMT-enhanced gasoline, and distributing the blended fuel throughout the country.<sup>18</sup> Thus, the import and shipment proscription had the further effect of halting the business of a single American corporation, Ethyl. Environmentalists supported the regulation, asserting that MMT is hazardous to human health and that MMT-enhanced fuels contribute to increased exhaust emissions by damaging emission control equipment on automobiles.<sup>19</sup> Both assertions were hotly contested. A critical industry supporting the regulation was the fledgling Canadian ethanol industry.<sup>20</sup> Ethanol is a grain-based fuel additive that could replace MMT.<sup>21</sup> The Canadian government first attempted to have the claim dismissed on jurisdictional issues.<sup>22</sup> When that attempt failed, Canada decided to settle rather than proceed with the arbitration process. Some observers felt that the settlement constituted a recognition that Chapter XI had successfully taken environmental regulation out of the hands of governments and given ultimate control to NAFTA investors.<sup>23</sup>

#### B. THE METALCLAD CLAIM

The Metalclad award is the only instance to date in which an arbitration tribunal has found a government liable for damages under Article 1110. The claim related to a hazardous-waste landfill built and owned by a Mexican company, Confinamiento Técnico de Residuos Industriales, S.A. de C.V. ("Coterin").<sup>24</sup> Coterin was purchased by Metalclad, a United States company.<sup>25</sup> The landfill is located seventy

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16. Soloway, *supra* note 9, at 85–87.

17. *Id.* at 85.

18. *Id.* at 55, 61.

19. *Id.* at 65–66.

20. *See id.* at 70–71.

21. *Id.*

22. Award on Jurisdiction, Ethyl Corp. v. Canada, NAFTA-UNCITRAL, June 24, 1998, <http://www.naftalaw.org>.

23. *See* DePalma, *supra* note 7.

24. Stephen L. Kass & Jean M. McCarroll, *The 'Metalclad' Decision Under NAFTA's Chapter 11*, N.Y.L.J., Oct. 27, 2000, at 3.

25. Technically, Coterin became a third-generation wholly-owned subsidiary of Metalclad. Final Award, Metalclad Corp. v. United Mexican States, NAFTA-ICSID (Additional Facility), ¶ 2, Sep. 2, 2000, at <http://www.naftalaw.org> [hereinafter Metalclad Award].

kilometers outside the city of Guadalcazar in the state of San Luis Potosí.<sup>26</sup> The city of Guadalcazar halted operation by refusing, *ex post*, to grant a construction permit.<sup>27</sup> Guadalcazar then sought and obtained an injunction preventing operation of the facility.<sup>28</sup> After Metalclad filed for arbitration, the governor of San Luis Potosí declared the area—including the landfill—to be a Natural Area for the preservation of rare cacti.<sup>29</sup>

The arbitration tribunal determined that the absence of clear rules regarding the necessity of a municipal construction permit, the denial of the municipal construction permit for reasons unrelated to construction issues, and the subsequent injunction of the operation of the completed facility all violated Article 1105(1), which requires “fair and equitable treatment.”<sup>30</sup> Further, the Mexican federal government’s toleration of the actions of Guadalcazar, which prevented Metalclad from operating the landfill even though the project was “fully approved and endorsed by the federal government,” was found to be a measure tantamount to expropriation in violation of Article 1110.<sup>31</sup> Finally, the tribunal accepted Metalclad’s assertion that the terms of the San Luis Potosí Ecological Decree would permanently prevent operation of the landfill and its implementation would separately constitute a measure tantamount to expropriation.<sup>32</sup> The Mexican government was ordered to reimburse \$16.7 million (U.S.) of Metalclad’s investment in the project.<sup>33</sup>

On appeal, Justice David Tysoe, of the Supreme Court of British Columbia, found that the arbitration panel’s reliance on the concept of transparency exceeded the scope of Chapter 11 jurisdiction by applying NAFTA provisions that are inapplicable to investor-state disputes.<sup>34</sup> Justice Tysoe set aside the award to the extent that he found it to be based upon Mexico’s failure “to ensure a transparent and predictable framework

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26. *Id.* ¶ 28.

27. *Id.* ¶ 90; James F. Smith, *Mexico Appeals Decision on Metalclad, Trade: NAFTA Panel Had Ordered the Government to Pay the Newport Beach Firm \$17.7 Million over Waste Plant*, L.A. TIMES, Sep. 1, 2000, at C2.

28. Metalclad Award, *supra* note 25, ¶¶ 94–95.

29. *Id.* ¶¶ 58–59.

30. *Id.* ¶¶ 74–101.

31. *Id.* ¶ 101.

32. *Id.* ¶¶ 109–111.

33. *Id.* ¶ 137.

34. See *United Mexican States v. Metalclad Corp.*, 2001 B.C.S.C. 664, ¶¶ 57–80 (Sup. Ct. B.C. May 2, 2001), available at Canadian Judicial Review Decision, <http://www.naftalaw.org>.

for Metalclad's business planning and investment."<sup>35</sup> Nonetheless, because the arbitration panel stated that the ecological decree constituted a separate basis for finding a breach of Article 1110, and because this basis for liability did not exceed the scope of the panel's jurisdiction, Justice Tysoe affirmed the award but less interest awarded for the time period preceding the ecological decree.<sup>36</sup> Following the decision of the Canadian court, the parties settled the claim for approximately \$16 million (U.S.).<sup>37</sup>

The factual details surrounding the Metalclad claim raise some prickly issues and merit closer inspection. First, whether this arbitration pitted environmental concern against free trade is not entirely clear. There is at least as good an argument that this case represents a conflict over the level of government best suited to making environmental decisions. Similarly, there is a clear conflict between environmentally-motivated grassroots democracy and environmentally-motivated countermajoritarianism.<sup>38</sup> Finally, although the Mexican government opposed the claim and appealed the award, it is not entirely clear whether the Mexican federal government supported Guadalcazar and San Luis Potosí or Metalclad.<sup>39</sup> Certainly, the claim implicates environmental protection, but to some degree it demands choosing between local or national environmental protection.

Mexico has long had difficulty dealing with hazardous waste.<sup>40</sup> Much of the hazardous waste generated in the country is illegally and unsafely dumped in the countryside.<sup>41</sup> This problem preexisted NAFTA,<sup>42</sup> but the increasing industrialization of Mexico, due to foreign direct investment resulting from NAFTA, has greatly exacerbated the problem.<sup>43</sup> Mexico

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35. *Id.* ¶ 72. *See also id.* ¶ 79 (stating that the finding of an expropriation under Article 1110 was based at least in part upon lack of transparency); *id.* ¶ 134 (partially setting aside the award to the extent that the Tribunal exceeded the scope of its authority).

36. *See id.* ¶¶ 81–105, 134–35.

37. *See* sources cited *supra* note 14 and accompanying text.

38. *Cf.* Naomi Klein, *Fighting Free Trade Laws*, *GUARDIAN* (London), Mar. 1, 2001, at 21 (asserting that NAFTA has redefined "democracy" as inappropriate "intervention").

39. *See* Joel Millman, *U.S. Companies Complain That NAFTA's Promise Is Not Being Fulfilled*, *WALL ST. J.*, May 26, 1999, at A17 [hereinafter Millman, *Companies Complain*]; Joel Millman, *Metalclad Is First to Sue Mexico Under NAFTA*, *WALL ST. J.*, Oct. 14, 1997, at A2 [hereinafter Millman, *Metalclad Is First*].

40. Millman, *Companies Complain*, *supra* note 39. *See also* Anthony DePalma, *Mexico Is Ordered to Pay a U.S. Company \$16.7 Million*, *N.Y. TIMES*, Aug. 31, 2000, at C4 (quoting a source who asserted that Mexico generates some 10 million tons of hazardous waste annually but only has one operating waste treatment facility); Smith, *supra*, note 27 (noting that Mexico generates more industrial waste than it has the capacity to process and reporting one Mexican official's estimate that less than half of Mexico's hazardous waste is treated and disposed of properly).

41. *See* DePalma, *supra* note 40.

42. Millman, *Companies Complain*, *supra* note 39.

43. *Id.*

produces approximately ten million tons of hazardous waste per year.<sup>44</sup> Mexico, however, can process only about ten to twenty percent of that amount<sup>45</sup> in its lone processing facility.<sup>46</sup> Exporting the excess is expensive and transporting it over long distances is itself environmentally hazardous. Together, these factors make the costs of appropriate disposal prohibitive in many instances, and the waste ends up illegally dumped.<sup>47</sup>

Coterin originally built and operated the landfill outside Guadalcázar.<sup>48</sup> It was discovered that Coterin had illegally disposed of more than 50,000 barrels of hazardous waste by dumping it, untreated, onto the ground.<sup>49</sup> The groundwater was found to be contaminated<sup>50</sup> and the facility was shut down.<sup>51</sup> The Mexican government was faced with enormous remediation costs and with the loss of a large portion of its already overtaxed hazardous waste disposal capacity.

Metalclad came in as something of a rescue operation. As one of the largest and most experienced hazardous waste disposal companies in the U.S., they had the expertise and capital to invest in remediation and renovation of the existing landfill.<sup>52</sup> It appears that Metalclad negotiated directly with the Mexican federal government and with Coterin.<sup>53</sup> Metalclad negotiated a six-month option to purchase Coterin along with Coterin's permits to construct and operate the landfill.<sup>54</sup> When assured that all the pertinent permits had been issued, Metalclad exercised its option and purchased Coterin.<sup>55</sup> Metalclad then invested approximately \$25 million (U. S.) in the construction project and was ready to open for business.<sup>56</sup>

The residents of Guadalcázar were understandably disaffected with landfills after the recent Coterin experience.<sup>57</sup> In addition, there seems to

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44. Smith, *supra* note 27.

45. *Id.*; Millman, *Metalclad Is First*, *supra* note 39.

46. Millman, *Metalclad Is First*, *supra* note 39; DePalma, *supra* note 40.

47. DePalma, *supra* note 40.

48. References to Coterin indicate Coterin as operated prior to its acquisition by Metalclad. After the acquisition the enterprise is referred to as Metalclad.

49. Defence of Canadian Liberty Committee/Le Comité de la Liberté Canadienne, at [http://www.canadianliberty.bc.ca/relatedinfo/report\\_31\\_January\\_2001.html](http://www.canadianliberty.bc.ca/relatedinfo/report_31_January_2001.html) [hereinafter Canadian Liberty].

50. Klein, *supra* note 38.

51. Canadian Liberty, *supra* note 49.

52. Joel Millman, *U.S.'s Metalclad to Discontinue Mexico Projects*, WALL ST. J., Mar. 30, 1999, at A22.

53. Metalclad Award, *supra* note 25, ¶¶ 30–35.

54. *Id.* ¶ 30.

55. *Id.* ¶¶ 31–36.

56. *Id.* ¶ 114.

57. Kass & McCarroll, *supra* note 24.

have been little or no effort made to involve or inform the local residents when Mexico and Metalclad planned the project.<sup>58</sup> Given Guadalucazar's recent bitter experience, perhaps no amount of involvement would have generated a willingness to have a hazardous-waste landfill in their backyard. The failure, however, to involve the municipality in the planning stages, combined with the recent landfill debacle on the site, created an extremely resolute grassroots opposition to the project.

With such fierce local antipathy, the state government also began to waver in its support. By the time of the arbitration hearing, San Luis Potosí was implicated in providing State Troopers to assist the public demonstration that blocked access to the facility, effectively preventing its grand opening.<sup>59</sup> Ultimately, it was the governor of San Luis Potosí who declared the area a cactus preserve—an act which, for practical purposes, permanently shut down the landfill.<sup>60</sup>

Even the federal government became ambivalent about the project. On the one hand, it continued to issue permits for construction and operation,<sup>61</sup> issued environmental reports declaring that the site was suitable for the project,<sup>62</sup> and gave assurances that the municipality had no authority to halt the project.<sup>63</sup> On the other, it recommended that Metalclad apply for a municipal construction permit as a courtesy to Guadalucazar,<sup>64</sup> failed to intervene in the standoff between the municipality and Metalclad, opposed Metalclad's claims in arbitration, and appealed the arbitration award—allegedly spending more in litigation expenses than in settling the claim.<sup>65</sup>

### C. THE MYERS CLAIM

By contrast, the Myers claim presents a far less complicated factual situation. S. D. Myers, Inc. ("SDMI") is a United States company in the business of disposal of polychlorinated biphenyl ("PCB") contaminated

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58. Klein, *supra* note 38.

59. DePalma, *supra* note 40.

60. Metalclad Award, *supra* note 25, ¶ 59.

61. *Id.* ¶¶ 43, 57.

62. *Id.* ¶ 44.

63. *Id.* ¶ 88.

64. *Id.* ¶ 41.

65. Grant Kessler, President of Metalclad, commented to reporters, "We understand that Mexico may have spent more in legal fees than the amount of the award to the company." *Mexico Pays*, *supra* note 13.

wastes.<sup>66</sup> SDMI sought to import PCBs from Canada to supplement its disposal business.<sup>67</sup> At the time, the U.S.-Canadian border was closed to private transborder shipment of PCBs due to United States Environmental Protection Agency (“EPA”) regulations.<sup>68</sup> SDMI lobbied for and, in October 1995, successfully obtained an enforcement discretion<sup>69</sup> from the EPA that permitted SDMI to ship PCBs from Canada into the United States for disposal.<sup>70</sup> In November 1995, Canada’s Minister for the Environment issued an interim order that prevented the export of PCBs from Canada into the United States.<sup>71</sup> The border remained closed for roughly sixteen months until further amendments to Canadian export regulations reopened the border in February 1997.<sup>72</sup> The border was opened and SDMI was able to receive PCB shipments from Canada for a period of approximately five months, after which the United States again closed the border.<sup>73</sup>

Canada raised a number of concerns in support of the PCB export ban; as listed in the arbitration award they were:

- whether the enforcement discretion fully complied with U.S. law;
- whether exports of PCB wastes to the U.S., a non-party, would comply with the Basel convention;
- whether PCBs would be disposed of in the United States in an environmentally sound manner;
- compliance with CANADA’s 1989 policy to destroy Canadian PCBs in CANADA;
- the long-term viability of domestic PCB disposal facilities; and
- what would happen in the event that the U.S. disposal facilities subsequently became unavailable, or if the U.S. border was closed again, as eventually happened.<sup>74</sup>

SDMI presented a number of “smoking gun” memos, which the arbitration tribunal deemed convincing evidence that Canada had been

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66. Partial Award, *S.D. Myers, Inc. v. Canada*, NAFTA-UNCITRAL, ¶¶ 89–90, Nov. 13, 2000, at <http://www.naftalaw.org>.

67. *Id.* ¶ 92.

68. *Id.* ¶ 101.

69. Part of Canada’s argument in the case was based on the fact that imports of PCBs to the United States remained technically illegal. The enforcement discretion obtained by SDMI merely represented the EPA’s assurance that the law would not be enforced against SDMI for the specified period. *Id.* ¶¶ 119, 121.

70. *Id.* ¶ 118.

71. *Id.* ¶ 123.

72. *Id.* ¶ 127.

73. *Id.* ¶¶ 127–28.

74. *Id.* ¶ 121.

acting primarily to protect the domestic PCB disposal industry.<sup>75</sup> The articulation of environmental concerns and overriding obligations under other treaties was ineffective to protect the closure of the border to PCB exports. The tribunal found that this action violated the standards required by both Article 1102: National Treatment and Article 1105: Minimum Standards of Treatment because the means chosen to promote otherwise defensible goals was unnecessarily restrictive of trade and favored domestic industry at the expense of foreign investment.<sup>76</sup> A unanimous panel decided, however, that the action by the Canadian government was not expropriatory and therefore not a violation of Article 1110.<sup>77</sup>

The partial award did not announce the amount of damages, which is expected to range between \$1 million and \$20 million (U.S.).<sup>78</sup> The Government of Canada is appealing the arbitration award,<sup>79</sup> seeking to reverse the finding of liability for violations of Articles 1102 and 1105.

#### D. THE METHANEX CLAIM

The issues in the Methanex claim and the United States defense are complex, and the facts are hotly disputed. Methanex's original claim, which is reported to run more than 1,000 pages, is not publicly available,<sup>80</sup> but much of its content can be inferred from the United States' Statement of Defense and Rejoinder and from Methanex's own Reply and Amended Claim. Methanex has filed for arbitration against the United States in response to the State of California's planned phaseout of methyl tertiary butyl ether ("MTBE") as a gasoline additive.<sup>81</sup> Methanex produces methanol, a primary component of MTBE, and asserts that the action by California violates Article 1105: Minimum Standards of Treatment and

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75. *Id.* ¶¶ 164–93.

76. *See id.* ¶¶ 252, 255, 298, 322.

77. *Id.* ¶ 288. SDMI had also alleged a violation of Article 1106: Performance Requirements. A majority of the tribunal found no violation of Article 1106. *Id.* ¶ 278. Although one member of the tribunal would have found a violation, he believed that such a finding was unlikely to result in the award of any additional damages. Separate Opinion by Dr. Bryan Schwartz, S.D. Myers, Inc. v. Canada, NAFTA-UNCITRAL, ¶ 201, Nov. 12, 2000, at <http://www.naftalaw.org> (concurring except with respect to performance requirements).

78. *Canada Intervenes*, *supra* note 12, at 66.

79. *Id.*

80. The lack of transparency of the arbitration process is a source of great criticism of the investor-state dispute settlement mechanism under Chapter XI. *E.g.*, DePalma, *supra* note 7. Because both arbitration facilities designated to settle these disputes operate as private commercial arbitration bodies, there is no provision for automatic publication of the memorials or awards. *Id.* However, both Canada and the United States have domestic law providing access to many of the documents. *Id.*

81. *Id.*

Article 1110: Expropriation and Compensation.<sup>82</sup> In February 2001, Methanex filed an amended claim, which also alleges violation of Article 1102: National Treatment.<sup>83</sup>

The environmental effects of MTBE are mixed. It is used as an oxygenate in gasoline, displacing the known carcinogen, benzene, and has been credited with dramatic reductions in exhaust emissions resulting in air quality improvements.<sup>84</sup> In areas where MTBE is used, however, it frequently shows up in the local water supply.<sup>85</sup> Part of the reason for this is that MTBE is more water-soluble and degrades more slowly than other components of gasoline.<sup>86</sup> Therefore, when gasoline is released into the environment, the MTBE will readily separate and combine with water, ultimately infiltrating local water supply sources. The health effects of MTBE in the water supply are uncertain. Intense exposure is linked to renal tumors in male lab rats, but more recent studies suggest that this is due to a reaction with a particular protein produced by male rats—a protein that is not produced by female rats or humans of either gender.<sup>87</sup> In fact, MTBE has been used medically for almost twenty years to dissolve gallstones.<sup>88</sup> This treatment, however, introduces MTBE into the gall bladder, which seems to contain the chemical, largely preventing absorption into the rest of the body.<sup>89</sup> Thus, the apparent safety of this therapeutic use of MTBE may not indicate that ingestion through drinking water would be similarly benign. Even if MTBE ingestion is not a direct health hazard, its infiltration of water supplies remains an environmental concern because even small amounts of the substance cause an unpleasant taste and odor, rendering the water unsuitable for drinking.<sup>90</sup>

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82. Claimant's Reply to the Statement of Defense, *Methanex Corp. v. United States*, NAFTA-UNCITRAL, ¶¶ 66, 76, Aug. 28, 2000, at <http://www.naftalaw.org> [hereinafter *Methanex Reply*].

83. Claimant Methanex Corporation's Draft Amended Complaint, *Methanex Corp. v. United States*, NAFTA-UNCITRAL, at 42, Feb. 12, 2001, at <http://www.naftalaw.org> [hereinafter *Methanex Amended Complaint*].

84. *Kidney Cancer: New MTBE Research Shows Rodent Kidney Cancer Risk Not Applicable to Humans*, CANCER WKLY. PLUS, May 19, 1997, at 21 [hereinafter *New MTBE Research*].

85. See Craig S. Marxsen, *MTBE Latest Victim of US Environmental Overregulation?*, OIL & GAS J., Feb. 26, 2001, at 21–22.

86. *Id.* at 22.

87. *New MTBE Research*, *supra* note 84.

88. See generally Mark J. Allen, Thomas J. Borody, Thomas F. Bugliosi, Gerald R. May, Nicholas F. LaRusso & Johnson L. Thistle, *Rapid Dissolution of Gallstones by Methyl Tert-Butyl Ether*, 312 NEW ENG. J. MED. 217 (1985).

89. *Id.* at 219–20.

90. See Marxsen, *supra* note 85, at 24 (noting that the EPA objects to MTBE “on the grounds that it makes water smell a little like paint thinner”).

It is likely that similar emission reductions can be achieved without MTBE use. A number of other fuel additives have been approved for use as gasoline oxygenates, most notably ethanol. Ethanol is a corn-based fuel additive that has been used far less frequently than MTBE, largely due to ethanol's higher costs and the impracticality associated with trucking ethanol to refineries around the country for blending.<sup>91</sup> Supporters of ethanol note that it is a renewable resource as opposed to MTBE, which is derived largely from natural gas. If it is likely that ethanol would replace MTBE after the phaseout, this would lend some support to Methanex's Article 1102 claim that the discontinuance of MTBE is designed to promote the domestic corn and ethanol industries at Canadian Methanex's expense.<sup>92</sup> California, however, is lobbying the U.S. federal government to lift the oxygenate requirement altogether,<sup>93</sup> arguing that similar emission levels can be achieved using reformulated gasoline that contains neither MTBE nor ethanol oxygenate additives.<sup>94</sup>

Furthermore, it is possible that the risk of groundwater contamination can be greatly reduced without discontinuing the use of MTBE in gasoline. Leaking underground storage tanks are the primary source of MTBE in water supplies.<sup>95</sup> Methanex points out that MTBE's propensity to infiltrate the water system provides a useful method of detecting the larger problem of underground tank leakage.<sup>96</sup> Removing MTBE from the gasoline does not stop leakage, it just reduces the likelihood that gasoline leakage will be detected. If California were to enforce existing environmental protections regarding underground storage tank safety, Methanex argues, then there would be very little risk of drinking contaminated water.<sup>97</sup>

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91. *Id.* at 21. "Because of its affinity for water, ethanol already blended into gasoline makes it unsuitable for transporting through pipelines; and trucks must therefore transport it to refineries as blendstock." *Id.*

92. See Peter Morton, *Methanex Cries Political Foul in \$1B Claim Against U.S.: Says Governor Influenced*, NAT'L POST (Canada), Mar. 9, 2001, at C03.

93. Methanex has alleged that the MTBE phaseout was driven by substantial contributions to California Governor Gray Davis' campaign by Archer Daniels Midland, a major U.S. producer of ethanol. Methanex Amended Complaint, *supra* note 83, at 1. Governor Davis' lobbying the federal government to revoke the oxygenate requirement seems to refute the accusation, but even Davis recognizes that the current administration is unlikely to be swayed by his lobbying efforts. See Matt Kelley, *Johanns and Vilsack Have Praise for Bush's Performance*, OMAHA WORLD-HERALD, Feb. 27, 2001, at 2.

94. U.C. Report, MTBE Fact Sheet, at <http://tsrtp.ucdavis.edu/mtberpt> (last visited Jan. 10, 2002).

95. *E.g.*, Marxsen, *supra* note 85, at 21-22.

96. See Methanex Reply, *supra* note 82, ¶ 20.

97. Methanex has filed a submission with the CEC Secretariat under NAAEC Article 14 alleging that the United States is failing to enforce its environmental regulations relating to underground fuel storage tanks effectively. The CEC determined that the submission warranted a response from the

In addition to the complexity of the environmental issues, the question of whether California's decision harms Methanex (in any legally cognizable way) is similarly byzantine. Methanex claims almost \$1 billion (U.S.) in damages for "lost profits associated with lost methanol sales to the MTBE market; profit margin losses on the balance of methanol sales due to the negative demand shock; and direct expenses incurred as a result of the measure taken by California."<sup>98</sup> Methanex claims that California's phase-out of MTBE has adversely affected the global market for methanol by marginally reducing demand.<sup>99</sup> The depression of the global market for methanol has harmed Methanex's investments in the United States and worldwide.<sup>100</sup> California is phasing out MTBE, however, not methanol.<sup>101</sup> Methanex actually does not produce MTBE. Instead, it produces methanol, which third party buyers use to produce MTBE.<sup>102</sup> MTBE production creates one market for methanol but not the largest market.<sup>103</sup> In 1999 less than one third of methanol sold globally was used for MTBE production.<sup>104</sup> In addition, although Methanex has production facilities in the U.S., it appears that the methanol used to manufacture MTBE for California gasoline comes from production facilities in Chile and New Zealand.<sup>105</sup>

## II. RECONCILING TRADE & THE ENVIRONMENT

The problem is not that free trade must always result in environmental harm, nor that environmental protection must always prove antithetical to open international trade. Although a certain degree of radical conflict exists between trade and the environment, it is not the whole story, nor perhaps the greatest obstacle to mutual cooperation. These basic differences are exacerbated by other less direct conflicts. Free trade is vulnerable to excessive environmental regulation, which can unexpectedly

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United States but has postponed further inquiry pending the outcome of Methanex' Chapter XI claim. Updated information and documents are available at North American Council for Environmental Cooperation, Citizen Submissions on Enforcement Matters, Methanex, at [http://www.cec.org/citizen/guides\\_registry/](http://www.cec.org/citizen/guides_registry/) (last visited Jan. 10, 2002).

98. Methanex Reply, *supra* note 82, ¶ 87.

99. *Id.* ¶ 1.

100. *See id.* ¶¶ 73, 79, 80.

101. Statement of Defense of Respondent United States of America, Methanex Corp. v. United States, NAFTA-UNCITRAL, ¶ 5, Aug. 10, 2000, at <http://www.naftalaw.org> [hereinafter U.S. Statement of Defense].

102. *Id.* ¶ 6.

103. The manufacture of formaldehyde is the largest market for methanol, accounting for around 36% of methanol usage worldwide. Methanex Reply, *supra* note 82, ¶ 2.

104. *Id.*

105. U.S. Statement of Defense, *supra* note 101, ¶ 26.

wipe out foreign investments in host countries or craftily provide unfair competitive advantage to domestic business. Environmental protection is similarly vulnerable to the greater clarity and enforceability of trade rules. The absence of proven models in reconciling the differences has created and fed a degree of mutual mistrust and animosity.<sup>106</sup> NAFTA made credible attempts to incorporate protections for both the domestic environment and foreign investors.<sup>107</sup> These provisions can function effectively only if applied in a manner that understands and balances the underlying interests on both sides.

The popular press often presents the debate as one between human greed and our more benevolent impulses.<sup>108</sup> On one side, there are corporate interests pushing unrestricted trade—profiting while externalizing the environmental costs. On the other are nonprofits promoting protection of the earth—preserving natural resources for future generations. Yet, this is a somewhat myopic view. There are profit-motivated reasons to push for more open trading regimes and for increased environmental regulation.<sup>109</sup> Similarly, respect for the earth and its human inhabitants can result in preference for either the environment or more open trade, depending upon one's vantage.<sup>110</sup> There is, however, a basic global conflict between wealthier and poorer countries on these issues that breaks down along the lines of trade versus environmental protection. The problem lies in the differing marginal utility of wealth on the one hand and of environmental protection on the other.<sup>111</sup> Wealthier countries, although certainly motivated to maintain and improve their standard of living, are often willing to sacrifice a bit of economic prosperity at the margin in order to improve their immediate environment.<sup>112</sup> Poorer, less industrialized nations, no doubt are interested in a safe and healthful environment, but it is easier to sacrifice scenic beauty or permit *potential* environmental harm when that is the cost of meeting more immediate needs for adequate food

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106. See Magraw, *supra* note 3, at 11–12 (discussing the difficulties encountered when trade and environmental communities attempt to work together).

107. See, e.g., NAFTA, *supra* note 1, Preamble, arts. 104, 709–23, 1102–06 at 297–298, 377–82, 639–40.

108. See Benson, *supra* note 7.

109. See, e.g., Soloway, *supra* note 9, at 59 (describing Baptist-Bootlegger coalitions that promote enhanced environmental regulation with both environmental and trade protectionist goals); John Kirton, Canada-U.S. Trade and the Environment: Regimes, Regulatory Refugees, Races, Restraints, and Results, at 7 (Nov. 5, 2000), <http://www.envireform.utoronto.ca/envireform/publications/Kirton/Vancouver.htm> (explaining the proliferation of “green and greedy coalitions” in North America).

110. Christopher D. Stone, *Deciphering “Sustainable Development,”* 69 CHI.-KENT L. REV. 977, 978 (1994).

111. *Id.*

112. *Id.*

and shelter.<sup>113</sup> Thus, shifting one's perspective away from the domestic players and their motivations, and focusing on the often enormous wealth differentials between the nations negotiating these issues, can redefine the moral high ground.

Another difficulty in resolving the two goals arises from an insularity of issues between the trade and environmental communities.<sup>114</sup> Environmental protection often affects trade and international trade frequently has environmental consequences. Until recently, neither group has made much effort to take into account the externalities that their respective agendas impose on one another.

Decisions under trade treaties prior to NAFTA considered only trade issues. To environmentalists, the rule of decision seemed to be that whenever environmental protection is perceived to conflict with trade, trade wins. For example, when a GATT<sup>115</sup> Panel heard Mexico's complaint against U.S. restrictions on the importation of tuna caught "on dolphin," it concluded that the number of dolphins killed incidental to tuna fishing had no effect on the end product; and therefore, the U. S. had to treat tuna caught by Mexican fishing vessels "no less favourab[ly]" than tuna caught by domestic vessels.<sup>116</sup> The GATT Panel held that, for practical purposes, the only issue to be considered was the quality of the tuna itself, not the environmental impact of the methods used to capture the tuna.

Promoters of environmental regulation similarly fail to consider potential effects on international trade. Increasing the level of environmental protection can set off a chain reaction of trade effects. For example, by requiring turtle emitter devices ("TEDs") on shrimp nets, the United States government imposed an additional cost on domestic shrimpers.<sup>117</sup> Subsequent free importation of shrimp caught by foreign vessels not utilizing TEDs would unfairly disadvantage domestic producers, who could not profitably compete with imported shrimp. They would either register their vessels outside the country to avoid the TED requirement or discontinue shrimping and seek other more profitable

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113. *Id.* at 978-79.

114. *Cf.* Magraw, *supra* note 3, at 11-12.

115. General Agreement on Tariffs and Trade, Oct. 30, 1947, 61 Stat. A3, T.I.A.S. 1700, 55 U.N.T.S. 194.

116. GATT Panel Report, United States—Restrictions on Imports of Tuna, 30 I.L.M. 1598, 1618 (1991).

117. For an excellent overview of the actual *Shrimp-Turtle* dispute, upon which this hypothetical is very loosely based, see Howard F. Chang, *Toward a Greener GATT: Environmental Trade Measures and the Shrimp-Turtle Case*, 74 S. CAL. L. REV. 31 (2000).

opportunities. This results not in turtle protection, but in transfer of shrimp harvesting from turtle-safe U. S. vessels to turtle-hazardous foreign vessels. Suppose, as a countermeasure, the United States were to ban imported shrimp. Such action could decimate foreign shrimp harvesting industries that are heavily dependent on the U. S. market. Neither of these actions seems "fair," and neither is.

Environmentalists tend to argue that "legitimate environmental regulation" should be exempted from review under trade regulation.<sup>118</sup> The problem, of course, is determining which environmental regulations are "legitimate" without any review. Free trade advocates are justified in demanding that environmental regulation be subject to more than a mere "rational basis test" of legitimacy. Under such a standard, restrictive regulation could easily substitute for tariffs and duties<sup>119</sup> whenever supported by legislative incantation—or worse—judicial imagination of an environmentally-protective purpose. Environmental protection plans must account for the potential effects on trade or there is no hope of effectively and efficiently protecting the environment in ways that spread costs equitably between foreign and domestic industries and between the appropriate consumers and the beneficiaries of the regulation.

The standard of review is problematic from the other side as well. Trade regulation and environmental regulation operate at different levels of ambiguity. This advantages trade law to some extent, due to the relative clarity with which the issues can be defined and the relative precision with which harm can be proven and measured. In addition to the obvious scientific certainty problems,<sup>120</sup> environmental issues suffer from scoping problems as well. The Metalclad case is a striking example of geographic scoping problems. There are good local environmental arguments for preventing operation of the hazardous waste treatment facility, but there are at least as persuasive national arguments that Mexico desperately needs greater capacity to dispose of hazardous waste safely. Methanex illustrates a definitional scoping problem. Narrowing the definition of environmental protection to focus only on drinking water suggests a different resolution than would follow if the definition were broadened to encompass air quality and soil contamination. Because most environmental protection

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118. Wagner, *supra* note 9, at 534–35.

119. ALAN RUGMAN, JOHN KIRTON & JULIE SOLOWAY, ENVIRONMENTAL REGULATIONS AND CORPORATE STRATEGY: A NAFTA PERSPECTIVE 115–17 (1999).

120. See, e.g., Soloway, *supra* note 9, at 67 (addressing the difficulty of assessing health risks of MMT).

measures can be second-guessed in a myriad of ways, subjecting such measures to strict scrutiny will ensure their failure.

Variation in linguistic ambiguity also disadvantages environmental regulation when it must compete with free trade promotion. The timidity of the “mandates” in the NAAEC, compared to the rather toothy provisions of the NAFTA, illustrates the difficulty of integrating trade and environmental issues in international agreements.<sup>121</sup> Treaties, however strongly worded, tend to offer little in the way of real enforcement provisions because sovereign nations are understandably unwilling to abdicate very much sovereignty.<sup>122</sup> Flexibility is the watchword of diplomacy. The NAAEC is written in diplomatic language. It encourages the Parties to cooperate on the issues,<sup>123</sup> to negotiate resolutions when conflict arises,<sup>124</sup> to engage in a great deal of study of the issues that are important to the principal goals of the treaty,<sup>125</sup> and to offer recommendations for further agreements in the future.<sup>126</sup> Because of the clarity and magnitude of the economic stakes involved, international trade agreements have incorporated more clearly articulated expectations while raising the costs of noncompliance.<sup>127</sup> International trade is much like a high stakes poker game among sovereigns. Each is reasonably willing to increase the penalty for cheating to a level sufficient to offset the rather large incentives to cheat in the first place. Thus, the penalties and enforcement provisions in trade agreements far surpass the “honor among sovereigns” standard, which is commonly found in most other international agreements. International trade law has perhaps attained the binding status of quasi-constitutional law.<sup>128</sup> Therefore, when conflict arises between environmental norms that are subject to “gentleman’s agreements”<sup>129</sup> and free-trade requirements that are subject to legally enforceable multi-million dollar damage awards,<sup>130</sup> environmentalists are probably not unreasonable in requesting some additional reassurance.

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121. Compare NAFTA, *supra* note 1, art. 2019 at 697, with NAAEC, *supra* note 2, arts. 34–36 at 1492–94 (describing the processes required under each treaty prior to suspending benefits for failure to implement arbitration panel determinations).

122. See CHRISTOPHER D. STONE, *THE GNAT IS OLDER THAN MAN* 97 (1993) (describing the noncompulsory language of treaties as beneficial for achieving wider participation of nations).

123. NAAEC, *supra* note 2, arts. 1, 20 at 1483, 1489–90.

124. *Id.* art. 22 at 1490.

125. *Id.* arts. 2, 10 at 1483, 1485–87.

126. *Id.* art. 10 at 1485–87.

127. Mann, *supra* note 4, at 391–92.

128. *Id.*

129. See STONE, *supra* note 122, at 100–04.

130. See Mann, *supra* note 4, at 391–92.

Some of the advantage trade has, due to the greater certainty of treaty language and reduced ambiguity of the issues, is probably offset by political considerations which may, ironically, favor greater environmental regulation. Foreign investors may be presumed to have less political influence<sup>131</sup> than the constituencies affected by domestic industry.<sup>132</sup> When foreign business competes with domestic industry, governments have incentives to protect domestic industry. When local economies stand to benefit from foreign investment or when domestic investors seek access to foreign markets, governments will seek trade agreements. Thus, governments have strong incentives both to enter into free-trade agreements and to try to circumvent those agreements for the benefit of domestic interests. Environmental regulation, popularly perceived as both morally positive and inherently local, can provide a defensible pretext for protecting the local natural and business environments simultaneously.

Historically, however, governments have tended to be somewhat less responsive to environmental concerns, perhaps because the stakes are more difficult to quantify. A great fear of environmentalists has been that freer trade, coupled with a desire to attract foreign direct investment, would incentivize governmental reduction of environmental protections.<sup>133</sup> As an antidote to the perceived risk, the NAFTA text incorporates admonitions that Parties should not lower environmental standards in order to attract investment<sup>134</sup> and the NAAEC provides a mechanism for reporting and correcting the failure of a Party to enforce its environmental regulations effectively.<sup>135</sup>

Increasingly, environmental organizations have become able to motivate elected officials to address environmental concerns in more than a cursory fashion. Indeed, it seems that just such motivations led to United States presidential candidate Bill Clinton's campaign promises in 1992 to ensure that NAFTA would include environmental protection provisions.<sup>136</sup>

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131. This argument recognizes how nondemocratically elected governments are not subject to the same pressures of the democratic process and may act more independently politically, yet these governments remain subject to political pressures of a more direct and violent nature should the domestic opposition be sufficiently motivated. Also, political influence is often for sale in both democratic and nondemocratic governments. Such influence as a commodity, however, is generally equally available to domestic and foreign influence purchasers. Thus, on balance, foreign interests are still likely to be less well represented in most decisions by government.

132. These constituencies would include private business owners, public stockholders, labor, private lenders, bondholders, state and municipal governments, material suppliers, and others.

133. Mann, *supra* note 4, at 397.

134. NAFTA, *supra* note 1, art. 1114(2) at 642.

135. NAAEC, *supra* note 2, art. 14–15, 22–36 at 1488–89, 1490–94.

136. Magraw, *supra* note 3, at 8.

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Environmental concern plays well to the public, particularly when the costs are expected to be relatively insignificant or to fall on others.

Of course, that is the rub. Environmental problems usually can be addressed in a number of ways, with the resultant costs and the distribution of those costs varying greatly. Following the implementation of NAFTA, the Parties did not tend, as was expected, to lower or suspend enforcement of environmental regulations; rather such regulation actually increased.<sup>137</sup> In cases where foreign business interests were required to shoulder a large share of those costs, trade advocates (not to mention the affected investors) became suspicious—particularly when domestic industry had lobbied in conjunction with environmental groups and would derive a clear competitive advantage from the heightened level of regulation.<sup>138</sup>

Proper application of the environmental provisions of NAFTA should permit each Party to set its own levels of environmental protection and freely regulate and enforce those levels of protection. Parties should not be permitted to lower environmental standards and enforcement in order to attract foreign investment in the classic “race to the bottom” scenario feared by environmentalists. Nor, however, should Parties be permitted to enact trade protectionist measures by fabricating an environmental pretext and engaging in a “race to the top” equally feared by free trade proponents.

Proper application of the trade provisions of NAFTA should require that each Party deal fairly with all other Parties’ investors. Foreign investors should be treated no less well than domestic investors, Most Favored Nation trading partners, or as required by generally accepted principles of international law, whichever standard affords the greatest level of protection. Further, investors should be able to anticipate roughly similar levels of protections within any of the NAFTA countries. Still, the enactment of environmental measures should not summarily give rise to governmental liability simply because such measures impose unavoidable collateral effects on NAFTA investors.

Application of Article 1110 should be informed by a jurisprudence adequately sophisticated to guide arbitration tribunals, which are asked to weigh apples against oranges. Fairly balancing the priorities of both trade and the environment is best served by a menu of equitable principles that serve as tools for achieving satisfactory equilibrium between distributive

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137. See Kirton, *supra* note 109, at 3–4.

138. See Soloway, *supra* note 9, at 59 (describing Baptist-Bootlegger coalitions, which promote enhanced environmental regulation with both environmental and trade protectionist goals); Kirton, *supra* note 109, at 7 (explaining the proliferation of “green and greedy coalitions” in North America).

and corrective justice. It is no answer to say that environmental regulation should be exempted from scrutiny or that environmental regulation cannot be permitted to affect foreign investment. Resolving these disputes faithfully to NAFTA and NAAEC requires arbitration panels to consider the whole picture. Free trade and environmental protection must be given similar levels of scrutiny. Governments and investors are equally inclined to attempt to externalize costs and risks. Arbitrators need evaluative principles to guide the redistribution of these costs and risks appropriately—fostering both environmental protection and fairness to foreign investors. The interplay of trade and the environment is complex, and resolving actual or perceived conflict between the two will require complex analysis.

### III. SELECTING A LEGAL STANDARD

#### A. THE NEED FOR EXTRINSIC INTERPRETIVE GUIDANCE

Arbitration tribunals convened to resolve NAFTA Chapter XI claims are given broad discretion to interpret and apply the provisions of the treaty. Article 1131 requires the tribunal to “decide the issues in dispute in accordance with this Agreement and under applicable rules of international law.”<sup>139</sup> The only other constraint is that an arbitration tribunal is bound by any interpretation of the treaty issued by the Free Trade Commission (“Commission”).<sup>140</sup> To date, the Commission has declined to provide a binding interpretation of the language of Article 1110.<sup>141</sup>

Applying the language of Article 1110<sup>142</sup> in an unmitigated, literal fashion would lead to perverse results. For example, consider that Article

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139. NAFTA, *supra* note 1, art. 1131(1) at 645.

140. *Id.* art. 1131(2). The Free Trade Commission is the international body charged with implementation of the treaty, comprised of cabinet level representatives of the Parties. *Id.* art. 2001 at 693.

141. “Canada has asked Mexico and the United States to work with it to develop a consensus interpretive statement . . . [A]n agreed understanding of what is included or excluded by the term “expropriation” issued by the NAFTA Free Trade Commission . . . could influence the use of Chapter 11 in environmental regulation cases.” Sanford E. Gaines, NAFTA Chapter 11 As a Challenge to Environmental Law Making—One View from the United States (2000), at <http://www.library.utoronto.ca/envireform/publications/Conference/Gaines.htm> (conference draft). Cf. Ian Jack, *New Debate on Controversial NAFTA Clause: Mexico Agrees to Talk: Chapter 11 of Free Trade Agreement Allows Firms to Sue Governments*, NAT’L POST (Canada), Mar. 6, 2001 at C04.

142. Article 1110(1) reads:

No 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 (“expropriation”), except:

(a) for a public purpose;

1135 restricts awards to monetary damages.<sup>143</sup> If a measure met the requirements of 1110(1)(a)–(c), the governmental action would be permissible, and compensation must be provided to the investor. If however, the measure failed one of the first three criteria (e.g., was determined not to further a public purpose) the governmental action would be impermissible, but the tribunal would have no authority to enjoin the action. At the same time, a damages award could not be based on Article 1110,<sup>144</sup> because the text requires payment of compensation only for *permissible* expropriations.

In addition, strict application of the language could result in the crushing liability feared by NAFTA critics.<sup>145</sup> Since the language does not clearly exempt any particular regulatory goals or actions, and since there is no guidance on which losses are compensable, requiring compensation for any regulation that generates investment losses would be a defensible application of the text alone. It seems unlikely, however, that Canada, Mexico, and the United States intended to compensate investors for any and all disappointments, however remotely associated with domestic regulations.

Further, without a legal context, the terminology is critically vague. Specifically, what is meant by “expropriation”? Can an investment be nationalized without also being expropriated? What distinguishes direct from indirect expropriation? Precisely, how does indirect expropriation differ from a “measure tantamount to” expropriation? The answers to these questions cannot be easily derived either empirically or intuitively. Thus, arbitration tribunals will necessarily have to select an interpretive paradigm that can both inform the language and mitigate perverse results.

Because international law provides little direction in this area,<sup>146</sup> tribunals reviewing Article 1110 claims will have to look elsewhere for

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(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.

NAFTA, *supra* note 1, at 641.

143. *Id.* art. 1135 at 646.

144. An argument can be made that Article 1105: Standards of Treatment could fill the gap and support the award of damages in this case. *Id.* art. 1105(1) at 639. This proves too much, however, because the same minimum standards of treatment would support an award of damages in an ordinary “legal” expropriation situation as well. Thus, seeking an interpretation of Article 1110 that would not render it superfluous requires a normative interpretive framework to prevent perverse application.

145. *See* Gaines, *supra* note 141.

146. *See* sources cited *supra* note 9.

guidance.<sup>147</sup> National laws tend to address issues of expropriation and compensation more directly than does international law. Thus, the national laws of the NAFTA Parties provide a reasonable resource to guide application of the provisions of the treaty.

#### B. MEXICAN LEGAL PERSPECTIVE

Although the Mexican Constitution declares that private property may be expropriated only for public use and requires payment of indemnification,<sup>148</sup> the federal government reserves broad powers to impose regulations that abridge private property rights in the furtherance of wide-ranging social goals without incurring any liability to pay compensation.<sup>149</sup> Such regulations must be of general application and cannot transfer title to the state.<sup>150</sup> Otherwise, however, the Mexican government is fairly unfettered by concerns of incurring liability to compensate the losers when it enacts virtually any sort of regulation. It seems that such weak protection of investments under Mexican law, in conjunction with reasonable concern that *foreign* investors would be even less well protected,<sup>151</sup> contributed to Mexico's failure to attract foreign investment prior to NAFTA. Since NAFTA came into force, foreign investment in Mexico has increased dramatically.<sup>152</sup> Probably for this reason, Mexico has been the least enthusiastic of the NAFTA countries to seek to restrict the application of Chapter XI's investor protections,<sup>153</sup> even though the disparity of protection between domestic law and NAFTA requirements is probably the greatest in Mexico. Thus, it would seem inappropriate to rely very heavily on Mexican domestic law as a model, since surely Article 1110 was intended, at least in part, to remediate the

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147. Customary international law does permit resort to supplementary interpretive materials especially when, as with Article 1110, good faith attempts to interpret the language of the treaty would yield ambiguous or absurd results. Vienna Convention on the Law of Treaties, May 23, 1969, art. 32, 1155 U.N.T.S. 331, 340.

148. Article 27 provides in part, "Las expropiaciones sólo podrán hacerse por causa de utilidad pública y mediante indemnización." Constitución Política de los Estados Unidos Mexicanos [CONST.] art. 27 (Mex.).

149. MEX. CONST. art. 27. *See also*, Wagner, *supra* note 9, at 514-17 (discussing regulatory takings under the Mexican Constitution).

150. Wagner, *supra* note 9, at 516.

151. Also under Article 27, the legal right to real property ownership is limited to native or naturalized citizens and Mexican corporations. MEX. CONST. art 27(I).

152. Mann, *supra* note 4, at 402.

153. *Id.* at 406.

unacceptably feeble level of protection that Mexican law was expected to provide to foreign investors.<sup>154</sup>

### C. CANADIAN LEGAL PERSPECTIVE

Under Canadian law, there is no constitutional requirement to compensate for regulatory takings of property.<sup>155</sup> Although provincial laws may provide superior protection,<sup>156</sup> the general rule is that when a regulation has the effect of depriving an owner of property, but does not destroy the property or transfer it to the expropriating agency, it is not considered to be an expropriation<sup>157</sup> and the legal presumption is that no compensation is required unless specified in the regulation.<sup>158</sup> Conversely, if the regulation requires the destruction of the property or transfers benefit of the property to the expropriating agency, the action will be considered an expropriation and the presumption is reversed: Compensation must be paid unless otherwise clearly specified in the regulation.<sup>159</sup> Thus, the filter for whether a measure is tantamount to expropriation under Canadian law would be to ask, "Is the property destroyed or is there a transfer of benefit from the investor to the host government?" If not, the measure would not be considered expropriatory. It seems that under Canadian law, unless the investor's property is destroyed, only direct nationalization or expropriation would generate compensation, and then only if the regulation failed to specify that compensation was denied. Of course, this type of interpretive model would amount to a de facto excision of Article 1110's compensation provisions related to indirect expropriation and measures tantamount to expropriation. Indeed, Parties could opt out of compensation for even direct expropriation or nationalization of an investment.

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154. *Id.* at 402; Soloway, *supra* note 9, at 88.

155. As a Canadian court recently observed:

[I]f regulatory legislation voiding but not expropriating property rights triggered a presumed right to compensation from the state, the effect would be to give property rights the equivalent of the protection accorded by s. 7 of the Charter despite the clear exclusion of such rights from the Canadian Charter of Rights and Freedoms by its drafters. In other words, an individual would have the right not to be deprived of his property by regulatory legislation except with compensation or with an explicit override of that right by legislative language.

This would seem to do indirectly something the framers of the Charter declined to do.

A & L Invs. Ltd. v. Ontario, 1997 C.R.R. LEXIS 224, at \*19 (Ontario Ct. App. 1997). *See* Wagner, *supra* note 9, at 510–11.

156. *See* IAN MACF. ROGERS, CANADIAN LAW OF PLANNING AND ZONING § 5.14 (Nov. 1999).

157. A & L Invs., Ltd., 1997 C.R.R. LEXIS at \*18.

158. *Id.* at \*18–\*19.

159. *Id.* at \*14 (quoting Belfast Corp. v. O.D. Cars, Ltd., [1960] A.C. 490, 523 (H.L.(N.I.))).

## D. UNITED STATES LEGAL PERSPECTIVE

The Fifth Amendment to the United States Constitution provides: "[N]or shall private property be taken for public use, without just compensation."<sup>160</sup> Although the text itself does not address the issue of regulatory takings, a rich history of case law has done so. Several guiding considerations emerge from United States regulatory takings jurisprudence: the character of the governmental action; the magnitude of the economic impact; and the degree of interference with reasonable investment-backed expectations.

Governmental actions that require the property owner to suffer a permanent physical invasion of the property are invariably held to constitute takings, no matter the seeming insignificance of the physical invasion.<sup>161</sup> "[P]ublic program[s] adjusting the benefits and burdens of economic life to promote the common good," however, are less likely to be seen as compensable takings.<sup>162</sup> To find otherwise could virtually incapacitate government.<sup>163</sup> Still, United States takings law does not permit the government unlimited discretion in regulation. There is a recognition that regulation can go too far,<sup>164</sup> "forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole."<sup>165</sup>

A regulation that deprives an owner of all economically viable use of property is recognized as a compensable taking,<sup>166</sup> even though the government has not physically destroyed the property, acquired the rights, or given the rights to a third party. Lesser levels of interference alone are generally insufficient to constitute a taking under U. S. law.<sup>167</sup> This naturally leads to what is often termed the "denominator question."<sup>168</sup> Has the regulation taken away all of a narrowly-defined property right or

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160. U.S. CONST. amend. V.

161. *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419, 419–20 (1982).

162. *Penn Cent. Transp. Co. v. New York City*, 438 U.S. 104, 124 (1978). For an insightful analysis of United States property and takings laws, including excellent paradigms for determining when regulation is likely to be considered a taking, see Carol M. Rose, *Property and Expropriation: Themes and Variations in American Law*, 2000 UTAH L. REV. 1.

163. See Frank I. Michelman, *Property, Utility, and Fairness: Comments on the Ethical Foundations of "Just Compensation" Law*, 80 HARV. L. REV. 1165, 1178–79 (1967).

164. *Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393, 415 (1922).

165. *Armstrong v. United States*, 364 U.S. 40, 49 (1960).

166. *Agins v. Tiburon*, 447 U.S. 255, 260 (1980).

167. *Penn Central Transp. Co.*, 438 U.S. at 131 (explaining that diminution in value alone is insufficient to constitute a taking).

168. Michelman, *supra* note 163, at 1192–93.

merely a portion of one more broadly drawn? Commonly in the cases, the issue of whether the regulation constitutes a deprivation of all economically productive use (taking) or a mere diminution of value (no taking) will turn on how the court circumscribes the property right in question.<sup>169</sup>

International cases will raise one denominator question that cannot be answered by United States law. Specifically, if government regulation completely destroys the entire value of a NAFTA investor's investment in the host country, is that a separate interest from the investor's international business as a whole? It does not appear that this version of the denominator question has yet been addressed. Perhaps, as a policy matter, the liability of NAFTA Parties for regulation of foreign investments ought not turn on the breadth of the investor's worldwide business, but rather on the degree to which the host country interferes with the portion of the investment over which it has regulatory authority. This would advantage the investor by providing a smaller subdivision as the applicable property interest to comprise the denominator when measuring magnitude of harm. Conversely, if the rule were applied uniformly both for measuring the magnitude of harm and for assessing damages, the host country would become the beneficiary of the rule when damages are assessed. Specifically, Parties would pay damages only for harms to business within the host country but would escape liability for harms done to an investor's domestic business or any business in a third country. For the purposes of the analysis in this Note, the scope of the protected interest will be considered to be so defined. This result is not certain to become the rule, nor is it prescribed by U.S. regulatory takings law.

United States takings jurisprudence also considers the extent to which the reasonable investment-backed expectations of the property owner have been abridged. This analysis focuses on two critical issues and has the ability to reverse a presumption of compensation under the preceding tests.<sup>170</sup> First, were the expectations of the property owner reasonable? In a highly regulated industry, for example, courts consider that the investor is on notice that regulations may at any time be changed or extended. To expect otherwise would be unreasonable. Even in an industry that is not yet highly regulated, if the use imposes a high magnitude of externalities on

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169. Compare *Pennsylvania Coal Co.*, 260 U.S. 393 (considering the support right to be a separate estate due to a quirk of Pennsylvania property law and thus holding that the loss of the support right was a compensable taking), with *Keystone Bituminous Coal Ass'n v. De Benedictis*, 480 U.S. 470 (1987) (conflating the support estate and mineral estate as together comprising the property in question and thus holding that the loss of the support right was a mere diminution).

170. See Michelman, *supra* note 163, at 1236–41.

the neighbors, regulation should be expected at some time.<sup>171</sup> Both state and federal courts, when evaluating property owner's takings claims, have implied that reasonable owners of brickyards<sup>172</sup> and feedlots<sup>173</sup> should expect eventual regulation. When an investor or property owner proceeds in a favorable regulatory environment or upon government issuance of requisite permits, however, the action would be based on reasonable expectations and the government may be afforded less flexibility to regulate without providing compensation. Second, even if the desired, but now impermissible, use is completely reasonable, the property owner's expectation must be demonstrated through concrete investment.<sup>174</sup> Although this requirement may lead to premature investment, in order to preserve a right against future potential regulation, it provides a handy filter to reduce moral hazard problems. By providing an objective measure of the property owner's resolve, the investment requirement obviates the need for subjective inquiry into hopes and ambitions. Combined, these tests can provide an appropriate legal basis for denying compensation when an environmental regulation is truly legitimate.

#### E. WHY INCORPORATE UNITED STATES LAW?

The most obvious reason to apply Article 1110 as an incorporation of United States takings law is because the text seems to do precisely that.<sup>175</sup> Among the NAFTA Parties, only United States law *requires* compensation for expropriation by regulation;<sup>176</sup> recognizes some regulations as de facto expropriations even in the absence of a literal transfer of property rights;<sup>177</sup> and provides an evaluative framework that balances legal protection of

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171. This probably grew out of older notions of nuisance law on the theory that it is unreasonable to expect to have a property right in the maintenance of a nuisance, but United States takings law has permitted uncompensated prohibition of uses which probably would not support a nuisance action at common law. *E.g.*, *Miller v. Schoene*, 276 U.S. 272 (1928) (finding the destruction of cedar trees to protect the neighbors' apple orchards was not a compensable taking).

172. *Hadacheck v. Sebastian*, 239 U.S. 394 (1915).

173. *Spur Indus., Inc. v. Del E. Webb Dev. Co.*, 494 P.2d 700 (Ariz. 1972).

174. *See Penn Cent. Transp. Co. v. New York City*, 438 U.S. 104, 124 (1978). *See also* Michelman, *supra* note 163, at 1192-93 (pondering the difficulty of the denominator question and questioning its relevance to assuring fairness in calculation of just compensation for takings).

175. *See generally*, David Schneiderman, *NAFTA's Takings Rule: American Constitutionalism Comes to Canada*, 46 U. TORONTO L.J. 499, (1996) (complaining that because Article 1110 incorporates United States constitutional law into NAFTA, it subjects the Canadian government to the constraints of the U.S. Constitution). Schneiderman's article accepts that U.S. takings law is incorporated into NAFTA through Article 1110, but the article asserts that such incorporation is undesirable. *Id.*

176. *See supra* Part III.D. and accompanying notes.

177. *See supra* Part III.D. and accompanying notes.

private property interests against ensuring governmental flexibility to further important public interests.<sup>178</sup> Article 1110 similarly *requires* compensation. By including “direct” and “indirect;” “nationalization” and “expropriation;” and the controversial “measures tantamount” language, Article 1110 appears to include expropriation by regulation and expropriation absent direct transfer of property rights, as does U.S. law. Further, to the extent that international law provides any illumination of these rather unique provisions, it is because international takings law has itself incorporated U.S. takings jurisprudence.<sup>179</sup> Thus, it is likely that Article 1110 has incorporated U.S. law either directly through the language used or indirectly by application of rules of international law as required under Article 1131.

There are also practical considerations that argue for applying Article 1110 as an incorporation of U.S. takings law, even if such application is not clearly required. With its history of weighing private rights against public interests, U.S. regulatory takings law provides an excellent resource for the application of Article 1110. The jurisprudence maintains the tension between public and private interests while providing guidance for weighing the two. It defines some bright line tests for government that will give rise to an obligation to compensate in such cases as physical occupation and prohibition of all economically beneficial use, and provides considerations such as reasonableness and preregulation investment, which may expand or constrict the flexibility afforded government in implementing regulations. Article 1110 creates a similar tension between empowering government to regulate for the public good and constraining government from targeting NAFTA investors to bear the costs associated with public benefit. An appropriate interpretive paradigm must preserve that tension. Understanding Article 1110 as an incorporation of United States takings law, to the extent such law is compatible with other provisions of NAFTA,<sup>180</sup> establishes precisely such a model.

This is also a sensible approach because it would equalize the level of protection provided investors throughout the NAFTA countries. NAFTA investors in the United States will receive this level of protection as the

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178. See *supra* Part III.D. and accompanying notes.

179. See Schneiderman, *supra* note 175, at 500–01; Soloway, *supra* note 9, at 87; Wagner, *supra* note 9, at 520–26. “Public international law . . . also has required that some or all of the conditions set out in NAFTA be met. While the ambit of those standards have been in some dispute, . . . those principles too are informed by the American constitutional experience.” Schneiderman, *supra* note 175, at 515.

180. Clearly any equitable remedies available in U.S. law would be proscribed by Article 1135, for example. Any inconsistencies should of course be resolved in favor of treaty provisions on point.

minimum allowed under Article 1102, which requires host countries to afford national treatment to NAFTA investors. Since United States regulatory takings law provides better protection to investors than do the laws of either Canada or Mexico, any less protective interpretation of Article 1110 would leave investment in those countries comparatively less well protected. Although NAFTA does not require that the protection of investments be harmonized among the Parties, such a result would be faithful to the spirit and intent of the Agreement as a method of encouraging foreign investment throughout all three countries. Affording weaker protections would provide disincentive to investment in Canada and Mexico. This is a particularly undesirable result for Mexico, for whom attracting investment is one of the most important goals of participation in the treaty. Thus, applying Article 1110 as an incorporation of U.S. law encourages foreign investment equally in each of the NAFTA countries, which affirms and furthers the free-trade goals of the treaty.

If the rule of decision favors compensation across a wide range of regulatory action, liability could become crushing. Government will be incapacitated and unable to pursue appropriate goals, such as environmental preservation. If instead, arbitration tribunals apply a model that is overly deferential to regulation, providing compensation in only the most egregious cases, the property regime is destabilized and foreign investment will seek more secure markets. The protection of property rights under United States law is well developed and has proven to safeguard foreign direct investment sufficiently<sup>181</sup> while permitting environmental (and other) regulation to proceed. Therefore, stronger protection is unnecessary to attract foreign investment and could undermine the Parties' efforts to provide environmental protection. Providing weaker protection than this, under Article 1110, would provide inferior protection to NAFTA investments outside the United States and thereby disadvantage Canada's and Mexico's efforts to attract foreign direct investment, ultimately undermining the trade promotion goals of the treaty. Thus, application of Article 1110 as an incorporation of United States regulatory takings law provides an excellent interpretive paradigm that should be used to evaluate investors' claims of expropriation.

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181. This phenomenon is evidenced in the level of foreign direct investment in the United States prior to NAFTA. See Jeffrey Lang, *Keynote Address: The International Regulation of Foreign Direct Investment: Obstacles and Evolution*, 31 CORNELL INT'L L.J. 455, 456 (1998).

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#### IV. APPLYING U.S. LAW TO THE ENVIRONMENTAL CLAIMS

##### A. ETHYL

Although the Canadian government elected to settle the Ethyl claim prior to an award on the merits, evaluation of what is known about the claim would suggest that the regulation prohibiting import and transprovincial shipment of MMT could give rise to liability under Article 1110 if evaluated under U.S. constitutional standards, although the Canadian government may have been able to regulate or ban MMT through other means.

First, as in most of the investor claims, there does not seem to be any basis to argue that the Canadian regulation effected a permanent physical invasion. This test is more clearly directed at tangible, physical property. Because most investor claims allege the infringement of a business interest, the physical invasion test often will be inapplicable.

It is unclear whether the Canadian regulation may have proscribed all economically beneficial use of Ethyl's investment. Ethyl Corp. would surely argue that the regulation had the effect of completely destroying its business in Canada. Yet, the Canadian government could respond that the regulation did not prohibit the use of MMT; it merely required that any MMT used in Canadian gasoline be produced in the province where it was sold. This would, however, oblige Ethyl to build production and blending facilities in each Canadian province. The expense of such an undertaking might be considered prohibitive—effectively preventing Ethyl from continuing business in Canada. Still, the international denominator question remains. Is the Canadian business a discrete property interest? If a factfinder determined that the regulation eradicated Ethyl's entire Canadian business, it is likely, though not certain, that compensation would be required because it deprives Ethyl of all economically beneficial use of its investment in Canada.

Initially, when one considers the reasonableness of Ethyl's investment-backed expectations for its Canadian business, the picture seems more favorable to Canada. As a fuel additive producer, Ethyl operates in a highly regulated industry. Domestic environmental laws in any country can be expected to change along with improvements in technology and increased understanding of the pertinent science. Thus, it may be unreasonable for Ethyl to expect to be able to manufacture and sell MMT indefinitely. Particularly, if and when MMT seems to cause as much harm as it prevents, Ethyl should have expected that the use would be

banned. Ethyl's argument that the research suggesting harmful effects of MMT is inadequate should not be sufficient to challenge a legislative determination that MMT is harmful. If it were unreasonable for Ethyl to expect no future regulation of MMT, then no compensation would be required under Article 1110—even if the measure effectively ended Ethyl's Canadian business.

That, however, was not the basis of the Canadian regulation. By failing to declare MMT harmful and by failing to prohibit its use in Canadian gasoline completely, the Canadian government effectively conceded that MMT was *not* dangerous. Such a concession, even if inadvertent, gives the regulation the appearance of being more of a trade restriction and less of an environmental protection. It is also difficult to imagine any reason that MMT produced in the United States would be more environmentally mischievous than that produced in Canada. Conceivably, the Ethyl claim may stand for the inability of Parties to enact environmental regulations indirectly, through trade restrictions, though perhaps the environmental regulations would be defensible if enacted directly.

#### B. METALCLAD

In the Metalclad claim, there may have been some argument that the declaration of a cactus preserve was a type of permanent physical occupation of Metalclad's landfill. It seems unlikely, however, since the physical occupation claims have generally involved occupation by governmental workers or property, a third party, or the property of a third party. Cactus, even protected and rare cactus, is unlikely to be considered the property of the government or a third party.

Much of the arbitration award in this claim implicitly seems to apply U.S. law to the facts at issue. Metalclad's best argument, under U.S. law, was that by completely prohibiting operation of the landfill, the Mexican government deprived Metalclad of all economically beneficial use of its investment. In fact, this is the argument that the ICSID tribunal found persuasive in awarding compensation. In addition, the tribunal noted that Metalclad was reasonable in relying on the Mexican federal government's repeated issuance of permits, environmental certification of the site, and assurances that the treatment facility could be operated.<sup>182</sup> Finally, the

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182. Justice Tysoe's holding that Chapter 11's investor-state dispute mechanism does not include a transparency requirement might seem to call this reasoning into question. Then again, the Canadian court seemed particularly concerned that the Methanex tribunal had imported the transparency concept

court noted the millions of dollars Metalclad had invested in completing the facility. Thus, the ICSID tribunal found that there was a compensable taking by applying the magnitude of the harm and reasonable investment-backed expectation tests.

### C. MYERS

It is interesting to note that although the UNCITRAL tribunal issued an award in favor of SDMI, it did not find that Canada had violated Article 1110. Application of United States law to the issues similarly supports a finding that there was no compensable taking. Although SDMI had made a fairly significant investment toward opening the Canada-United States border for importation of PCB waste, this was not a case of an investor acting within a favorable regulatory regime or in reliance on governmental encouragement, as in the Metalclad case. The facts were quite the opposite. There was a history of prohibition against shipping PCBs from Canada to the United States, and the two governments had been unsuccessful in negotiating an agreement for doing so. In addition, the transportation and disposal of PCBs had been highly regulated, and it was the high degree of regulation that made the disposal business so lucrative. The only *reasonable* expectation would be that the pursuit of opening the

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from Chapter 18 into Chapter 11 in order to find a breach of Article 1105. See *United Mexican States v. Metalclad Corp.*, 2001 B.C.S.C. 664, ¶¶ 57–75 (Sup. Ct. B.C. May 2, 2001), available at Canadian Judicial Review Decision, <http://www.naftalaw.org>. Justice Tysoe's reasoning on the pre-ecological decree finding of expropriation seems to accept that the tribunal found that the breach of Article 1105 resulted in violation of Article 1110. See *id.* ¶¶ 77–79. Since the court did not accept the tribunal's finding an Article 1105 violation, any Article 1110 liability could not be based on breach of Article 1105. Thus, Justice Tysoe's decision may say less about application of Article 1110 than it does about interpretation of Article 1105.

Furthermore, international law commentators have been critical of Judge Tysoe's reasoning. See, e.g., *Questions Remain After B.C. Supreme Court Upholds Metalclad Victory in Mexico Case: Q&A with NAFTA Legal Expert Todd Weiler*, MEXICAN FORECAST, May 15, 2001, at 1, 2, 6 (discussing the Canadian decision and its likely effects on future NAFTA arbitrations). Weiler asserts that Justice Tysoe misunderstood the reasoning of the arbitration tribunal and the application of international law concepts:

This misunderstanding may be rooted in Mr. Justice Tysoe's having taken a domestic law approach to an international law concept. The Tribunal did not say that because Mexico breached the transparency provisions of NAFTA Chapter 18, it owed compensation under Chapter 11. It was merely employing an international lawyer's approach to explaining how the "principal of transparency" can be found throughout the ever-expanding body of international law, including other provisions of the NAFTA text.

*Id.* at 6. Further, Weiler notes that the decision is unlikely to be influential to future arbitration panels for three reasons: (1) the decision is "municipal law," which has little persuasive value to the "international law" community; (2) arbitration panels are not bound by precedent; and (3) "[t]he international arbitral community is not very large, and the Chair of the Tribunal is a leading member of it [whereas] very few are likely to have heard of Mr. Justice Tysoe." *Id.* at 2, 6.

border was a speculative venture. Although, regulatory takings law seeks to stabilize the property regime to promote investment, it should not be expected to eliminate speculative investment risk.<sup>183</sup>

#### D. METHANEX

The Methanex claim has the potential to test how far arbitration panels are willing to extend the concept of compensable expropriation, perhaps even beyond the protections provided under U.S. takings law. Under any U.S. takings analysis, Methanex would probably be unable to prove that a government action that discontinued the use of MTBE in gasoline constitutes a compensable taking because again, the MTBE industry is highly regulated. In fact, regulations requiring the use of oxygenates (including MTBE) in gasoline have quite literally created this particular market for MTBE. It would be highly unreasonable for Methanex to believe that the MTBE-enhanced gasoline business would continue in perpetuity without further regulation. Methanex's argument that taking MTBE out of gasoline will not prevent or reverse underground storage tank leakage is technically correct, but it is not determinative. Because of its unique characteristics, MTBE poses distinguishable environmental risks from other components of gasoline. Thus, a reasonable person would expect that it may be subject to different regulation. In addition, groundwater contamination has led to lawsuits against providers of MTBE-enhanced gasoline.<sup>184</sup> Thus, Methanex should reasonably expect that some gasoline producers would begin to avoid MTBE use to reduce their exposure to lawsuits.<sup>185</sup> Thus, the business may wane even without government regulatory action.

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183. See Michelman, *supra* note 163, at 1240–41.

184. See, e.g., *Martin v. Shell Oil Co.*, No. 3-99-CV-1428 (JCH), U.S. Dist. LEXIS 690 (D. Conn. 2002) (denying defendant's motion for summary judgment in an action alleging MTBE contamination of groundwater near a Shell service station); *Dusoe v. Mobil Oil Corp.*, 167 F. Supp. 2d 155 (D. Mass. 2001) (granting defendant's motion for summary judgment in an action alleging inter alia that gasoline released from a Mobil pipeline had caused MTBE contamination of plaintiff's drinking water); *In re Methyl Tertiary Butyl Ether Products Liability Litigation*, No. 1358, 2000 U.S. Dist. LEXIS 14901 (J.P.M.L. 2000) (ordering consolidation of two cases filed in Illinois and one filed in New York against Atlantic Richfield Co. related to MTBE contamination of drinking water); Earl J. Imhoff & William K. Enger, *Suits Target "Clean Air" Gas Additive: Plaintiffs Allege that MTBE Is a Defective Product; Defendants Say the Clean Air Act Prevents this Claim*, N.Y.L.J., Nov. 12, 2001, at B14 (reporting on product defect claims filed against refiners and distributors in five states alleging that MTBE-containing gasoline is a defective product because of its propensity to contaminate drinking water).

185. One California refinery operator, for example, asserted that it had "'publicly and visibly advocated and supported the reduced use or elimination of MTBE in gasoline' and is actively studying alternatives to MTBE due to MTBE's potential threat to drinking water." *Tosco Corp. v. Cmty. for a Better Env't*, 41 F. Supp. 2d 1061, 1063 (C.D. Cal. 1999).

Besides the argument that it is unreasonable to expect static regulation of the MTBE market, there is a question of the extent to which such expectations have been truly *investment-backed*. Methanex has consistently redirected its operations from the United States to other countries—most U.S. plants having already been idled.<sup>186</sup> Thus, Methanex's expectations have been backed by *divestment out* of the United States market. Regulatory takings law need not, and under the investment-backed expectations test, does not provide compensation for projected business losses where the property owner has abandoned business operations.

Finally, the complete prohibition of MTBE in gasoline would not constitute a denial of all economically viable use. First, as discussed above, MTBE has uses other than as a fuel additive.<sup>187</sup> Second, Methanex's methanol production and distribution facilities are not predominantly, much less exclusively, dedicated to production of methanol for the MTBE market.<sup>188</sup> At best, the loss of methanol purchases by California MTBE producers constitutes a noncompensable "mere diminution" of value.

Of course, as in the Myers claim, getting past Article 1110 liability does not mean that there is no NAFTA violation. If Methanex can make out its claim under Articles 1102 or 1105, the United States may yet incur liability. Application of Article 1110 as incorporating U.S. regulatory takings law could, however, in this situation, prevent the host country from incurring liability for expropriation under Article 1110.

### CONCLUSION

Arbitration tribunals applying Article 1110 to investor-state disputes are well advised to view the text as an incorporation of U.S. regulatory takings jurisprudence. United States law provides a sophisticated model of interpretation which maintains the tension between promotion of public benefit and protection of private property. United States regulatory takings law prohibits direct nationalization or expropriation by requiring payment of compensation when the government literally takes private property rights on behalf of the public. In addition, U.S. law establishes that requiring an investor/owner to use his or her own property solely for the public benefit, even without depriving the investor/owner of title, should

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186. See *supra* note 105 and accompanying text.

187. See *supra* notes 88–89 and accompanying text.

188. See *supra* notes 101–104 and accompanying text.

equally require compensation. Such regulations can be viewed as "indirect expropriation." Moreover, when government regulations deprive an investor/owner of all economically beneficial use of private property, the measure is, certainly from the investor's perspective, "tantamount to expropriation" and should be compensated even though the investor/owner is not further required to provide a more direct benefit to the public. Yet, U.S. regulatory takings law excludes nuisance-like uses from the concept of property, recognizing that investors or private property owners do not have a vested right to benefits derived by externalizing the harms associated with their activity. This level of protection of private property has proven sufficient to attract and protect foreign direct investment while permitting the government adequate flexibility to enact, enforce, and maintain environmental protections efficiently. Because United States law provides the highest level of protection for property rights within NAFTA countries, applying the U.S. standard would ensure that NAFTA investors would enjoy equivalent levels of protections in each of the NAFTA countries—ensuring that the playing field remains level for the attraction of foreign investment throughout Mexico, Canada, and the United States. Because the United States must afford this level of protection equally to NAFTA and domestic investors, regardless of the interpretation of Article 1110, incorporation of the U.S. standard into Article 1110 ensures that all NAFTA Parties are subject to the same freedoms and limitations with respect to the implementation and enforcement of environmental measures—mitigating the effects of races either to the top or to the bottom which endanger free trade and environmental protection. Thus, application of Article 1110 as an incorporation of United States regulatory takings law provides a reasonable way of keeping NAFTA "green" for investors and the environment, as was intended by the Parties.

