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Articles

The North American Free Trade Agreement and the Environment: The Lessons of *Metalclad Corporation v. United Mexican States*

Lucien J. Dhooge*

[The *Metalclad* decision] most certainly was a decisive legal victory. Equally important is the guidance it gives to host states and investors.¹

[The *Metalclad* decision] reinforces our long-held fears that NAFTA's rules for international investors open up the back door to attacks on environmental laws and regulations. Corporations should not be allowed to sue governments when environmental protection decisions do not go in their favor.²

I. INTRODUCTION

On October 31, 1990, the Mexican Secretariat of Urban and Ecological Development (SEDUE) authorized Salvador Aldrett, a Mexican national, to build and operate a transfer station for the temporary storage of hazardous waste at La Pedrera, a valley located in the Municipality of Guadalcazar, State of San Luis Potosi, Mexico.³ On January 23, 1993, the National

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1. Rossella Brevetti & John Nagel, *Arbitration Panel Awards U.S. Firm Metalclad \$16.7 Million in NAFTA Dispute with Mexico*, 17 INT'L TRADE REP. 1374 (Sept. 7, 2000) (quoting Clyde C. Pearce, lead attorney for Metalclad Corporation, *Metalclad Corp. v. United Mexican States*, Int'l Centre for the Settlement of Inv. Disputes, No. ARB(AF)/97/1 (2000)).

2. *Id.* (quoting Brent Blackwelder, President, Friends of the Earth).

3. See Award, *Metalclad Corp. v. United Mexican States*, Int'l Centre for the Settlement of Inv. Disputes, No. ARB(AF)/97/1, ¶ 28, at 9 (2000) [hereinafter Award]; see also METALCLAD CORP., MEMORIAL IN SUPPORT OF CLAIMS BEFORE THE

Ecological Institute (INE), an independent sub-agency of the Secretariat of the Mexican Environment, National Resources and Fishing (SEMARNAP), granted Aldrett's successor-in-interest, Confinamiento Técnico de Residuos Industriales, S.A., a Mexican corporation (COTERIN), a federal permit to construct a hazardous waste landfill at La Pedrera (Landfill).⁴ COTERIN also received a permit from INE and SEDUE's successor agency, the Secretariat of Social Development, authorizing construction of the Landfill on February 3, 1993.⁵ Finally, on May 11, 1993, the State of San Luis Potosi granted COTERIN a state land use permit to construct the Landfill.⁶ Based upon assurances of support received by the President of INE, the General Director of SEDUE, the Governor and Congress of San Luis Potosi, professors at the Autonomous University of San Luis Potosi (AUSLP) and other government officials, and believing that all necessary government permits had been obtained or were in progress, on April 23, 1993, Metalclad Corporation (Metalclad), a U.S. corporation organized pursuant to the laws of the State of Delaware, entered into a six-month option agreement to purchase COTERIN.⁷ On August 10, 1993, INE granted COTERIN a federal permit for the operation of the Landfill.⁸ Shortly thereafter, on September 10, 1993, Metalclad exercised its option and purchased COTERIN, the Landfill and all associated permits.⁹

However, Metalclad encountered immediate difficulties in constructing and operating the Landfill. Shortly after completion of its purchase of COTERIN, the Governor of San

INT'L CENTRE FOR THE SETTLEMENT OF INV. DISPUTES 1 & ¶ 16, at 51 (1997) [hereinafter MEMORIAL]. Mexican governmental agencies will be referred to throughout this article by their translated English designations.

4. See Award, *supra* note 3, ¶ 29, at 9.

5. See MEMORIAL, *supra* note 3, at 2 & ¶ 22, at 54.

6. See *id.* at 2 & ¶ 23, at 54-55; see also Award, *supra* note 3, ¶ 31, at 9.

7. See Award, *supra* note 3, ¶ 30, at 9; see also MEMORIAL, *supra* note 3, at 2, ¶¶ 23-24, at 55-56 & ¶ 49, at 67.

8. See Award, *supra* note 3, ¶ 35, at 10; see also MEMORIAL, *supra* note 3, at 3 & ¶ 24, at 55.

9. See Award, *supra* note 3, ¶ 35, at 10; see also MEMORIAL, *supra* note 3, at 3. Metalclad acquired COTERIN, the Landfill and the associated permits through two subsidiaries. Eco-Metalclad Corporation (Eco-Metalclad), a corporation organized pursuant to the laws of Utah and wholly-owned by Metalclad, owned Ecosistemas Nacionales, S.A. (ECONSA), a Mexican corporation, which in turn acquired COTERIN and its assets. See Award, *supra* note 3, ¶ 2, at 2-3; see also MEMORIAL, *supra* note 3, ¶ 2, at 40. For purposes of this article, the designation "Metalclad" will be collectively utilized to refer to the Delaware corporate entity as well as Eco-Metalclad and ECONSA unless otherwise noted.

Luis Potosi, Horacio Sanchez Unzueta, and the State Director of the Environment, Pedro Medellin Milan, embarked upon a public campaign to denounce and prevent construction and operation of the Landfill.¹⁰ This opposition continued unabated despite an agreement reached in April 1994 between Metalclad and officials of San Luis Potosi pledging support for the Landfill and permitting the commencement of construction at the site.¹¹ Construction continued until October 26, 1994, when officials of Guadalucazar ordered cessation of all building activities due to the absence of a municipal construction permit.¹² Construction resumed on November 15, 1994 after Metalclad was directed to resume its activities on the site by a representative of the Federal Attorney's Office for the Protection of the Environment (PROFEPA) on the basis that federal authority was preeminent in this area.¹³

Nevertheless, Metalclad applied for a construction permit from Guadalucazar on November 15, 1994.¹⁴ Guadalucazar subsequently rejected Metalclad's application on December 5, 1995. This denial occurred despite the granting of additional construction permits by INE on January 31, 1995, the issuance of positive environmental audits by AUSLP and PROFEPA in February and March 1995, the completion of Metalclad's construction activities in March 1995 and the execution on November 25, 1995 of an agreement between Metalclad, INE and PROFEPA providing for the operation of the Landfill.¹⁵ Metalclad was never notified of the Guadalucazar Town Council meeting at which its permit application was discussed and denied nor did the Council take notice of any of the activities occurring at the site during the thirteen-month pendency of the permit application.¹⁶

Guadalucazar also initiated administrative and judicial

10. See Award, *supra* note 3, ¶ 37, at 10; see also MEMORIAL, *supra* note 3, at 4 & ¶¶ 9-10, at 44-49, ¶¶ 28-29, at 58-59 & ¶¶ 48-147, at 66-107.

11. See Award, *supra* note 3, ¶ 38, at 10; see also MEMORIAL, *supra* note 3, at 5 & ¶¶ 66-68, at 73-74.

12. See Award, *supra* note 3, ¶ 40, at 10; see also MEMORIAL, *supra* note 3, at 7, ¶ 9(4), at 45 & ¶¶ 80-81, at 78-79.

13. See Award, *supra* note 3, ¶ 41, at 10; see also MEMORIAL, *supra* note 3, at 7 & ¶ 81, at 79.

14. See Award, *supra* note 3, ¶ 42, at 10; see also MEMORIAL, *supra* note 3, at 7 & ¶ 83, at 80.

15. See Award, *supra* note 3, ¶¶ 43-45 & 47-50, at 11-12; see also MEMORIAL, *supra* note 3, at 8-15, ¶ 14, at 50-51, ¶¶ 34-40, at 60-64 & ¶¶ 84-86, at 80-81.

16. See Award, *supra* note 3, ¶¶ 51 & 54, at 12; see also MEMORIAL, *supra* note 3, at 15.

proceedings against Metalclad in an attempt to prevent the opening of the Landfill.¹⁷ Metalclad further alleged that Guadalcazar and San Luis Potosi officials retained demonstrators who blocked access to the Landfill, thereby preventing initiation of operations.¹⁸ Subsequent attempts to resolve the controversy through negotiation failed, and, on September 23, 1997, three days before the expiration of his term, Unzueta issued a decree creating an ecological preserve that included within its boundaries the entirety of the Landfill.¹⁹ As a result, Metalclad's operations at La Pedrera ceased, and the Landfill never opened for business.²⁰

In the era of the pre-global economy, Metalclad would have suffered economic losses arising from the actions of Guadalcazar and San Luis Potosi without the opportunity for recompense. However, on October 2, 1996, Metalclad notified Mexico of its intent to initiate arbitration pursuant to Subchapter B of the North American Free Trade Agreement (NAFTA) to recover losses suffered by it as a result of the actions of officials of Guadalcazar and San Luis Potosi with respect to the Landfill.²¹ Metalclad claimed that it had been "whipsawed" between the federal, state and local governments²² and that the operation of the Landfill had become increasingly political at the expense of science and fundamental property rights.²³ The company alleged that the actions of Guadalcazar and San Luis Potosi constituted a violation by Mexico of its obligations with respect to the protection of international investments pursuant to NAFTA.²⁴ Metalclad initiated arbitration proceedings against Mexico before the International Centre for the Settlement of Investment Disputes (ICSID) on January 2, 1997.²⁵ Over three and one-half years later, on August 30, 2000, the ICSID tribunal

17. See Award, *supra* note 3, ¶¶ 55-56, at 12-13; see also MEMORIAL, *supra* note 3, at 17, 26, ¶ 9(2), at 44-45, ¶¶ 42-44, at 65 & ¶ 140, at 104-5.

18. See Award, *supra* note 3, ¶ 46, at 11; see also MEMORIAL, *supra* note 3, at 9, 16, ¶ 9(5), at 45-46, ¶ 29, at 58-59 & ¶¶ 89-90, at 82-83.

19. See Award, *supra* note 3, ¶¶ 58-59, at 13; see also MEMORIAL, *supra* note 3, at 16-27, ¶ 9(6), at 46 & ¶¶ 102-47, at 88-107.

20. See Award, *supra* note 3, ¶ 62, at 13; see also MEMORIAL, *supra* note 3, at 27 & ¶ 146, at 106-7.

21. See Award, *supra* note 3, ¶ 7, at 5; see also MEMORIAL, *supra* note 3, at 35.

22. MEMORIAL, *supra* note 3, ¶ 11, at 49.

23. See MEMORIAL, *supra* note 3, at 15, 20-21, 23, ¶ 97-98, at 86-87 & ¶¶ 148-50, at 108-9.

24. See generally North American Free Trade Agreement, Dec. 8, 1993, 107 Stat. 2057, 32 I.L.M. 289, 1993 WL 574441 [hereinafter NAFTA].

25. See Award, *supra* note 3, ¶ 8, at 5; see also MEMORIAL, *supra* note 3, at 35.

issued an opinion in which it determined that Mexico failed to accord Metalclad's investment fair and equitable treatment in violation of Article 1105²⁶ and expropriated such investment in violation of Article 1110.²⁷ The tribunal's decision marked the first time that one of the three NAFTA member states had lost a case brought against it pursuant to the investor-state provisions of Chapter Eleven.²⁸

The *Metalclad* Arbitration provoked a firestorm of criticism. Environmentalists decried the claims as an assault upon domestic environmental laws²⁹ and an abuse of Chapter Eleven's investor-state provisions in a manner not intended by the contracting parties.³⁰ Critics further charged that Metalclad's claims were demonstrative of a trend in the utilization of Chapter Eleven favoring the protection of the profits of multinational corporations over legitimate exercises of sovereignty by local governments.³¹ The procedures by which Metalclad's claims were resolved were condemned as undemocratic primarily due to their secrecy and the lack of input from Guadalupe and San Luis Potosi.³² Furthermore, critics claimed that utilization of NAFTA in this fashion would deny the public its previously uninhibited right to clean water and air and serve to chill the adoption of environmental measures by national and local governments in the future.³³ As a result, several environmental groups, including the Council of Canadians, Greenpeace and the Sierra Club of Canada, have called upon NAFTA's Free Trade Commission to suspend proceedings challenging environmental protections until such time as the contracting parties clarify the relation of

26. See Award, *supra* note 3, ¶¶ 74-101, at 17-20.

27. See *id.* ¶¶ 102-12, at 20-22.

28. See James F. Smith, *Mexico Appeals Decision on Metalclad*, L.A. TIMES, Sept. 1, 2000, at C2.

29. See Danielle Knight, *Mexico Ordered to Pay U.S. Company \$17 Million*, INTER PRESS SERV., available at <http://www.globalpolicy.org/socecon/environment/nafta/html> (Aug. 31, 2000).

30. See Brevetti & Nagel, *supra* note 1, at 1375; see also Abid Aslam, *Corporations Use Trade Pact to Sue Countries*, INTER PRESS SERV., available at <http://www.globalpolicy.org/socecon/tncs/aslam.html> (Sept. 2, 1998); Knight, *supra* note 29.

31. See Knight, *supra* note 29; see also Danielle Knight, *Profit-Hungry Transnationals Will Accelerate Eco-Disasters*, FREE PRESS J., available at <http://www.indiaworld.co.in/news/features/feature378.html> (June 6, 2000).

32. See Brevetti & Nagel, *supra* note 1, at 1375; see also Knight, *supra* note 31.

33. See Aslam, *supra* note 30; see also Knight, *supra* note 29; Jonathon Peterson, *A World of Difference in Trade Views*, L.A. TIMES, Nov. 28, 1999, at A1.

environmental laws to NAFTA's investor-state provisions.³⁴ These groups charged that claims, such as those asserted by Metalclad, would grow in number and severity without immediate action to amend or reinterpret NAFTA's investor-state provisions.³⁵ These concerns were echoed by the U.S. Environmental Protection Agency and NAFTA's Commission for Environmental Cooperation.³⁶

This article examines the tribunal's decision in the *Metalclad* Arbitration and its impact upon environmental regulation. Initially, the article examines the factual background underlying the *Metalclad* Arbitration. Particular emphasis is placed upon the governmental process to which Metalclad was subjected, its impact upon Metalclad's ability to operate the Landfill and the tribunal's decision. Part III of the article analyzes the meaning of the tribunal's decision, its potential impact upon future Chapter Eleven claims and its implications for national and local environmental regulation. The article concludes that, although the tribunal reached the proper result in granting Metalclad relief upon its claims, the consequences for future national and local environmental regulation arising from such claims are nothing short of disastrous. These consequences should provide further impetus to the contracting parties to amend or clarify NAFTA's Chapter Eleven investor-state provisions.

II. THE HISTORICAL BACKGROUND TO METALCLAD

34. See *Environmentalists Press for Broad Review of NAFTA Handling of Cases*, INSIDE U.S. TRADE (Sierra Club of Canada, Ottawa, Ont., Can.), July 1, 1999, at 1 available at <http://www.seirraclub.ca/national/trade-env/wto-brief-jul99.html>; see also Sierra Club of Canada, *Put Growing Number of NAFTA Lawsuits on Hold, Say Groups Concerned with Environment* available at <http://www.canadians.org/campaigns/campaigns-tradedia990422.html> (last modified Apr. 22, 1999); Letter from the Sierra Club of Canada to the North American Commission for Environmental Cooperation 2 (June 28, 1999) (on file with author); Letter from the Sierra Club of Canada to the North American Free Trade Commission 2 (June 24, 1999) (on file with author).

35. See *Latest NAFTA Lawsuit Proves Threat of Chapter 11 to Health and Environmental Laws, Again* (Council of Canadians, Ottawa, Ont., Can.), June 16, 1999, at 1.

36. See *Environmentalists Press for Broad Review of NAFTA Handling of Cases*, *supra* note 34. Former U.S. Environmental Protection Agency Administrator Carol Browner questioned the validity of claims challenging environmental laws pursuant to Chapter Eleven of NAFTA, and the North American Commission for Environmental Cooperation expressed "deep concern over the use of Chapter 11 cases to undermine environmental legislation." *Id.*

CORPORATION V. UNITED MEXICAN STATES

A. THE NORTH AMERICAN FREE TRADE AGREEMENT

Although a comprehensive history of NAFTA is beyond the scope of this article, a brief review of its applicable provisions is necessary in order to place the *Metalclad* Arbitration in its proper context. Effective on January 1, 1994, NAFTA serves several different purposes.³⁷ NAFTA's Preamble identifies fourteen separate purposes to be accomplished by the creation of a free trade area between the United States, Canada and Mexico.³⁸ These purposes are further elaborated in six objectives identified in Article 102. Article 102 specifically provides that the objectives of NAFTA are to: (1) eliminate tariff and non-tariff barriers to trade; (2) promote fair competition; (3) increase investment opportunities; (4) provide protection for intellectual property rights; (5) create procedures for effective implementation and enforcement of the Agreement; and (6) establish a forum for further enhancement and expansion of the benefits provided by the Agreement.³⁹ Article 102(2) provides that the specific provisions of the Agreement are to be

37. NAFTA was implemented in the United States through the adoption of the NAFTA Implementation Act of 1993. See 19 U.S.C. §§ 3301-3473 (1994).

38. See NAFTA, *supra* note 24, at pmb1. NAFTA's purposes as identified in the Preamble are to:

Strengthen the special bonds of friendship and cooperation among [the] nations; contribute to the harmonious development and expansion of world trade and provide a catalyst to broader international cooperation; create an expanded and secure market for the goods and services produced in [the member states'] territories; reduce distortions to trade; establish clear and mutually advantageous rules governing [the member states'] trade; ensure a predictable commercial framework for business planning and investment; build on [the member states'] respective rights and obligations under the General Agreement on Tariffs and Trade and other multilateral and bilateral instruments of cooperation; enhance the competitiveness of [the member states'] firms in the global marketplace; foster creativity and innovation, and promote trade in goods and services that are the subject of intellectual property rights; create new employment opportunities and improve working conditions and living standards in [the member states'] respective territories; undertake each of the preceding in a manner consistent with environmental protection and conservation; preserve [the member states'] flexibility to safeguard the public welfare; promote sustainable development; strengthen the development and enforcement of environmental laws and regulations; and protect, enhance and enforce basic workers' rights.

Id. (capitalization omitted).

39. See *id.* art. 102(1)(a-f).

interpreted and applied "in light of these objectives" and "in accordance with applicable rules of international law."⁴⁰ These purposes and objectives and their implementation within the specific provisions of the Agreement are binding upon the federal governments of the respective parties as well as their subnational components.⁴¹

The rules governing the treatment and protection of foreign investments made by the parties or their nationals within each other's respective territories are set forth in Chapter Eleven of the Agreement. Chapter Eleven has three primary objectives. These objectives are:

- (1) to establish a secure investment environment through the elaboration of clear rules of fair treatment of foreign investment and investors; (2) to remove barriers to investment by eliminating or liberalizing existing restrictions; and (3) to provide an effective means for the resolution of disputes between an investor and the host government.⁴²

These purposes are accomplished through the provision of five basic protections for NAFTA investors and their investments. These basic protections are: (1) nondiscriminatory treatment; (2) freedom from performance requirements; (3) the right to freely transfer funds related to an investment; (4) expropriation only in conformity with international law; and (5) the right to international arbitration to seek redress for purported violations of the Agreement's protections.⁴³ These

40. *Id.* art. 102(2).

41. *See id.* art. 201(2).

42. Daniel M. Price & P. Bryan Christy III, *An Overview of the NAFTA Investment Chapter*, in *THE NORTH AMERICAN FREE TRADE AGREEMENT: A NEW FRONTIER IN INTERNATIONAL TRADE AND INVESTMENT IN THE AMERICAS* 172 (Judith H. Bello et al. eds., 1994).

43. *See* U.S. GEN. ACCT. OFFICE, REP. NO. GAO/GGD-93-137B, *NORTH AMERICAN FREE TRADE AGREEMENT - ASSESSMENT OF MAJOR ISSUES*, vol. 2, at 18 (1993) [hereinafter *GAO REPORT*]. From the standpoint of the United States, these five basic protections incorporate the protections granted to foreign investment by the Canada-United States Free Trade Agreement and the prototypical bilateral investment treaty utilized by the United States. *See id.* at 19. The bilateral investment treaty utilized by the United States provides for:

- (1) nondiscriminatory treatment; (2) elimination of performance requirements; (3) unrestricted "transfers," including capital and profit repatriation; (4) expropriation protection based on international legal standards, including compensation equivalent to the "fair market value" of the investment; and (5) binding third-party arbitration to resolve disputes.

Id. at 19 n.11.

The United States insisted upon the inclusion of these basic protections primarily to liberalize Mexico's investment regime, which was perceived as

protections are broader than any bilateral or multilateral instrument to which the United States is a party and establish a standard for future hemispheric and global investment treaties.⁴⁴

Chapter Eleven applies to “measures adopted or maintained by a Party relating to: (a) investors of another Party; (b) investments of investors of another Party in the territory of the Party; and (c) with respect to Articles 1106 (performance requirements) and 1114 (environmental measures), all investments in the territory of the Party.”⁴⁵ The term “investment” embraces virtually all forms of participation in a business enterprise including majority and minority ownership interests, income and profit-sharing agreements, tangible and intangible property (including goodwill and intellectual property rights) and real estate.⁴⁶ Government procurement and financial

constraining and containing few protections for private investors from state interference. See HOWARD MANN & KONRAD VON MOLTKE, NAFTA’S CHAPTER 11 AND THE ENVIRONMENT: ADDRESSING THE IMPACTS OF THE INVESTOR-STATE PROCESS ON THE ENVIRONMENT 12 (1999).

44. See Price & Christy, *supra* note 42, at 182; see also MANN & VON MOLTKE, *supra* note 43, at 5 (noting that Chapter Eleven contains “the most extensive combination of rights and remedies ever provided to foreign investors in an international agreement”). *Id.*

45. NAFTA, *supra* note 24, art. 1101(1). An “investor of a Party” is defined as “a Party or state enterprise thereof, or a national or an enterprise of such Party, that seeks to make, is making or has made an investment.” *Id.* art. 1139. An “investment of an investor of a Party” is defined as “an investment owned or controlled directly or indirectly by an investor of such Party.” *Id.*

46. Article 1139 defines the term “investment” to mean:

(a) an enterprise; (b) an equity security of an enterprise; (c) a debt security of an enterprise (i) where the enterprise is an affiliate of the investor, or (ii) where the original maturity of the debt security is at least three years, but does not include a debt security, regardless of original maturity, of a state enterprise; (d) a loan to an enterprise (i) where the enterprise is an affiliate of the investor, or (ii) where the original maturity of the loan is at least three years, but does not include a loan, regardless of original maturity, to a state enterprise; (e) an interest in an enterprise that entitles the owner to share in income or profits of the enterprise; (f) an interest in an enterprise that entitles the owner to share in the assets of that enterprise on dissolution, other than a debt security or a loan excluded from subparagraph (c) or (d); (g) real estate or other property, tangible or intangible, acquired in the expectation or used for the purposes of economic benefit or other business purposes; and (h) interests arising from the commitment of capital or other resources in the territory of a Party to economic activity in such territory, such as under (i) contracts involving the presence of an investor’s property in the territory of a Party, including turnkey or construction contracts, or concessions, or (ii) contracts where remuneration depends substantially on the production, revenues or profits of an enterprise; but investment does not mean, (i) claims to money that

services are excluded from NAFTA's investment provisions.⁴⁷ The investment provisions are also subject to general exceptions for national security, taxation, balance of payments and Canadian "cultural industries."⁴⁸

Chapter Eleven is divided into two subchapters. Subchapter A of the Agreement, encompassing Articles 1101 through 1114, sets forth the substantive rights of investors and the duties of the parties with respect to investment. There are six basic protections afforded to investors and investments pursuant to Subchapter A. Article 1102 requires that each party accord to investors of another party and investments of investors of another party "treatment no less favorable than that it accords, in like circumstances, to its own investors [and investments of its own investors] with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments."⁴⁹ This national treatment requirement extends to sub-national states and provinces of the parties.⁵⁰ Article 1103 requires that each party accord to investors of another party and investments of investors of another party "treatment no less favorable than it accords, in like circumstances, to investors [and investments of investors] of any other Party or of a non-Party with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments."⁵¹ Investors of another party and their investments are entitled to the most favorable of the treatments required by Articles 1102 and 1103.⁵² In any event, Article 1105 requires that each party treat investments of investors of another party "in accordance with international law, including fair and equitable treatment

arise solely from (i) commercial contracts for the sale of goods or services by a national or enterprise in the territory of a Party to an enterprise in the territory of another Party, or (ii) the extension of credit in connection with a commercial transaction, such as trade financing, other than a loan covered by subparagraph (d); or (j) any other claims to money, that do not involve the kinds of interests set out in subparagraphs (a) through (h).

NAFTA, *supra* note 24, art. 1139.

47. See GAO REPORT, *supra* note 43, at 20.

48. See *id.* at 20-21. The cultural industries exception does not apply to obligations between the United States and Mexico. See *id.* at 21.

49. NAFTA, *supra* note 24, arts. 1102(1) & (2). Government subsidies payable exclusively to domestic enterprises are excluded from the national treatment provisions of Article 1102. See GAO REPORT, *supra* note 43, at 21.

50. See NAFTA, *supra* note 24, art. 1102(3).

51. *Id.* arts. 1103(1) & (2).

52. See *id.* art. 1104.

and full protection and security.”⁵³ Article 1106 eliminates performance requirements for foreign investors and their investments operating in the territory of a party,⁵⁴ and Article 1109 eliminates restrictions upon the transfer of investment-related funds into and out of a party.⁵⁵

Chapter Eleven also protects investors in the event of expropriation or nationalization of property. Article 1110(1) prohibits the parties from “directly or indirectly nationaliz[ing] or expropriat[ing] an investment of an investor of another Party

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

54. *See id.* art. 1106. Article 1106(1) lists seven performance requirements that may not be imposed with respect to the establishment, acquisition, expansion, management, conduct or operation of an investment of an investor of a party or of a non-party in its territory. *See id.* art. 1106(1). The prohibited requirements include: (1) exportation of a given level or percentage of goods or services; (2) achievement of a specified level of domestic content; (3) purchase from or giving preference to a local supplier; (4) restrictions upon imports to a certain volume or value of exports or to an amount of foreign exchange inflows; (5) restrictions upon domestic sales to a certain volume or value of exports or to an amount of foreign exchange earnings; (6) transfers of technology, production processes or other proprietary knowledge to a domestic entity; and (7) acting as an exclusive supplier of the goods or services it produces to a specific region or world market. *See id.* Furthermore, parties may not utilize the first four listed performance measures as a condition to receive an advantage such as a tax concession or other investment incentive. *See id.* art. 1106(3). However, parties may condition receipt of such advantages on “compliance with a requirement to locate production, provide a service, train or employ workers, construct or expand particular facilities, or carry out research and development, in its territory.” *Id.* art. 1106(4). Parties are also permitted to impose performance requirements other than those prohibited by Articles 1106(1) and (3). *See id.* art. 1106(5). Finally, provided that such measures are not applied in an arbitrary or unjustifiable manner, or do not constitute a disguised restriction on international trade or investment, parties are free to adopt and maintain measures “necessary to secure compliance with laws and regulations that are not inconsistent with the provisions of this Agreement . . . necessary to protect human, animal or plant life or health; . . . or necessary for the conservation of living or non-living exhaustible natural resources.” *Id.* art. 1106(6).

55. *See id.* art. 1109. The prohibition upon transfer restrictions contained within Article 1109 applies to profits, dividends, interest, capital gains, royalties, management fees, returns in kind and other amounts derived from investments. *See id.* art. 1109(1). Proceeds obtained from the sale or liquidation of all or any part of an investment, payments under a contract entered into by an investor or investment and payments arising out of an investment dispute are also subject to the prohibition upon transfer restrictions. *See id.* Furthermore, the parties must permit such transfers to be made in freely convertible foreign currency at the market rate of exchange prevailing on the date of the transfer. *See id.* art. 1109(2). However, these prohibitions are subject to NAFTA’s balance of payment exception as well as restrictions applied in an equitable, non-discriminatory and good faith manner with respect to bankruptcy, insolvency and other proceedings for the protection of creditors, securities laws, criminal or penal offenses, reports of transfers of currency and other monetary instruments or measures designed to ensure satisfaction of judgments. *See id.* art. 1109(4).

in its territory or tak[ing] a measure tantamount to nationalization or expropriation of such an investment” unless the party is able to satisfy four separate criteria.⁵⁶ These criteria are that the taking must: (1) be for a public purpose; (2) occur on a non-discriminatory basis; (3) occur in accordance with due process of law and the requirements of Article 1105(1) of equity, fairness, full protection and security as provided in international law; and (4) occur only upon the payment of compensation.⁵⁷ Adequate compensation is defined in Article 1110(2) as the equivalent of “fair market value of the expropriated investment immediately before the expropriation took place . . . [without] reflect[ing] any change in value occurring because the intended expropriation had become known earlier.”⁵⁸ Criteria that may be utilized to calculate fair market value include going concern value, asset value (including the declared tax value of tangible property) and other appropriate measures of value.⁵⁹ Compensation reflecting the fair market value of the expropriated investment must be paid without delay upon calculation and must be fully transferable and realizable.⁶⁰ If fair market value is to be paid in a G7 currency, such compensation must also include interest at a “commercially reasonable rate” from the date of expropriation to the date of actual payment.⁶¹

Article 1110 does not define what constitutes “a measure

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

57. *See id.*

58. *Id.* art. 1110(2).

59. *See id.*

60. *See id.* arts. 1110(3) & (6). “Fully realizable and transferable compensation” prohibits a party from compensating an injured investor in local currency and then preventing that investor from converting the local currency into the currency of another country before removing it from the territory of the expropriating party. *See* GAO REPORT, *supra* note 43, at 23 n.15.

61. NAFTA, *supra* note 24, art. 1110(4). Article 1138 defines G7 currency as “the currency of Canada, France, Germany, Italy, Japan, the United States or the United Kingdom of Great Britain and Northern Ireland.” *Id.* art. 1138. By contrast, if a party elects to pay compensation in a currency other than that of a G7 country, the amount payable to the injured investor, if converted into a G7 currency at the market rate of exchange prevailing on the date of payment, shall be no less than:

if the amount of compensation owed on the date of expropriation had been converted into that G7 currency at the market rate of exchange prevailing on that date, and interest had accrued at a commercially reasonable rate for that G7 currency from the date of expropriation until the date of payment.

Id. art. 1110(5).

tantamount to nationalization or expropriation.”⁶² Article 1110(8) does provide that a non-discriminatory measure of general application “shall not be considered a measure tantamount to an expropriation of a debt security or loan . . . solely on the ground that the measure imposes costs on the debtor that cause it to default on the debt.”⁶³ Article 1110(7) exempts the creation, licensing, limitation and revocation of intellectual property rights from the operation of Article 1110(1) in the event that such actions occur in a manner consist with Chapter Seventeen of the Agreement relating to intellectual property.⁶⁴ What is clear is that Article 1110’s expropriation and compensation provisions enjoyed full support among representatives of the United States, Canada and Mexico during NAFTA negotiations.⁶⁵ Furthermore, there is no exception to Article 1110 granted to national, state, provincial or local governments, and all levels of government are bound by Article 1110’s commitment.

Subchapter B establishes procedures concerning the settlement of investor disputes. The purpose of Subchapter B is to establish “a mechanism for the settlement of investment disputes that assures both equal treatment among investors of the Parties in accordance with the principle of international reciprocity and due process before an impartial tribunal.”⁶⁶ The investor dispute resolution procedures established by Subchapter B differ from other dispute resolution provisions contained within NAFTA by creating a process that may “be initiated by the investor, without the cooperation or any involvement of its own government, using existing legal procedures for the resolution of international commercial disputes.”⁶⁷ Indeed, the dispute resolution processes set forth in Subchapter B are the first in any multilateral trade or

62. *Id.* art. 1110(1); see also Price & Christy, *supra* note 42, at 175. One prescient commentator noted at the time of the implementation of NAFTA that “[t]his is an area which is certain to receive attention from future NAFTA dispute settlement panels as acts which are not considered to constitute expropriation by the host state, but which impair the benefits of NAFTA investors, may be subject to this NAFTA obligation.” BARRY APPLETON, *A CONCISE USER’S GUIDE TO THE NORTH AMERICAN FREE TRADE AGREEMENT* 86 (1994).

63. NAFTA, *supra* note 24, art. 1110(8).

64. See *id.* art. 1110(7).

65. See LESLIE A. GLICK, *UNDERSTANDING THE NORTH AMERICAN FREE TRADE AGREEMENT* 25 (2d ed. 1994).

66. NAFTA, *supra* note 24, art. 1115.

67. Tim Kennish, *NAFTA and Investment - A Canadian Perspective*, in *NAFTA AND INVESTMENT* § 4.2, at 31 (Seymour J. Rubin & Dean C. Alexander eds., 1995).

investment agreement to grant foreign private investors the capacity to directly challenge host governments with respect to their compliance with the Agreement.⁶⁸ Pursuant to Articles 1116 and 1117, an investor of a party, on its own behalf,⁶⁹ or on behalf of an enterprise that the investor owns or controls,⁷⁰ may initiate a claim alleging that the investor or the enterprise has suffered injury as a result of a breach by the host state of a provision of NAFTA.⁷¹ Private parties are not required to exhaust available remedies pursuant to the laws of the host state prior to initiating a claim pursuant to Chapter Eleven's investor dispute resolution mechanism.⁷²

Actions of national, state, provincial and local governments in contravention of Chapter Eleven may form the basis of a valid claim asserted by an injured investor pursuant to NAFTA's investor dispute resolution procedures.⁷³ The national governments of the Parties are charged with responsibility for assuring implementation of NAFTA's provisions and are accountable in the event that they are unable to secure state or

68. See MANN & VON MOLTKE, *supra* note 43, at 4. From the U.S. standpoint, the primary target of this unprecedented grant of standing to private foreign investors was Mexico in order that "U.S. companies no longer face an unbalanced environment in an investment dispute with the Mexican government but can seek arbitration outside Mexico by an independent body." *Id.* at 12.

69. See NAFTA, *supra* note 24, art. 1116(1). Article 1116(1) provides, in part, that "[a]n investor of a Party may submit to arbitration under this section a claim that another Party has breached an obligation under . . . Section A . . . and that the investor has incurred loss or damage by reason of, or arising out of, that breach." *Id.*

70. See *id.* art. 1117(1). Article 1117(1) provides, in part, that:

[a]n investor of a Party, on behalf of an enterprise of another Party that is a juridical person that the investor owns or controls directly or indirectly, may submit to arbitration under this Section a claim that the other Party has breached an obligation under . . . Section A . . . and that the enterprise has incurred loss or damage by reason of, or arising out of, that breach.

Id.

Commentators have noted the importance of this provision in permitting investors to maintain actions against host states where the alleged injury is indirect. See Kennish, *supra* note 67, § 4.3, at 32 (noting that "[t]he importance of this provision is that it permits the investor to assert a claim [on behalf of an entity] . . . where the only injury has been sustained by the entity and the investor has himself not been independently or directly injured.") *Id.* See also Price & Christy, *supra* note 42, at 177 (noting that Article 1117 "is intended to . . . [permit] the investor to assert a claim for injury to its investment even where the investor itself does not suffer loss or damage independent from that of the injury to its investment.") *Id.*

71. An investor making a claim pursuant to Subchapter B is referred to as a "disputing investor." NAFTA, *supra* note 24, art. 1139. The state against which a claim has been made is referred to as a "disputing Party." *Id.*

72. See Kennish, *supra* note 67, § 4.2, at 31 & § 4.3, at 32.

73. See Price & Christy, *supra* note 42, at 178.

provincial compliance. Article 105 provides that “[t]he Parties shall ensure that all necessary measures are taken in order to give effect to the provisions of this Agreement, including their observance . . . by state and provincial governments.”⁷⁴ Article 105 codifies an established principle of international law that holds national governments responsible for acts of their component states, even where existing law does not provide them with the means of compelling such states to fulfill existing international obligations.⁷⁵ In addition, Article 105 codifies the long-standing recognition by the United States that it is responsible for the misconduct of its states⁷⁶ as well as its understanding with respect to the liability of national governments for violations of NAFTA by their component states and provinces.⁷⁷ Article 1105(1) also requires that the parties provide “full protection and security” to investments of investors of other Parties.⁷⁸ This provision codifies another established principle of international law holding states responsible for their failure to exercise due care to prevent harm to aliens caused by third parties within their jurisdiction.⁷⁹

Arbitration is the mode of dispute resolution selected by NAFTA with respect to claims between injured investors and the national governments of the Parties. Article 1122 provides

74. NAFTA, *supra* note 24, art. 105.

75. See IAN BROWNLIE, SYSTEM OF THE LAW OF NATIONS: STATE RESPONSIBILITY 141 (1983) (noting that “[i]t is well settled that a state cannot plead the principles of municipal law, including its constitution, in answer to an international claim.”).

76. The U.S. State Department has acknowledged that, in its relations with other states maintaining federal forms of government, “[the United States has] invariably insisted on the liability of the Federal Government, although the failure . . . was chargeable to the officials of one of the constituent states or provinces.” 5 GREEN HAYWOOD HACKWORTH, DIGEST OF INTERNATIONAL LAW § 527, at 594 (1943).

77. The U.S. Statement of Administrative Action with respect to NAFTA provides that “no country can avoid its commitments under the Agreement by claiming that the measure in question is a matter of state or provincial jurisdiction.” [NAFTA] Statement of Administrative Action 5, *in* Message From the President of the United States, H.R. DOC. NO. 103-159, vol. 2, at 5 (1993). In this regard, the U.S. Trade Representative noted that “Article 105 . . . mean[s] that the federal government will be held accountable if it cannot secure state or provincial compliance with NAFTA obligations.” Letter from Michael Kantor, U.S. Trade Representative, to Henry A. Waxman, Chairman, Subcommittee on Health and the Environment 4 (Sept. 7, 1993), *reprinted in* 1993 U.S.C.C.A.N. 2858, 2862.

78. NAFTA, *supra* note 24, art. 1105(1).

79. See RESTATEMENT (SECOND) OF THE FOREIGN RELATIONS LAW OF THE UNITED STATES § 183(b)(ii) (1965); *see also* BROWNLIE, *supra* note 75, at 161; LOUIS HENKIN, INTERNATIONAL LAW: CASES AND MATERIALS 717 (3d ed. 1993).

that each Party consents to the submission of claims to arbitration in accordance with Subchapter B.⁸⁰ Investors may submit their arbitration claims under the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID Convention),⁸¹ the Additional Facility Rules of the ICSID Convention⁸² or the Arbitration Rules of the United Nations Commission on International Trade Law.⁸³ Despite these options, as the United States is the only NAFTA member currently a signatory to the ICSID Convention, arbitration claims against it can only proceed pursuant to the Additional Facility Rules or the UNCITRAL Arbitration Rules.⁸⁴

There are several limitations placed upon claims asserted by investors against the national governments of the parties. Claims must be submitted within three years "from the date on which the investor first acquired, or should have acquired, knowledge of the alleged breach and knowledge that the investor has incurred loss or damage."⁸⁵ However, claims cannot

80. See NAFTA, *supra* note 24, art. 1122(1).

81. See *id.* art. 1120(1)(a). See generally Convention on the Settlement of Investment Disputes, Mar. 18, 1965, 17 U.S.T. 1270, 575 U.N.T.S. 159 [hereinafter ICSID Convention]. A claim for arbitration can only be brought pursuant to the ICSID Convention if "both the disputing Party and the Party of the investor are parties to the Convention." NAFTA, *supra* note 24, art. 1120(1)(a).

82. See NAFTA, *supra* note 24, art. 1120(1)(b). See generally Rules Governing the Additional Facility for the Administration of Proceedings by the Secretariat of the International Centre for Settlement of Investment Disputes, ICSID Doc. 11 (June 1979), available at www.icsid/facility/facility/htm [hereinafter Additional Facility Rules]. A claim for arbitration pursuant to the Additional Facility Rules may be brought if "either the disputing Party or the Party of the investor, but not both, is a party to the ICSID Convention." NAFTA, *supra* note 24, art. 1120(1)(b).

83. See NAFTA, *supra* note 24, art. 1120(1)(c). See generally Arbitration Rules of the United Nations Commission on International Trade Law, Report of the United Nations Commission on International Trade Law, Official Records of the United Nations General Assembly, 31st Sess., Supp. No. 17 (A/31/17), ch. V § C (1976) [hereinafter UNCITRAL Arbitration Rules].

84. The ICSID Convention had been signed or ratified by 148 states as of September 2000. See *List of Contracting States and Other Signatories of the Convention*, Int'l Centre for Settlement of Inv. Disputes, at 1-5 (2000). The United States signed the ICSID Convention on August 27, 1965 and deposited its ratification on June 10, 1966. See *id.* at 5. The ICSID Convention entered into force with respect to the United States on October 14, 1966. See *id.* See also Price & Christy, *supra* note 42, at 178.

85. NAFTA, *supra* note 24, arts. 1116(2) & 1117(2). A claim is deemed submitted when:

- (a) the request for arbitration under paragraph (1) of Article 36 of the ICSID Convention has been received by the Secretary-General; (b) the notice of arbitration under Article 2 of Schedule C of the ICSID Additional Facility Rules has been received by the Secretary-General; or (c) the notice

be filed within six months of the occurrence of the events giving rise to the claims.⁸⁶ Article 1121(1) requires the disputing investor to waive the right to initiate or continue litigation of the dispute before another administrative tribunal, court or other dispute settlement body as a condition precedent to submission of a claim for arbitration pursuant to Article 1116.⁸⁷ Article 1121(2) establishes the same condition precedent for claims initiated pursuant to Article 1117.⁸⁸ Disputes arising from the financial services industry⁸⁹ or from an action of a party involving national security interests⁹⁰ are outside of the scope of Subchapter B. Subchapter B also is not applicable to certain decisions by Canadian and Mexican investment authorities⁹¹ as well as disputes that an investor may have with private parties in the state in which it invests.⁹²

NAFTA's procedures with respect to investment disputes initially require the parties to attempt to settle claims through consultation or negotiation.⁹³ Failing settlement of the claim, a disputing investor is required to serve upon the disputing party written notice of its intention to submit a claim to arbitration at least ninety days before the actual submission.⁹⁴ The tribunal

of arbitration given under the UNCITRAL Arbitration Rules is received by the disputing Party.

Id. art. 1137(1).

86. *See id.* art. 1120(1).

87. *See id.* arts. 1121(1)(a) & (b). As arbitration panels convened pursuant to Subchapter B are only permitted to award monetary damages and interest, Article 1121 exempts "proceedings for injunctive, declaratory or other extraordinary relief, not involving the payment of damages, before an administrative tribunal or court" from the waiver requirement. *Id.* art. 1121(1)(b); *see also* art. 1135(1).

88. *See id.* arts. 1121(2)(a) & (b).

89. Procedures and protections for the financial services industry are set forth in Chapter 14 of NAFTA. *See* NAFTA, *supra* note 24, arts. 1401-16; *see also* Kennish, *supra* note 67, § 4.3, at 33.

90. *See* NAFTA, *supra* note 24, art. 1138(1) (providing, in part, that "a decision by a Party to prohibit or restrict the acquisition of an investment in its territory by an investor of another Party, or its investment, pursuant to [Article 2102 (National Security)] shall not be subject to [Subchapter B].") *Id.*

91. *See id.* annex 1138.2 With respect to Canada, Annex 1138.2 provides, in part, that "[a] decision . . . following a review under the Investment Canada Act, with respect to whether or not to permit an acquisition that is subject to review, shall not be subject to the dispute settlement provisions of Section B." *Id.* The same exemption is granted to decisions of Mexico's National Commission on Foreign Investment. *See id.*

92. *See* Kennish, *supra* note 67, § 4.3, at 33.

93. *See* NAFTA, *supra* note 24, art. 1118.

94. *See id.* art. 1119. The notice of intent to submit a claim to arbitration must disclose: (1) the name and address of the disputing investor; (2) the name and address of the enterprise (if the claim is to be brought pursuant to Article 1117); (3)

responsible for conducting the arbitration consists of three arbitrators with one arbitrator appointed by each of the disputing parties and a third, who is designated as the presiding arbitrator, appointed by agreement of the disputing parties.⁹⁵ Regardless of its composition, the tribunal must decide the issues in dispute in accordance with NAFTA and applicable rules of international law.⁹⁶

The tribunal is authorized to order interim measures to preserve the rights of the parties or ensure the full effectiveness of the tribunal's jurisdiction.⁹⁷ If a tribunal makes a final award in favor of a disputing investor, it may only award, separately or in combination, monetary damages, interest, restitution of property and costs in accordance with applicable arbitration rules.⁹⁸ Tribunals are expressly prohibited from ordering a party to pay punitive damages.⁹⁹

Although lacking the force of precedent,¹⁰⁰ final awards are binding upon the disputing parties¹⁰¹ and must be fully enforced

the provisions of NAFTA alleged to have been violated by the disputing party; (4) the issues raised by the claim and factual basis for the claim; (5) the factual basis for the claim; and (6) the relief sought and amount of damages claimed. *See id.*

95. *See id.* art. 1123. If a tribunal is not constituted within ninety days from the date of submission of the claim, the secretary-general of ICSID may appoint the arbitrator or arbitrators not yet appointed upon the request of either party. *See id.* art. 1124(2). If the disputing parties are unable to agree upon a presiding arbitrator, the secretary-general of ICSID, on the request of either party, may appoint such arbitrator from a roster of forty-five designated arbitrators appointed by consensus by the parties. *See id.* arts. 1124(3) & (4). The presiding arbitrator so appointed cannot be a national of the disputing investor or party. *See id.* art. 1124(3). If no such person is available to serve as a presiding arbitrator, the secretary-general of ICSID must make his appointment from the ICSID Panel of Arbitrators. *See id.* In any event, the arbitrator selected from the ICSID Panel of Arbitrators may not be a national of any of the parties. *See id.*

96. *See id.* art. 1131(1).

97. *See id.* art. 1134.

98. *See id.* art. 1135(1). In the event the tribunal awards a disputing investor restitution of property, such award must provide that the disputing party may pay monetary damages and applicable interest in lieu of restitution. *See id.*

99. *See id.* art. 1135(3).

100. *See id.* 1136(1). Article 1136(1) specifically provides that "[a]n award made by a Tribunal shall have no binding force except between the disputing parties and in respect of the particular case." *Id.*

101. *See id.* art. 1136(2). Article 1136(2) specifically provides that "a disputing party shall abide by and comply with an award without delay." *Id.* However, a disputing party may not seek enforcement of a final award rendered pursuant to the ICSID Convention until 120 days have elapsed from the date of the award. *See id.* arts. 1136(3)(a)(i-ii). Final awards entered pursuant to the Additional Facility Rules or UNICITRAL Arbitration Rules may not be enforced until three months have elapsed from the date of the award without a request for revision, setting aside or annulment or dismissal by a court possessing jurisdiction without further appeal.

in the territory of all parties.¹⁰² In the event that a disputing party fails to abide by a tribunal's final award, NAFTA's Free Trade Commission, upon request by a party whose investor was a party to the arbitration, shall establish a panel pursuant to Article 2008. This panel must determine whether the disputing party's failure to comply with the tribunal's final award is inconsistent with its obligations pursuant to NAFTA and may recommend that the party comply with the final award.¹⁰³ An investor may seek enforcement of an arbitration award against a disputing party pursuant to the ICSID Convention, the Convention on the Recognition and Enforcement of Foreign Arbitral Awards or the Inter-American Convention on International Commercial Arbitration regardless of the pendency of enforcement proceedings.¹⁰⁴

B. THE FACTUAL BACKGROUND TO THE METALCLAD ARBITRATION

Originally incorporated in 1947 as an Arizona corporation, Metalclad was reincorporated in Delaware in November 1993.¹⁰⁵ The reincorporated Metalclad is a publicly traded company with approximately four thousand shareholders, including institutional shareholders throughout the United States and Europe.¹⁰⁶ Metalclad has wholly owned subsidiaries in the United States and Mexico. Metalclad's subsidiaries in the United States include Eco-Metalclad, Metalclad Insulation

See id. arts. 1136(3)(b)(i-ii).

102. *See id.* art. 1136(4).

103. *See id.* art. 1136(5). Established pursuant to Article 2001(1), NAFTA's Free Trade Commission consists of cabinet-level representatives of the parties and is empowered to "(a) supervise the implementation of [the] Agreement; (b) oversee its further elaboration; (c) resolve disputes that may arise regarding its interpretation or application; (d) supervise the work of all committees and working groups established under this Agreement; . . . and (e) consider any other matter that may affect the operation of this Agreement." *Id.* arts. 2001(1) & (2).

104. *See id.* art. 1136(6); *see also* ICSID Convention, *supra* note 81 and accompanying text; Convention on the Recognition and Enforcement of Foreign Arbitral Awards, June 10, 1958, 21 U.S.T. 2517, 330 U.N.T.S. 38; Inter-American Convention on International Commercial Arbitration, Jan. 30, 1975, 104 Stat. 448 O.A.S.T.S. No. 42, *reprinted in* 1 ICCA INTERNATIONAL HANDBOOK ON COMMERCIAL ARBITRATION, GENERAL INTRODUCTION TO INTER-AMERICAN ARBITRATION, Supp. 2, annex 1 (1984).

105. *See* METALCLAD CORP., 1999 FORM 10-K 3 (2000) [hereinafter METALCLAD 1999 10-K].

106. *See id.* *See also* MEMORIAL, *supra* note 3, ¶ 1, at 40.

Corporation and Metalclad Environmental Contractors.¹⁰⁷ Metalclad's Mexican subsidiaries include Eco Administración, S.A., Consultaria Ambiental Total, S.A., ECONSA and COTERIN.¹⁰⁸ For purposes of this article, Eco-Metalclad and COTERIN are the most relevant subsidiaries. Metalclad is the sole owner of Eco-Metalclad, which in turn is the sole owner of ECONSA.¹⁰⁹ ECONSA in turn wholly owns COTERIN.¹¹⁰

Metalclad has provided insulation and asbestos abatement services to refineries, utilities, chemical and petrochemical plants, manufacturing facilities, commercial properties and various governmental facilities for over thirty years.¹¹¹ Metalclad's insulation services include the installation of high and low temperature insulation on pipe, ducts, furnaces, boilers and other types of industrial equipment.¹¹² Metalclad's asbestos abatement services include removal and disposal of asbestos-containing products.¹¹³ Metalclad also fabricates specialty items for the insulation industry and sells insulation material and accessories incident to its services business to a wide range of customers and contractors.¹¹⁴ These activities generated gross revenue of \$13.4 million in 1999.¹¹⁵

107. See METALCLAD 1999 10-K, *supra* note 105, at 3.

108. See *id.*

109. See Award, *supra* note 3, ¶ 2, at 3-4; see also MEMORIAL, *supra* note 3, ¶ 2, at 40.

110. See Award, *supra* note 3, ¶ 2, at 3-4; see also MEMORIAL, *supra* note 3, ¶ 2, at 40.

111. See METALCLAD 1999 10-K, *supra* note 105, at 3.

112. See *id.*

113. See *id.*

114. See *id.*

115. See *id.* at 26. Gross revenue for 1999 consisted of \$13.1 million in contract revenues, \$224,850 in material sales and \$62,136 in revenues from other sources. See *id.* Gross revenue for 1998 totaled ten million dollars with \$9.9 million derived from contracts, \$92,227 derived from material sales and \$4,250 originating from other activities. See *id.* Gross revenue for 1997 totaled \$8.9 million with \$8.5 million in contract revenues, \$201,900 in material sales and \$235,700 from other sources. See *id.* However, it is important to note that Metalclad incurred operating losses in each of the above-referenced years. In 1999, Metalclad incurred operating expenses of \$12.9 million, resulting in an operating loss of \$1.6 million. See *id.* When combined with its losses from continuing operations (\$1.9 million) and its discontinued operations in Mexico (\$2.2 million), Metalclad suffered a net loss in excess of \$4.1 million in 1999. See *id.* In 1998, Metalclad incurred operating costs of \$9.6 million, resulting in an operating loss of \$1.5 million. See *id.* When combined with losses from continuing operations (\$1.7 million) and its discontinued operations in Mexico (three million dollars), Metalclad suffered a net loss of \$4.7 million in 1998. See *id.* Finally, Metalclad incurred operating costs of \$8.8 million in 1997, resulting in an operating loss of two million dollars. See *id.* When combined with losses from its continuing operations (two million dollars) and its discontinued

Metalclad first began to seriously evaluate entry into the integrated industrial waste management business in Mexico in the late 1980s. Metalclad viewed Mexico as an “exciting” market for its hazardous waste treatment business “with potential for increased growth, capital and revenues.”¹¹⁶ There was ample evidence to support this belief. Mexico generated six million tons of industrial waste annually in the early 1990s.¹¹⁷ It has been estimated that only 300,000 tons of this waste was adequately treated in accordance with international environmental standards.¹¹⁸ The remaining waste was stored on site or dumped into sewers or at illegal sites.¹¹⁹ In fact, only one facility in the entire country offered treatment of hazardous industrial waste in conformance with international standards.¹²⁰ Located in Mina in the northern Mexican State of Nuevo Leon, this facility has a maximum annual capacity of 600,000 tons of hazardous waste and is a nine-hour drive from Mexico’s primary industrial areas, where seventy percent of the country’s hazardous waste is produced.¹²¹

By the mid-1990s, Mexico was generating in excess of ten million tons of hazardous waste annually.¹²² Metalclad estimated that less than ten percent of this waste was properly treated.¹²³ Despite this increase in the amount of hazardous waste produced in the country, only one additional disposal facility was in operation.¹²⁴ Located in the state of Hermisillo, this small facility only accepted hazardous waste generated within the state.¹²⁵ Representatives of the Mexican government, Mexican industry and national and international organizations were in agreement that “waste treatment and disposal [was] one

operations in Mexico (\$2.6 million), Metalclad suffered a net loss of \$4.6 million in 1997. *See id.* All references to currency will be denominated in U.S. dollars unless otherwise noted.

116. Andrew Wheat, *Toxic Shock in a Mexican Village*, 16 MULTINATIONAL MONITOR 1 (Oct. 1995) (quoting Elgin Williams of Metalclad).

117. *See* Arturo Borja Tamayo, *The New Federalism, Internationalization and Political Change in Mexico: A Theoretical Analysis of the Metalclad Case*, Doc. No. 59, Centro de Investigación y Docencia Económicas 8 (1998).

118. *See id.*

119. *See id.* at 9.

120. *See id.*

121. *See* MEMORIAL, *supra* note 3, at 28. The Mina facility is located near the city of Monterrey and is operated by a joint venture between Residuos Industriales Multiquin, S.A. (RIMSA) and U.S.-based WMX Technologies. *See id.* ¶ 19, at 53.

122. *See id.*

123. *See id.*

124. *See id.*

125. *See id.*

of the most urgent national development problems."¹²⁶ Metalclad was thus justifiably bullish about the potential of the Mexican hazardous waste industry.

In 1990, Metalclad set a goal of capturing seventy percent of Mexico's toxic waste management market.¹²⁷ It was Metalclad's express intent to "provide a full-service network of locations, including treatment and disposal facilities, to provide professional, environmentally safe, handling and disposal of industrial waste streams."¹²⁸ Metalclad launched its plan in 1991 through vigorous acquisition and marketing strategies throughout Mexico.¹²⁹ In addition to its acquisition of COTERIN, Metalclad advanced substantial amounts of capital to its Mexican subsidiaries.¹³⁰ Metalclad's subsidiary Total Environmental Consulting, S.A. was to provide environmental consulting services while Metalclad's subsidiaries Omega Chemistry and Potosi Ecosystems were to recycle toxic wastes and oil into fuels for Mexican industries and provide waste confinement and incineration services.¹³¹ Capital for the development of Metalclad's operations in Mexico was obtained through private placements of common stock and convertible subordinated debentures and the securing of loans from financial institutions.¹³² Most importantly, Metalclad established contacts with Mexican federal and state authorities in order "to obtain information about authorizations for industrial waste-processing facilities."¹³³ These contacts included Teofilo Torres Corzo, the governor of the Mexican State of San Luis Potosi.¹³⁴

Located in the eastern half of central Mexico, San Luis Potosi is a predominantly agrarian state consisting of scattered small villages that have not shared in the growing prosperity enjoyed in other parts of the country. As in other parts of Mexico, hazardous waste disposal constitutes a significant environmental threat. There are approximately seventy clandestine dump sites within San Luis Potosi that contain

126. Tamayo, *supra* note 117, at 5.

127. See Wheat, *supra* note 116, at 4.

128. METALCLAD 1999 10-K, *supra* note 105, at 3.

129. See *id.* See also Wheat, *supra* note 116, at 4.

130. See METALCLAD 1999 10-K, *supra* note 105, at 16.

131. See Wheat, *supra* note 116, at 5.

132. See METALCLAD 1999 10-K, *supra* note 105, at 16.

133. Tamayo, *supra* note 117, at 10.

134. See *id.*

hazardous waste.¹³⁵ With a population of 28,357, the municipality of Guadalucazar is a county within San Luis Potosi.¹³⁶ As in San Luis Potosi, the population is predominantly rural and resides in small villages.¹³⁷ The municipality is impoverished with no transportation facilities and only one medical facility.¹³⁸ Ninety-nine percent of the homes within Guadalucazar lack drainage, ninety-five percent lack running water and seventy-four percent do not have electricity.¹³⁹ Residents of Guadalucazar suffer from a high degree of illiteracy,¹⁴⁰ and the population is highly migratory, thereby resulting in negative population growth.¹⁴¹ Most importantly for purposes of this article, within the borders of Guadalucazar and one hundred kilometers northeast of the capital city of San Luis Potosi lies the valley known as La Pedrera.¹⁴²

In late 1989, SEDUE closed a hazardous waste landfill operated by Salvador Aldrett, a Mexican national, located in Mexquitic de Carmona in San Luis Potosi.¹⁴³ Aldrett had owned and operated the Mexquitic landfill since 1981. As part of its closure order, SEDUE agreed that Aldrett could relocate the Mexquitic landfill to La Pedrera.¹⁴⁴ On October 31, 1990, pending approval of an application to establish the Landfill, SEDUE authorized Aldrett, by and through COTERIN, to build and operate a transfer station for the temporary storage of hazardous waste at the site.¹⁴⁵ Upon receipt of the SEDUE permit and with the consent of authorities in San Luis Potosi

135. See Smith, *supra* note 28, at C2.

136. See MEMORIAL, *supra* note 3, ¶ 7, at 42. Municipalities in Mexico are subdivisions of states and are similar to counties in states within the United States. The municipality of Guadalucazar accounts for 1.69% of the population of the state of San Luis Potosi. See *id.*

137. See *id.* Only five of the eighty-two communities within Guadalucazar have more than one thousand inhabitants. See *id.*

138. See *id.* ¶ 7, at 42-43.

139. See *id.* ¶ 7, at 42.

140. See *id.*

141. See *id.*

142. See *id.* ¶ 7, at 43.

143. See Wheat, *supra* note 116, at 1. The reasons for SEDUE's closure order are of some dispute. In his study of the Metalclad Arbitration, Andrew Wheat concluded that SEDUE shut the Mexquitic landfill due to health and environmental complaints from local residents. See *id.* By contrast, in its Memorial filed with ICSID, Metalclad stated that the closure order was the result of a "political dispute" between Aldrett and the governor of San Luis Potosi. MEMORIAL, *supra* note 3, ¶ 16, at 52.

144. See MEMORIAL, *supra* note 3, ¶ 16, at 52.

145. See *id.* ¶ 16, at 51.

and Guadalcazar, COTERIN constructed the hazardous waste transfer station at La Pedrera.¹⁴⁶ It is important to note that Guadalcazar did not require Aldrett or COTERIN to obtain a permit of any kind prior to the construction and operation of the transfer station.¹⁴⁷ In any event, between the opening of the transfer station in October 1990 and its subsequent closure by SEDUE for unauthorized activities in excess of the permit on September 25, 1991, 55,000 drums representing approximately 20,000 tons of waste were stored at La Pedrera.¹⁴⁸ This amount constituted approximately twenty-eight percent of the hazardous waste generated on an annual basis in San Luis Potosi.¹⁴⁹

Despite the closure of the transfer station, COTERIN continued to pursue its application to operate the Landfill, conducting soil tests and geological and hydrogeological studies and drafting environmental impact and risk assessment statements.¹⁵⁰ In addition to COTERIN's activities, two separate studies of the suitability of La Pedrera for a hazardous waste landfill were conducted during this period of time. In July 1991, Sergio Aleman Gonzalez, a professor at AUSLP, published a study of the geology underlying the Landfill.¹⁵¹ In his study, Aleman concluded that La Pedrera was unsuitable as a landfill site due to the existence of numerous aquifers, underground streams and caverns, the porous nature of its rock strata and evidence of recent seismic activity in the region.¹⁵² By contrast, in October 1991, Gilbert Humara Gomez, a consultant retained by COTERIN, published his findings with respect to the geology underlying the Landfill.¹⁵³ Humara's findings were in direct contradiction to those made by Aleman. Humara accused Aleman of falsifying data and claimed that the tests allegedly performed by Aleman were incapable of being performed at the time and in the manner claimed.¹⁵⁴ As a result, Humara labeled

146. *See id.* ¶ 17, at 52.

147. *See id.*

148. *See id.* ¶ 19, at 53; *see also* Wheat, *supra* note 116, at 2.

149. *See* MEMORIAL, *supra* note 3, ¶ 19, at 53. San Luis Potosi generates approximately 72,000 tons of hazardous waste on an annual basis. *See id.*

150. *See id.* ¶ 20, at 53.

151. *See id.* ¶ 54, at 68-69.

152. *See id.* In its Memorial, Metalclad contended that the conclusions reached by Aleman were suspect due to his resignation from AUSLP in August 1991 in order to accept a position as a consultant with RIMSA. *See id.*

153. *See id.* ¶ 57, at 69-70.

154. *See id.*

Aleman's study as a "patent sham."¹⁵⁵ Rather, Humara claimed that his tests demonstrated that La Pedrera met all national and local requirements governing the operation of hazardous waste landfills.¹⁵⁶ Regardless of the merits of either of these studies, COTERIN's pursuit of an operating permit for the Landfill continued unabated throughout the remainder of 1991 and the entirety of 1992.

The lengthy nature of this permitting process took a toll upon the health of Aldrett, who consequently expressed an interest in selling his interest in COTERIN.¹⁵⁷ Concerned that Aldrett's withdrawal would negatively impact the Landfill project, Mexican federal officials actively sought out and introduced potential U.S. investors to Aldrett.¹⁵⁸ One such potential investor was Metalclad.¹⁵⁹ As a result, Metalclad officers met with numerous Mexican government officials, including the Secretary and Deputy Secretary for Environment of SEDUE, the Secretary of Labor, the President and Vice President of the Mexican Investment Board and the Mexican Ambassador to the United States.¹⁶⁰ In the meantime, on January 23, 1993, INE, on behalf of SEMARNAP, granted COTERIN a federal permit to construct the Landfill.¹⁶¹ Three months later, on April 23, 1993, Metalclad entered into a six month option agreement to purchase Aldrett's interest in COTERIN, including its issued permits and those in process in order to construct and operate the Landfill.¹⁶²

Two and one-half weeks after the execution of the option agreement, on May 11, 1993, the Secretariat of Urban and Ecological Development of San Luis Potosi granted COTERIN a state land use permit to construct the Landfill.¹⁶³ The permit was issued subject to the condition that the project adapt to specifications and technical requirements established by federal and state authorities.¹⁶⁴ The permit was also conditional upon the concurrence of the San Luis Potosi Congress.¹⁶⁵ As part of its

155. *Id.*

156. *See id.* at 1.

157. *See id.* ¶ 20, at 53.

158. *See id.* ¶ 20, at 53-54.

159. *See id.* ¶ 20, at 54.

160. *See id.*

161. *See Award, supra* note 3, ¶ 29, at 9.

162. *See id.* ¶ 30, at 9; *see also* MEMORIAL, *supra* note 3, ¶ 22, at 54.

163. *See Award, supra* note 3, ¶ 31, at 9; *see also* MEMORIAL, *supra* note 3, ¶ 23, at 54-55.

164. *See Award, supra* note 3, ¶ 31, at 9.

165. *See* MEMORIAL, *supra* note 3, ¶ 23, at 55.

deliberative process, the state congress requested a review of the La Pedrera site by a group of three geology professors from AUSLP.¹⁶⁶ The professors determined the La Pedrera site to be adequate and recommended approval of the state land use permit, which recommendation was accepted by the state congress.¹⁶⁷

In order to gain support for the Landfill, Metalclad initiated a series of meetings with federal and state government officials after the issuance of the state land use permit. On June 11, 1993, Metalclad officials met with Horacio Sanchez Unzueta, the newly elected governor of San Luis Potosi, who had declared during his campaign that the establishment of a hazardous waste treatment facility within the state was his "highest priority."¹⁶⁸ Unzueta subsequently issued a letter assuring Metalclad of his support for the Landfill.¹⁶⁹ Additionally, during the summer of 1993, Metalclad met with the Secretary of Social Development, the Mexican Attorney General for the Environment and the President of INE.¹⁷⁰ Metalclad specifically alleged that it was told by the President of INE that "all necessary permits for the landfill had been issued with the exception of the federal permit for operation of the landfill."¹⁷¹ Metalclad further asserted that the General Director of SEDUE stated that "responsibility for obtaining project support in the state and local community lay with the federal government."¹⁷² Subsequent to these meetings, on August 10, 1993, INE granted COTERIN a federal permit for the operation of the Landfill.¹⁷³ Based upon the issuance of this permit and the assurance of federal and state government officials that COTERIN now possessed all of the necessary permits to construct and operate the Landfill, Metalclad exercised its option upon Aldrett's interest in COTERIN on September 10, 1993.¹⁷⁴

Metalclad's confidence in the security of its investment was to prove to be short-lived. In June 1993, Dr. Pedro Medellin

166. *See id.*

167. *See id.*

168. *Id.* ¶ 49, at 67. Unzueta was inaugurated as Governor of San Luis Potosi on May 18, 1993. *See id.* ¶ 48, at 66.

169. *See id.* ¶ 49, at 66.

170. *See id.* ¶ 24, at 55-56; *see also* Award, *supra* note 3, ¶¶ 33-34, at 9-10.

171. Award, *supra* note 3, ¶ 33, at 9.

172. *Id.* ¶ 34, at 10.

173. *See id.* ¶ 35, at 10; *see also* MEMORIAL, *supra* note 3, ¶ 24, at 55.

174. *See* Award, *supra* note 3, ¶¶ 35-36, at 10; *see also* MEMORIAL, *supra* note 3, ¶ 24, at 55-56.

Milan, one of the three geology professors who studied the Landfill site on behalf of the state congress, succeeded Dr. Fernando Diaz Barriga as State Director of the Environment in San Luis Potosi.¹⁷⁵ Barriga's strong support was replaced by equally strong opposition by Medellin, who reversed his previous position with respect to the Landfill.¹⁷⁶ In November 1993, Medellin sent correspondence to numerous Mexican federal officials expressing his "official doubts" about the Landfill.¹⁷⁷ Medellin's withdrawal of support was based primarily on the results of the previously referenced report by Aleman.¹⁷⁸

Medellin's skepticism with respect to the Landfill subsequently infected Governor Unzueta, who publicly announced his opposition to the Landfill on January 9, 1994.¹⁷⁹ Unzueta met with representatives of Metalclad on January 28, 1994, at which time he purportedly retracted his opposition to the construction of the Landfill if Metalclad satisfied additional technical concerns raised by certain AUSLP faculty members.¹⁸⁰ Metalclad initiated the requested study in conjunction with AUSLP on February 3, 1994.¹⁸¹ Despite the pendency of the requested AUSLP study, Unzueta subsequently consented to the initiation of construction activities at the Landfill site. After obtaining an eighteen-month extension of the previously issued federal construction permit from INE, Metalclad commenced construction on May 16, 1994.¹⁸² Barring interruption, Metalclad estimated completion of its construction activities and opening of the Landfill on December 15, 1994.¹⁸³ During the

175. See MEMORIAL, *supra* note 3, ¶ 53, at 68.

176. See *id.*

177. *Id.*

178. See *id.* ¶ 54, at 68-69.

179. See *id.* ¶ 61, at 70-71.

180. See *id.* ¶ 63, at 71.

181. See *id.* ¶ 64, at 71-72. Governor Unzueta appointed three professors from the faculty of AUSLP to undertake the requested study of the Landfill site. See *id.* ¶ 64, at 71. These professors concluded that additional permeability, hydrogeology and underground water flow studies were necessary as well as the drilling of additional test holes and analysis of resultant core samples. See *id.* ¶ 64, at 72. The study was not completed until April 1995. See *id.* ¶ 64, at 71. In its Memorial, Metalclad alleged that the AUSLP professors reached a consensus that "the La Pedrera site was adequate for a landfill and the project complied with all scientific and technological requisites." *Id.* ¶ 64, at 72. However, Metalclad further alleged that Unzueta prohibited the AUSLP professors from issuing their report or publicly revealing their conclusions. See *id.* ¶ 64, at 72 & ¶ 76, at 77.

182. See *id.* ¶ 68, at 74; see also Award, *supra* note 3, ¶ 38, at 10.

183. See MEMORIAL, *supra* note 3, ¶ 68, at 74.

intervening period of time, Metalclad requested that PROFEPA conduct an ecological audit of the Landfill in order to dispel doubts arising from the past operation of the transfer station.¹⁸⁴ PROFEPA agreed to undertake the requested audit upon the condition that Metalclad fund its cost.¹⁸⁵

Construction continued on the Landfill without interruption until October 26, 1994.¹⁸⁶ At that time, Guadalcazar served a notice upon Metalclad ordering an immediate cessation of construction activities due to the absence of a municipal construction permit.¹⁸⁷ In its Memorial, Metalclad alleged that the October 26 order was “the first indication by any governmental official that a municipal construction permit was essential.”¹⁸⁸ This cessation of construction activities was ordered despite the fact that Guadalcazar had no office or official charged with the issuance and oversight of construction permits, had never received a request for or granted such a permit, had never sanctioned any person for engaging in construction without a permit and had never submitted reports on its permit activities as required by the laws of San Luis Potosi.¹⁸⁹ Despite the prohibition contained within the order, Metalclad alleged that it was directed to resume construction by Zaragoza García, PROFEPA’s delegate to San Luis Potosi, who assured the company of the primacy of federal approval of the project over state and municipal concerns.¹⁹⁰ Nevertheless, García instructed Metalclad to submit an application for a municipal construction permit as a gesture of respect for local government officials.¹⁹¹ Metalclad submitted its application to Guadalcazar and resumed construction on the site on November

184. *See id.* ¶ 74, at 76.

185. *See id.* Initiated in November 1994 and completed on March 28, 1995 by outside environmental consultants approved by PROFEPA, the results of the environmental audit were publicly announced on June 6, 1995. *See id.* at 10 & ¶ 14, at 50. In its Memorial, Metalclad contended that Antonio Azuela, the chief operating official of PROFEPA, concluded that La Pedrera was “the best site in Mexico for a hazardous waste landfill.” *Id.* at 11. PROFEPA subsequently issued a public statement that Metalclad had complied with all federal laws and regulations with respect to the Landfill and authorized its operation in September 1995. *See id.* at 12. Metalclad alleged that the combined costs of the AUSLP study and PROFEPA audit were in excess of \$1.5 million. *See id.* ¶ 74, at 76.

186. *See Award, supra* note 3, ¶ 39, at 10.

187. *See id.* ¶ 40, at 10; *see also* MEMORIAL, *supra* note 3, ¶ 80, at 78.

188. MEMORIAL, *supra* note 3, ¶ 80, at 78.

189. *See id.* ¶ 214, at 141.

190. *See id.* ¶ 81, at 79; *see also* Award, *supra* note 3, ¶ 41, at 10.

191. *See Award, supra* note 3, ¶ 41, at 10; *see also* MEMORIAL, *supra* note 3, ¶ 81, at 79.

15, 1994.¹⁹²

Municipal opposition continued unabated in 1995 despite the issuance of an additional permit by INE on January 31, 1995 for construction of the final disposition cell for hazardous waste and the Landfill's administration building and laboratory.¹⁹³ Construction activities were substantially completed on March 10, 1995, at which time Metalclad scheduled an "Opening Celebration" involving over three hundred invited local and foreign dignitaries.¹⁹⁴ Although invited, Unzueta refused to attend and, according to Metalclad, disrupted the event through the transportation of approximately one hundred armed demonstrators to the Landfill.¹⁹⁵ These demonstrators allegedly intimidated Metalclad's guests and blocked access to the site in excess of three hours.¹⁹⁶ Metalclad further alleged that Unzueta caused armed state police officers to be placed at the entrance to the Landfill, who stopped, searched and occasionally denied access to vehicles attempting to enter the site.¹⁹⁷ Refusing to acquiesce in the transformation of San Luis Potosi into a "national dumpsite,"¹⁹⁸ Unzueta and Medellin urged INE to withdraw its support of Metalclad and instead support Promoción y Desarrollo de Infraestructura, S.A., a group of local Mexican businessmen headed by Medellin and organized for the purpose of building and operating a hazardous waste landfill in competition with Metalclad.¹⁹⁹ Unzueta also renewed his objection to the Landfill due to the absence of a municipal construction permit and threatened to revoke the state construction permit previously issued to COTERIN in May 1993.²⁰⁰

Despite this ongoing opposition, COTERIN and Metalclad and the Mexican federal government, by and through INE, SEMARNAP and PROFEPA, entered into an agreement to

192. See Award, *supra* note 3, ¶ 42, at 10; see also MEMORIAL, *supra* note 3, ¶ 83, at 80.

193. See Award, *supra* note 3, ¶ 43, at 11; see also MEMORIAL, *supra* note 3, ¶ 84, at 80.

194. See Award, *supra* note 3, ¶ 45, at 11; see also MEMORIAL, *supra* note 3, ¶ 27, at 57.

195. See Award, *supra* note 3, ¶ 46, at 11; see also MEMORIAL, *supra* note 3, ¶ 89, at 82.

196. See Award, *supra* note 3, ¶ 46, at 11; see also MEMORIAL, *supra* note 3, ¶ 89, at 82-83.

197. See MEMORIAL, *supra* note 3, ¶ 90, at 83.

198. *Id.* at 10.

199. See *id.* at 11 & ¶¶ 97-98, at 86-87.

200. See *id.* at 13.

remediate existing contamination at the site and operate the Landfill on November 24, 1995 (Convenio).²⁰¹ The government of San Luis Potosi initially agreed to participate in the negotiation of the Convenio but subsequently withdrew from negotiations and refused to execute the final document.²⁰² Commercial operation of the Landfill was approved for an initial five-year term subject to renewal by INE and PROFEPA.²⁰³ The Convenio noted the results of the PROFEPA environmental audit, including the existence of deficiencies and Metalclad's plan for remediation thereof.²⁰⁴ Metalclad's plan required remediation to occur within the first three years of commercial operation of the Landfill.²⁰⁵ In addition to its remediation obligations, Metalclad was required to designate thirty-four hectares of the Landfill site as a buffer zone for the conservation of endemic species.²⁰⁶ Metalclad was also required to make significant contributions to the community, including performance of social work in Guadalcazar, the provision of a ten percent discount for treatment of hazardous waste generated in San Luis Potosi, employment opportunities, free medical advice, and technical training for residents of Guadalcazar.²⁰⁷ Finally, Metalclad was required to consult with government authorities on hazardous waste matters and provide two courses annually on the management of hazardous waste to personnel employed in the public and private sectors.²⁰⁸

The governments of San Luis Potosi and Guadalcazar had a two-fold response to the execution of the Convenio. Initially, on December 5, 1995, the Town Council of Guadalcazar refused to consider Metalclad's application for a municipal construction permit.²⁰⁹ Metalclad was not notified of the Council's meeting and was not afforded any opportunity to participate in the decision process.²¹⁰ The Town Council specifically noted the "impropriety" of Metalclad's construction of the Landfill prior to receiving municipal permission.²¹¹ There was no indication that

201. See *id.* at 14 & ¶ 40, at 64; see also Award, *supra* note 3, ¶ 47, at 11.

202. See Award, *supra* note 3, ¶ 49, at 12; see also MEMORIAL, *supra* note 3, ¶ 40, at 64; Tamayo, *supra* note 117, at 11.

203. See Award, *supra* note 3, ¶ 48, at 11.

204. See *id.*

205. See *id.*

206. See *id.*

207. See *id.* ¶ 48, at 12.

208. See *id.*

209. See *id.* ¶ 50, at 12.

210. See *id.* ¶ 54, at 12.

211. *Id.*

the Council considered any of the environmental studies performed with respect to the Landfill, Metalclad's activities upon the site, or its compliance with the terms of its multiple federal and local permits and the Convenio.²¹² The Town Council subsequently denied Metalclad's formal request for reconsideration of its decision with respect to the municipal permit.²¹³ Unzueta reinforced the Town Council's decision by dispatching armed state police officers, who stopped and searched all vehicles entering and departing from the Landfill.²¹⁴

The second response was the initiation of an administrative petition against the Convenio filed with SEMARNAP on December 27, 1995.²¹⁵ Secretary Carabias Lillo subsequently denied the petition on behalf of SEMARNAP.²¹⁶ Undeterred by Lillo's denial, Guadalcazar filed an amparo proceeding in the Mexican courts challenging SEMARNAP's dismissal of its complaint on January 31, 1996.²¹⁷ The presiding federal judge admitted Guadalcazar's amparo on February 6, 1996.²¹⁸ The judge also ordered a suspension of operations at the Landfill pending resolution of the amparo but permitted remediation to continue during the proceedings.²¹⁹ The proceedings remained pending for eighteen months until August 29, 1997, when Metalclad received notice that the judge had rejected the amparo on the basis that, as a municipality, Guadalcazar lacked standing to initiate such a proceeding.²²⁰ However, the order prohibiting Metalclad from operating the Landfill remained in force and effect until the expiration of the municipality's appeal rights.²²¹ As a result, the amparo was finally dismissed and the injunction against further operations lifted in May 1999.²²²

212. *See id.* ¶¶ 51-52, at 12.

213. *See id.* ¶ 54, at 12; *see also* MEMORIAL, *supra* note 3, at 16.

214. *See* MEMORIAL, *supra* note 3, at 16.

215. *See id.* ¶ 42, at 65; *see also* Award, *supra* note 3, ¶ 55, at 12.

216. *See* Award, *supra* note 3, ¶ 55, at 12; *see also* MEMORIAL, *supra* note 3, ¶ 43, at 65.

217. *See* Award, *supra* note 3, ¶ 56, at 13; *see also* MEMORIAL, *supra* note 3, ¶ 43, at 65. Under Mexican amparo laws, "a private citizen may request a federal court to declare any official governmental action null and void as against that citizen on grounds that the action violates either a specific constitutional guarantee or constitutes a denial of due process." MEMORIAL, *supra* note 3, at 170 n.4.

218. *See* MEMORIAL, *supra* note 3, ¶ 44, at 65.

219. *See id.* *See also* Award, *supra* note 3, ¶ 56, at 13.

220. *See* MEMORIAL, *supra* note 3, ¶ 143, at 104.

221. *See id.* ¶ 140, at 104-5.

222. *See* Award, *supra* note 3, ¶ 56, at 13.

The government of Guadalcazar and San Luis Potosi continued their attempts to prevent the operation of the Landfill in 1996. Despite the granting of an additional permit by INE authorizing Metalclad to expand the capacity of the Landfill from 36,000 tons to 360,000 tons annually on February 8, 1996,²²³ state and local government officials continued to insist that Metalclad did not have necessary authorization to construct or operate the Landfill.²²⁴ These officials also continued to insist that the Landfill was responsible for health problems plaguing the local population, including the birth of malformed and brain-damaged children, chronic breathing disorders and multiple abortions.²²⁵ In addition, government officials issued warnings that the Landfill presented a serious risk of explosion.²²⁶ Negotiations with respect to the Landfill continued between Metalclad and representatives of San Luis Potosi from May through December without success.²²⁷ In fact, the negotiations became so fractious that, in August 1996, James Jones, the U.S. Ambassador to Mexico, threatened to "blacklist San Luis Potosi as hostile to U.S. investment."²²⁸

Metalclad's ever-waning chance of completing construction and initiating operation of the Landfill permanently ended in 1997. On September 18, 1997, Unzueta entered into an agreement on behalf of San Luis Potosi declaring a 600,000 acre portion of the Altiplano region of the state, including La Pedrera, to be an ecologically protected area in order to ensure the preservation of twenty species of native cacti.²²⁹ Five days later and three days before the expiration of his term as governor, Unzueta signed and published an official decree implementing the ecological agreement with respect to the Altiplano region.²³⁰ The decree included the entirety of Metalclad's property in San Luis Potosi and the Landfill.²³¹ The decree also required immediate cessation of all industrial activity in the ecological zone, including activities associated with the Landfill.²³² Unzueta's decree was subsequently

223. See *id.* ¶ 57, at 13.

224. See MEMORIAL, *supra* note 3, at 17.

225. See *id.* at 19 & 21.

226. See *id.* at 21.

227. See Award, *supra* note 3, ¶ 58, at 13.

228. MEMORIAL, *supra* note 3, at 21.

229. See *id.* at 26.

230. See *id.* at 27 & ¶ 146, at 106-7; see also Award, *supra* note 3, ¶ 59, at 13.

231. See MEMORIAL, *supra* note 3, ¶ 146, at 107.

232. See *id.*

reconfirmed by his successor, Fernando Silva Nieto, who succeeded Unzueta on September 26, 1997.²³³ San Luis Potosi officials stated that the decree “definitely canceled any possibility that exists of opening the industrial waste landfill at La Pedrera”²³⁴ and “expressed confidence in closing . . . all possibility for . . . Metalclad to operate its landfill.”²³⁵ Activity at the Landfill ceased and the site became dormant.²³⁶

Metalclad subsequently determined to discontinue its Mexican operations in 1999.²³⁷ On October 8, 1999, Metalclad transferred its interest in its Mexican subsidiaries to Geologic, S.A., a Mexican corporation, for five million dollars and the assumption by Geologic of all outstanding debts of these subsidiaries estimated at \$3.8 million.²³⁸ Metalclad specifically excluded the Landfill from the sale, the value of which the company estimated at \$4.4 million.²³⁹

The Landfill ultimately proved to be a financial disaster for Metalclad. Between 1997 and 1999, Metalclad estimated that it had suffered losses as a result of its operations in Mexico in excess of \$7.8 million.²⁴⁰ Metalclad’s stock also suffered an eighty percent decline in value.²⁴¹ The company estimated its ultimate loss as a result of its Mexican operations at forty-five million dollars.²⁴² With respect to recovery of the portion of these losses attributable to the Landfill, Metalclad was left with one avenue of recourse, specifically, the investor-state provisions of NAFTA, having, in its words, “exhausted the limits of its negotiation resources, and its investment [having been] taken by political and judicial actions.”²⁴³

C. METALCLAD’S NOTICE OF CLAIM

Metalclad initiated an arbitration proceeding with respect

233. See Tamayo, *supra* note 117, at 11.

234. Award, *supra* note 3, ¶ 60, at 13.

235. *Id.* ¶ 61, at 13.

236. See *id.* ¶ 62, at 13.

237. See METALCLAD 1999 10-K, *supra* note 105, at 3-4.

238. See Press Release, Metalclad Corporation, Metalclad Announces the Sale of its Mexican Businesses (Oct. 21, 1999) (on file with the author).

239. See *id.* at 2; see also METALCLAD 1999 10-K, *supra* note 105, at 13 & 32.

240. See METALCLAD 1999 10-K, *supra* note 105, at 26 & 32; see also *supra* note 115 and accompanying text.

241. See Tamayo, *supra* note 117, at 2-3.

242. See *NAFTA Panel Sides with Metalclad on Claim*, DOW JONES NEWSWIRE, at <http://www.google.com/search?q=cache:www...000081619.html> (Aug. 31, 2000).

243. MEMORIAL, *supra* note 3, ¶ 131, at 99.

to the actions of Guadalcazar and San Luis Potosi with ICSID on January 2, 1997.²⁴⁴ Metalclad was identified as the sole claimant, and Mexico was identified as the sole respondent.²⁴⁵ Metalclad alleged that Mexico was liable for injuries arising from the actions of San Luis Potosi and Guadalcazar for two reasons. Initially, Metalclad alleged that Mexico was strictly liable for any breaches of NAFTA by its component states pursuant to Article 105.²⁴⁶ Second, Metalclad alleged that Mexico failed to adequately protect its investments in COTERIN and the Landfill in violation of Article 1105.²⁴⁷

Metalclad stated six separate legal bases for its claim that the conduct of Mexican federal, state and local authorities violated Chapter Eleven. Initially, Metalclad alleged that Mexico breached its obligation to accord Metalclad "treatment in accordance with international law, including fair and equitable treatment and full protection and security" in violation of Article 1105(1).²⁴⁸ This claim had four underlying factual bases. First, although it represented to Metalclad that it possessed exclusive authority over matters relating to hazardous waste, the Mexican federal government failed to override local opposition to the Landfill.²⁴⁹ Metalclad alleged that the Mexican federal government aggressively sought its investment and repeatedly reassured it that the federal government "had full and exclusive authority in the area of hazardous waste [and] that obtaining the federal construction and operating permits, with the state land use permit, satisfied all the legal requirements necessary for the Company to open and operate its landfill."²⁵⁰ Further evidence of federal exclusivity was contained in the Convenio, which was negotiated and executed without the participation of the state or municipal governments.²⁵¹ Moreover, SEMARNAP's actions throughout

244. See *id.* at 35; see also Award, *supra* note 3, ¶ 8, at 5. Metalclad had previously provided Mexico with notice of its intent to initiate arbitration before ICSID pursuant to Article 1119 of NAFTA on October 2, 1996. See Award, *supra* note 3, ¶ 7, at 5; see also MEMORIAL, *supra* note 3, at 35. Metalclad consented to the submission of its claims to arbitration and waived its right to initiate or continue legal proceedings before other forums as required by Article 1121 of NAFTA on December 30, 1996. See Award, *supra* note 3, ¶ 7, at 5.

245. See Award, *supra* note 3, ¶¶ 2 & 5, at 2-3.

246. See MEMORIAL, *supra* note 3, ¶ 153, at 110-11.

247. See *id.* ¶¶ 159-65, at 115-17.

248. *Id.* at 115.

249. See *id.* ¶¶ 166-82, at 117-25.

250. *Id.* ¶ 166, at 117-18.

251. See *id.* ¶ 167, at 118-19.

the administrative challenge and amparo proceedings initiated by Guadalcázar were consistent with federal exclusivity.²⁵² Specifically, SEMARNAP represented to the Mexican federal court that Metalclad's right to operate the Landfill rested not on the Convenio, but rather, on the "respective authorizations and licenses . . . granted to the Company."²⁵³ SEMARNAP characterized the suspension of Metalclad's operations as a result of the pendency of the amparo proceeding as an interference with a "vested right granted in accordance with the corresponding laws."²⁵⁴ Metalclad relied upon the representations and actions of the federal government in exercising its option to purchase COTERIN and proceeding with the construction of the Landfill.²⁵⁵ However, the Mexican federal government ultimately failed to defend Metalclad' against the threats, acts of violence and misuse of state law enforcement personnel by San Luis Potosí authorities.²⁵⁶

The second factual basis for Metalclad's claim related to the subsequently revoked representations of support received by Metalclad from the government of San Luis Potosí.²⁵⁷ Metalclad noted the state government's granting of a use permit for the Landfill on May 11, 1993.²⁵⁸ The granting of this permit was alleged by Metalclad to have the effect of "ratify[ing] the sufficiency of the federal construction permit and the primacy of federal authority."²⁵⁹ Metalclad also noted that Unzueta expressed his unconditional support for the construction and ultimate operation of the Landfill in correspondence dated June 11, 1993.²⁶⁰ Furthermore, Metalclad noted that several other San Luis Potosí officials, including the AUSLP professors who studied the underlying geology and Medellín, expressed their approval of the location of the Landfill in La Pedrera.²⁶¹ Nevertheless, state approval was ultimately replaced with active resistance, thereby resulting in injury to Metalclad and its investment in COTERIN.²⁶²

252. See ¶¶ 168-69, at 119-20.

253. *Id.* ¶ 169, at 120.

254. *Id.*

255. *See id.* ¶ 179, at 123.

256. *See id.* ¶ 182, at 125.

257. *See id.* at 125.

258. *See id.* ¶ 183, at 125.

259. *Id.* ¶ 184, at 126.

260. *See id.* ¶ 185, at 126.

261. *See id.* ¶¶ 187-88, at 127-28.

262. *See id.* ¶¶ 193-96, at 129-31.

The third factual basis involved the misuse of public power and authority by the Unzueta administration.²⁶³ Metalclad noted that the Unzueta administration had utilized the Aleman Report as a basis for opposing the Landfill despite the scientifically unsound nature of its methodology and conclusions.²⁶⁴ Metalclad noted the false allegations made by state health officials and broadcast by representatives of the Unzueta administration that the Landfill was responsible for birth defects, multiple abortions and chronic respiratory diseases.²⁶⁵ The Unzueta administration further maligned Metalclad's integrity through false statements contained within correspondence forwarded to select members of the U.S. Congress and Metalclad's largest investors.²⁶⁶ Upon the failure of these tactics, Metalclad alleged that the Unzueta administration illegally deployed state police officers to forcibly close the Landfill.²⁶⁷ The ultimate closure of the Landfill through the unilateral creation of the ecological zone in the dwindling days of the Unzueta administration constituted, in Metalclad's opinion, a final act of desperation.²⁶⁸

Finally, Metalclad alleged that corruption and abuse of public trust prevented its investment from receiving fair and equitable treatment.²⁶⁹ Metalclad alleged that government officials had solicited bribes on two separate occasions for two hundred thousand and one million dollars in return for municipal approval of the Landfill.²⁷⁰ Furthermore, Metalclad contended that RIMSA, directly or through one of its subsidiaries, made payments to government officials in Guadalcazar and funded environmental groups opposed to the opening of the Landfill.²⁷¹ The alleged payments by RIMSA and

263. *See id.* at 131.

264. *See id.* ¶ 197, at 131.

265. *See id.* ¶ 199, at 132.

266. *See id.* ¶ 200, at 133. Metalclad specifically referenced correspondence from Unzueta to U.S. Senator Paul Simon dated December 10, 1995, which purportedly contained statements that "cheapen[ed] and discredit[ed]" Metalclad and its supporters. *Id.* Metalclad alleged that copies of this correspondence were subsequently forwarded by Unzueta to Oakes Fitzwilliams and First Analysis Corporation, Metalclad's largest investors. *See id.*

267. *See id.* ¶ 204, at 134-35.

268. *See id.* ¶ 205, at 135-36.

269. *See id.* at 136.

270. *See id.* ¶ 208, at 137. Metalclad specifically identified the municipal president of Guadalcazar as the official responsible for the solicitation of the bribes. *See id.*

271. *See id.*

Metalclad's refusal to pay matching bribes were alleged to have resulted in its inability to overcome municipal opposition to the Landfill.²⁷²

The second legal basis upon which Metalclad's claims rested was Mexico's alleged failure to accord Metalclad national treatment as provided by Article 1102.²⁷³ In support of this claim, Metalclad contended that "[t]he imposition of the requirement for a construction permit from the Municipality of Guadalcazar was enforced selectively and singularly upon [it]."²⁷⁴ In fact, Metalclad noted that Guadalcazar did not have an office, agency or official responsible for processing applications and issuing licenses.²⁷⁵ Metalclad further claimed that its survey of past and present projects concluded that no person had ever sought or was granted a municipal permit, nor was any person sanctioned for failure to obtain such a permit.²⁷⁶ Metalclad additionally alleged that Guadalcazar had not submitted annual reports to the state government detailing its construction permit activities as required by state law.²⁷⁷ Furthermore, the necessity of a municipal construction permit was rendered more dubious by the repeated authorization of Metalclad's construction activities by agencies within the Mexican federal government.²⁷⁸ None of these federal agencies withheld their approval on the basis of the lack of a municipal construction permit.²⁷⁹ In any event, no mention was made of the requirement of a municipal construction permit until November 13, 1995, more than two years after the issuance of the initial federal construction permit by INE and Metalclad's subsequent exercise of its option to purchase COTERIN.²⁸⁰

The third and fourth legal bases for Metalclad's claims against Mexico were its purported failure to accord Metalclad most favored nation treatment and national treatment.²⁸¹ Metalclad contended that Mexico violated the requirement of most favored nation treatment established by Article 1103 by imposing license, permit, testing and study requirements as

272. See *id.* ¶¶ 208-11, at 137-38.

273. See *id.* at 139.

274. *Id.* ¶ 214, at 140.

275. See *id.* ¶ 214, at 141.

276. See *id.*

277. See *id.* ¶ 215, at 141.

278. See *id.* ¶ 219, at 144-45 & ¶ 222, at 146-47.

279. See *id.*

280. See *id.* ¶ 224, at 147.

281. See *id.* ¶¶ 227-30, at 149-50.

well as political accommodations upon it which were not required of similarly-situated persons.²⁸² Furthermore, Metalclad alleged that Mexico had failed to accord it the better of most favored nation or national treatment.²⁸³ Specifically, Metalclad alleged that, by failing to accord it treatment either as favorable as that accorded to similarly-situated Mexican or foreign nationals, Mexico failed to meet its obligation to treat Metalclad in the most favorable fashion as required by Article 1104.²⁸⁴

Metalclad also alleged that Mexico imposed performance requirements upon it in violation of Article 1106.²⁸⁵ Metalclad contended that the Unzueta administration had demanded the transfer of proprietary information to the government of San Luis Potosi as a condition of its approval of the Landfill.²⁸⁶ In this regard, Metalclad asserted that state government officials demanded copies of all of its “drawings, studies, designs, operating manuals, safety manuals, financial data, and most of what is necessary to construct and operate a hazardous waste landfill facility.”²⁸⁷ According to Metalclad, there was no legal, scientific or technological basis for requiring such disclosures.²⁸⁸ Furthermore, Metalclad objected to the numerous social service commitments it had been required to undertake in order to obtain local approval of the Landfill, including construction of a laboratory for use by AUSLP professors, the provision of free medical care, potable water and educational funding for the community and free consultation with the federal government on matters relating to hazardous waste.²⁸⁹ While Metalclad expressed its willingness to provide such benefits, especially for those in the immediate vicinity of the Landfill, the company noted that it had no choice with respect to such matters.²⁹⁰

Finally, Metalclad contended that Mexico expropriated Metalclad’s investment in COTERIN and the Landfill without compensation in violation of Article 1110.²⁹¹ Metalclad’s confiscated investment included “[an] enterprise, equity and

282. *See id.* ¶ 228, at 149.

283. *See id.* at 149.

284. *See id.* ¶ 230, at 150.

285. *See id.* at 150.

286. *See id.* ¶ 232, at 151.

287. *Id.*

288. *See id.*

289. *See id.* ¶ 235, at 151-52.

290. *See id.* ¶ 235, at 152.

291. *See id.* at 152.

debt securities, loan to an enterprise, a share in income and profits, intangible property, commitment of capital [and] contracts dependent on revenues or profits.”²⁹² In addition, Metalclad alleged that it had been deprived of “its vested right pursuant to its construction, operating and land use permits to its investment.”²⁹³ These deprivations had been imposed by the Unzueta administration for over two years, thereby rendering them permanent and irreversible.²⁹⁴ Furthermore, the taking of Metalclad’s investment was not for a public purpose as mandated by Article 1110(1), but rather was based upon “political” and “personal” purposes.²⁹⁵

Despite these alleged violations of NAFTA, Metalclad noted that it had not received compensation from Mexico. Thus, Metalclad sought entry of a judgment in the amount of ninety million dollars plus costs and attorneys’ fees.²⁹⁶ This amount represented discounted future profits from the Landfill had it been permitted to open for business.²⁹⁷ According to Metalclad, the profitability of the Landfill was reasonably certain given “the predictability of the demand for [Metalclad’s] . . . services”²⁹⁸ and the state-of-the-art nature of the facility.²⁹⁹ Alternatively, Metalclad sought recovery of its actual investment in the Landfill project, which it valued in excess of \$20.4 million.³⁰⁰ Metalclad also sought an additional twenty-five million dollars for the negative impact of Guadalcazar and San Luis Potosi’s conduct upon its other business operations.³⁰¹ Metalclad also sought an award of interest at the rate of nine percent per annum.³⁰²

The ICSID tribunal designated to hear Metalclad’s claims was constituted on May 19, 1997.³⁰³ The panel consisted of former U.S. Attorney General Benjamin R. Civiletti, Jose Luis Siqueiros, an international jurist from Mexico, and Elihu

292. *Id.* ¶ 239, at 155.

293. *Id.* ¶ 245, at 158.

294. *See id.* ¶¶ 249-50, at 160-62.

295. *Id.* ¶ 253, at 163.

296. *See id.* ¶ 263(4), at 166. Critics noted that the amount of damages sought by Metalclad exceeded the combined annual income of every family in San Luis Potosi. *See Knight, supra note 29*, at 2.

297. *See Award, supra note 3*, ¶ 114, at 22.

298. MEMORIAL, *supra note 3*, ¶ 260, at 165.

299. *See id.* ¶ 261, at 166.

300. *See Award, supra note 3*, ¶ 114, at 22 & ¶ 123, at 24.

301. *See id.* ¶ 115, at 23.

302. *See MEMORIAL, supra note 3*, at 169.

303. *See Award, supra note 3*, ¶ 10, at 5.

Lauterpacht, a law professor from Cambridge, England.³⁰⁴ The tribunal's first session was held in Washington, D.C. on July 15, 1997.³⁰⁵ The tribunal subsequently determined that the place of arbitration would be Vancouver, British Columbia, Canada.³⁰⁶ Metalclad and Mexico filed their opening, answer and reply briefs throughout 1997 and 1998.³⁰⁷ Furthermore, as permitted by Article 1128, Canada and the United States filed written submissions with the tribunal on July 28, 1999 and November 9, 1999 respectively.³⁰⁸ Hearings were held in Washington, D.C. from August 30, 1999 through September 9, 1999, at which time both parties appeared and presented the testimony of witnesses and other evidence.³⁰⁹ The case was subsequently deemed at issue in September 1999.³¹⁰

D. *METALCLAD CORPORATION V. UNITED STATES OF MEXICO:*
THE ICSID TRIBUNAL'S DECISION

The ICSID tribunal issued its opinion on August 30, 2000. The Award consisted of fourteen pages of factual findings and eleven pages of legal conclusions.³¹¹ In its conclusions of law, the panel addressed four specific issues arising from Mexico's conduct concerning the Landfill. These issues were: (1) the responsibility of national governments for conduct of their subnational components; (2) Metalclad's claim that Mexico's behavior with respect to the Landfill violated the requirement of fair and equitable treatment set forth in Article 1105; (3) Metalclad's claim that Mexico's behavior constituted an uncompensated expropriation in contravention of Article 1110; and (4) the quantification of damages, interest and costs awardable to Metalclad as a result of Mexico's violation of its treaty obligations.

The tribunal initially addressed the issue of Mexico's

304. See *NAFTA Panel Sides with Metalclad on Claim*, *supra* note 242, at 2.

305. See Award, *supra* note 3, ¶ 11, at 5.

306. See *id.*

307. See *id.* ¶¶ 14-15, at 6 & ¶¶ 19-20, at 7.

308. See *id.* ¶¶ 24 & 27, at 8-9. Article 1128 of NAFTA provides that "[o]n written notice to the disputing parties, a Party may make submissions to a Tribunal on a question of interpretation of this Agreement." NAFTA, *supra* note 24, art. 1128.

309. See Award, *supra* note 3, ¶ 25, at 8.

310. See *id.*

311. The tribunal's factual findings were predominantly in accord with the factual background previously set forth in this article. As such, the tribunal's findings of fact will not be restated but rather discussed only to the extent necessary to place its legal conclusions in their proper context.

responsibility for the actions of San Luis Potosi and Guadalcazar.³¹² The tribunal noted that Mexico had “proceed[ed] [throughout the arbitration] on the assumption that the normal rule of state responsibility applie[d]; that is, that [Mexico] can be internationally responsible for the acts of state organs at all three levels of government.”³¹³ Proceeding in this manner thus constituted an admission of state responsibility by Mexico.³¹⁴ Furthermore, Article 105 placed responsibility for ensuring state and provincial compliance with NAFTA’s provisions on the federal governments of the signatories.³¹⁵ This reference to “state and provincial governments” included local governments within the states and provinces.³¹⁶ The exemptions from the requirements of fair and equitable treatment and expropriation set forth in Article 1108 were not applicable to state and local governments.³¹⁷ The final basis upon which Mexico’s responsibility rested was customary international law. The tribunal summarized customary international law as providing that “[t]he conduct of an organ of a State, of a territorial government entity or of an entity empowered to exercise elements of the governmental authority, such organ having acted in that capacity, shall be considered an act of the State under international law.”³¹⁸ This principle held true “even if, in the particular case, the organ [of the territorial or local government] exceeded its competence according to internal law or contravened instructions concerning its activity.”³¹⁹

The tribunal then addressed the issue of whether Mexico treated Metalclad’s investment “in accordance with international law, including fair and equitable treatment and full protection and security.”³²⁰ The tribunal concluded that Mexico failed to accord such treatment to Metalclad’s investment on three separate bases. Initially, the tribunal noted

312. See Award, *supra* note 3, ¶ 73, at 16-17.

313. *Id.* ¶ 73, at 16.

314. See *id.*

315. See *id.*

316. See *id.* The tribunal specifically cited Article 201(2) in support of this conclusion. Article 201(2) provides that “[f]or purposes of this Agreement, unless otherwise specified, a reference to a state or province includes local governments of that state or province.” NAFTA, *supra* note 24, art. 201(2).

317. See Award, *supra* note 3, ¶ 73, at 16. Article 1108 does not contain reservations or exceptions for state and local governments from the requirements of Articles 1105 and 1110(1).

318. *Id.* ¶ 73, at 16.

319. *Id.* ¶ 73, at 17.

320. NAFTA, *supra* note 24, art. 1105(1).

the prominence of the principle of transparency throughout NAFTA.³²¹ The tribunal defined transparency to mean that “all relevant legal requirements for the purpose of initiating, completing and successfully operating investments made, or intended to be made, under the Agreement should be capable of being readily known to all affected investors of another Party.”³²² The tribunal specifically dispelled “[any] room for doubt or uncertainty on [any such legal requirements].”³²³ Furthermore, once a federal government becomes aware of the existence of any misunderstanding or confusion with respect to the establishment or operation of a foreign investment within its boundaries, it is the duty of such government “to ensure that the correct position is properly determined and clearly stated so that investors can proceed with all appropriate expedition in the confident belief that they are acting in accordance with all relevant law.”³²⁴

The tribunal held that Mexico failed to comply with such duty with respect to Metalclad’s investment in the Landfill. Citing the Mexican Constitution, the tribunal found that the authority of municipal governments extended only “to [the] grant[ing] [of] licenses and permits for constructions and . . . [participation] in the creation and administration of ecological reserve zones.”³²⁵ Governmental power to authorize the construction and operation of hazardous waste landfills resides exclusively with the Mexican federal government pursuant to the *Ley General del Equilibrio Ecológico y de Protección al Ambiente* de 1988 (General Ecology Law).³²⁶ Specifically, Article Five of the General Ecology Law provides, in part, that the powers of the federal government include “[t]he regulation and control of activities considered to be highly hazardous, and of the generation, handling and final disposal of hazardous materials and wastes.”³²⁷ Furthermore, the General Ecology Law limits the environmental powers of municipal governments to issues relating to non-hazardous waste. Specifically, Article Eight grants municipal governments

321. See Award, *supra* note 3, ¶ 76, at 17.

322. *Id.*

323. *Id.*

324. *Id.*

325. *Id.* ¶ 81, at 17-18, citing CONSTITUCIÓN POLITICA DE LOS ESTADOS UNIDOS MEXICANOS tit. V, art. 115.

326. See Award, *supra* note 3, ¶ 82, at 18.

327. “Ley General del Equilibrio Ecológico y de Protección al Ambiente,” at ch. II, art. 5, § VI, D.O., 28 de enero de 1988.

authority to adopt “[l]egal provisions in matters of prevention and control of the effects on the environment caused by generation, transportation, storage, handling, treatment and final disposal of solid industrial wastes which are not considered to be hazardous in accordance with the provisions of Article 137 of [the General Ecology Law].”³²⁸ All powers not expressly granted to municipal governments by the General Ecology Law are reserved to the federal government.³²⁹

Based upon its exclusive authority, the Mexican government issued construction and operating permits for the Landfill prior to Metalclad’s purchase of COTERIN.³³⁰ The tribunal further noted that the Mexican government assured Metalclad that all necessary permits had been issued for the Landfill prior to its purchase of COTERIN.³³¹ The federal government also assured Metalclad that Guadalcazar had no authority to require a construction permit and that any application submitted to the municipality would be issued as a matter of course.³³² The tribunal found that Metalclad relied upon these representations in purchasing COTERIN and proceeding with construction of the Landfill.³³³ Nevertheless, Guadalcazar officials denied Metalclad the construction permit and ultimately proved successful in blocking operation of the Landfill. The tribunal found that Guadalcazar’s success was, in part, attributable to “[t]he absence of a clear rule as to the requirement or not of a municipal construction permit as well as the absence of any established practice or procedure as to the manner of handling applications for a municipal construction permit.”³³⁴ These absences and ensuing uncertainty constituted a failure by Mexico “to ensure a transparent and predictable framework for Metalclad’s business planning and investment” in contravention of NAFTA.³³⁵

The tribunal also concluded that Mexico failed to ensure fair and equitable treatment to Metalclad based upon the absence of procedural due process associated with the municipal permitting process. The tribunal noted the extraordinary length of time that elapsed between Metalclad’s application for the

328. *Id.* ch. II, art. 8, § IV.

329. *See id.* ch. II, art. 7, § XXI.

330. *See Award, supra* note 3, ¶ 78, at 17.

331. *See id.* ¶ 80, at 17.

332. *See id.* ¶ 88, at 19.

333. *See id.* ¶ 85, at 18 & ¶ 89, at 19.

334. *Id.* ¶ 88, at 19.

335. *Id.* ¶ 99, at 20.

municipal construction permit and its ultimate denial in December 1995.³³⁶ This period of time was particularly prejudicial given the continuation of construction activities upon the site by Metalclad at the insistence of federal authorities.³³⁷ The municipal permitting process was further procedurally flawed by the complete absence of notice of the Guadalcazar Town Council meeting at which Metalclad's application was discussed and ultimately denied.³³⁸ As a result, Metalclad was improperly denied an opportunity to be heard on an issue of central importance to its investment.³³⁹ These deficiencies led the tribunal to conclude that there was "a lack of orderly process and timely disposition in relation to an investor of a Party acting in the expectation that it would be treated fairly and justly in accordance with the NAFTA."³⁴⁰

Finally, the tribunal concluded that Mexico failed to ensure fair and equitable treatment to Metalclad based upon the violation of substantive due process with respect to the municipal permitting process. The tribunal specifically noted the absence of municipal authority with respect to all environmental issues arising from the Landfill.³⁴¹ The sole power possessed by Guadalcazar extended to "appropriate construction considerations."³⁴² However, Guadalcazar's decision to ultimately deny the construction permit was not based upon this limited grant of authority. Rather, the denial was based upon "the opposition of the local population, the fact that construction had already begun when the application was submitted, the denial of the permit to COTERIN in December 1991 and January 1992, and the ecological concerns regarding the environmental effect and impact on the site and surrounding communities."³⁴³ None of these reasons were related to construction problems.³⁴⁴ Thus, the denial of the permit was not based upon a legitimate exercise of municipal authority.³⁴⁵ The tribunal noted that the municipality lacked confidence in its authority in this regard, thereby necessitating

336. *See id.* ¶ 90, at 19.

337. *See id.*

338. *See id.* ¶ 91, at 19.

339. *See id.*

340. *Id.* ¶ 99, at 20.

341. *See id.* ¶ 86, at 18.

342. *Id.*

343. *Id.* ¶ 92, at 19.

344. *See id.*

345. *See id.* ¶ 93, at 19.

the filing of an administrative complaint with SEMARNAP challenging the legality of the Convenio.³⁴⁶ The tribunal concluded that the filing of the complaint with SEMARNAP, coupled with the procedural and substantive deficiencies associated with the denial of the construction permit, supported its decision that the insistence upon and ultimate denial of the permit was improper.³⁴⁷

The tribunal then addressed the issue of whether the actions of Mexico, San Luis Potosi and Guadalcazar constituted an uncompensated expropriation in contravention of Article 1110. The tribunal determined that expropriation could take one of two forms. Initially, expropriation included “open, deliberate and acknowledged takings of property, such as outright seizure or formal or obligatory transfer of title in favour of the host State.”³⁴⁸ However, expropriation also included “covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use of reasonably-to-be-expected economic benefit of property even if not necessarily to the obvious benefit of the host State.”³⁴⁹

Applying this definition, the tribunal concluded that the actions of Guadalcazar, San Luis Potosi and Mexico constituted expropriation of Metalclad’s investment in COTERIN and the Landfill.³⁵⁰ Initially, with respect to Guadalcazar, the tribunal noted that what few procedures Guadalcazar had in place with respect to municipal construction permits were untimely and disorderly.³⁵¹ Furthermore, no other entity had been required to procure a construction permit prior to commencing construction in the municipality.³⁵² The tribunal also noted that Guadalcazar’s denial of the construction permit, “without any basis in the proposed physical construction or any defect in the site, and extended by its subsequent administrative and judicial actions regarding the Convenio, effectively and unlawfully prevented [Metalclad’s] operation of the landfill.”³⁵³ The tribunal concluded that these actions constituted an indirect expropriation of Metalclad’s investment in COTERIN and the

346. *See id.* ¶ 94, at 19.

347. *See id.* ¶ 97, at 20.

348. *Id.* ¶ 103, at 21.

349. *Id.*

350. *See id.* ¶¶ 102-12, at 20-22.

351. *See id.* ¶ 107, at 21.

352. *See id.* ¶ 108, at 22.

353. *Id.* ¶ 106, at 21.

Landfill.³⁵⁴

The tribunal also concluded that the actions of the Mexican federal government constituted an indirect expropriation of Metalclad's investment. The tribunal restated its previous conclusion that "exclusive authority for siting and permitting a hazardous waste landfill resides with the Mexican federal government."³⁵⁵ The tribunal also reiterated that the Mexican government had represented its exclusive authority in this field and that Metalclad had relied upon such representations in proceeding with the purchase of COTERIN and its interest in the Landfill.³⁵⁶ Nevertheless, the federal government refused to exercise its exclusive authority when confronted by the obstinate behavior of municipal officials with respect to the construction permit.³⁵⁷ By tolerating Guadalcazar's conduct, the tribunal held that the federal government had effectively participated in the deprivation of Metalclad's rights with respect to the Landfill.³⁵⁸ The tribunal thus concluded that the federal government had taken a measure tantamount to expropriation in violation of Article 1110(1).³⁵⁹

Although unnecessary for its conclusion with respect to the issue of expropriation, the tribunal held that Unzueta's creation of the ecological zone encompassing the Landfill provided an additional basis for its finding of expropriation.³⁶⁰ The tribunal noted that Unzueta's decree creating the ecological zone forbid any activities inconsistent with a management plan to be developed for the zone.³⁶¹ The management plan was directed at the diagnosis and remediation of ecological problems existing in the zone and ensuring its future preservation.³⁶² In addition, Unzueta's decree forbid "any conduct that might involve the discharge of polluting agents on the reserve soil, subsoil, running water or water deposits" as well as any other potentially polluting activities.³⁶³ Finally, all activities requiring permits or licenses were prohibited within the zone unless such activities related to the exploration, extraction or utilization of

354. *See id.* ¶ 107, at 21.

355. *Id.* ¶ 105, at 21.

356. *See id.* ¶¶ 107-8, at 21.

357. *See id.* ¶ 104, at 21.

358. *See id.*

359. *See id.*

360. *See id.* ¶ 109, at 22.

361. *See id.* ¶ 110, at 22.

362. *See id.*

363. *See id.*

natural resources.³⁶⁴ The tribunal held that these conditions had the effect of forever barring the Landfill's operation.³⁶⁵ The tribunal expressly refused to consider the intent of the parties involved in the creation of the ecological zone or the propriety of their actions.³⁶⁶ Rather, the tribunal merely concluded that, although not essential to its decision, the implementation of Unzueta's ecological decree would, in and of itself, constitute an act tantamount to expropriation.³⁶⁷

The final substantive issue addressed by the tribunal was that of the quantification of damages, interest and costs to be awarded to Metalclad. Although it found two separate violations, the tribunal determined that the compensation payable as a result of these violations was identical.³⁶⁸ The tribunal reached this conclusion based on the fact that the result of both violations was the same, specifically, "the complete frustration of the operation of the landfill, [thereby] negat[ing] the possibility of any meaningful return on Metalclad's investment."³⁶⁹ Regardless of the source of the violation, Metalclad had "completely lost" its investment.³⁷⁰

The tribunal was also confronted with choosing between Metalclad and Mexico's alternate methods of calculating damages. Metalclad proposed two methods for calculating damages. Initially, Metalclad utilized a discounted cash flow analysis of profits accruing from the future operation of the Landfill to establish a fair market value of its investment of ninety million dollars.³⁷¹ Alternatively, Metalclad calculated its actual investment in the Landfill at approximately twenty-five million dollars.³⁷² In addition to claiming the fair market value of its investment, Metalclad also sought recovery of twenty-five million dollars for "the negative impact the circumstances . . . have had on [Metalclad's] other business operations."³⁷³ By contrast, Mexico alleged that a discounted

364. *See id.*

365. *See id.* ¶ 109, at 22.

366. *See id.* ¶ 111, at 22.

367. *See id.*

368. *See id.* ¶ 113, at 22.

369. *Id.*

370. *Id.*

371. *See id.* ¶ 114, at 22.

372. *See id.*

373. *Id.* ¶ 115, at 23. The tribunal disallowed this additional claim on the basis that a wide variety of factors other than Mexico's behavior with respect to the Landfill affected Metalclad's share price. *See id.* The tribunal concluded that "[t]he causal relationship between Mexico's actions and the reduction in value of

cash flow analysis was not appropriate due to the fact that the Landfill was not a going concern.³⁷⁴ Mexico offered an alternative calculation of fair market value based on COTERIN's capitalization, which Mexico estimated at between thirteen and fifteen million dollars.³⁷⁵ Mexico also offered an alternate theory of damages based upon Metalclad's direct investment in the Landfill.³⁷⁶ Mexico estimated Metalclad's direct investment to be approximately three to four million dollars.³⁷⁷

The tribunal ultimately determined that Metalclad was entitled to compensation in an amount equivalent to the fair market value of the Landfill immediately prior to its expropriation.³⁷⁸ The tribunal held that the fair market value of a going concern that has a history of profitable operation is normally based upon "an estimate of future profits subject to a discounted cash flow analysis."³⁷⁹ However, the tribunal noted that future profits cannot be used to determine going concern or fair market value "where the enterprise has not operated for a sufficiently long time to establish a performance record or where it had failed to make a profit."³⁸⁰ The tribunal concluded that a two or three year presence in the market constitutes the minimum period of time necessary in order to establish continuing business operations.³⁸¹

As the Landfill was never operational, the tribunal concluded that a discounted cash flow analysis was inappropriate.³⁸² The tribunal noted that any award based upon such an analysis would be wholly speculative due to the absence of reliable evidence upon which it could quantify such loss.³⁸³ Rather, the tribunal determined that fair market value could best be estimated by reference to Metalclad's actual investment

Metalclad's other business operations [were] too remote and uncertain" to support this additional award of damages. *Id.*

374. *See id.* ¶ 116, at 23.

375. *See id.*

376. *See id.* ¶ 117, at 23.

377. *See id.*

378. *See id.* ¶ 118, at 23.

379. *Id.* ¶ 119, at 23; *see also* Benvenuti & Bonfant, Sri v. Congo, 1 ICSID (W. Bank) 330 (1980); AGIP Co. v. Congo, 1 ICSID (W. Bank) 306 (1979).

380. Award, *supra* note 3, ¶ 120, at 23; *see also* Sola Tiles, Inc. v. Iran, 14 Iran-U.S. Cl. Trib. Rep. 224, 240-42 (1987).

381. *See* Award, *supra* note 3, ¶ 120, at 23; *see also* Asian Agric. Prods. Ltd. v. Sri Lanka, 4 ICSID (W. Bank) 246, 292 (1990).

382. *See* Award, *supra* note 3, ¶ 121, at 23.

383. *See id.* ¶ 121, at 23 & ¶ 122, at 24.

in COTERIN and the Landfill.³⁸⁴ An award of damages to Metalclad reflecting its actual investment in COTERIN and the Landfill was, in the opinion of the tribunal, consistent with universally accepted principles, specifically, that “where the state has acted contrary to its obligations, any award to the claimant should, as far as is possible, wipe out all the consequences of the illegal act and reestablish the situation which would in all probability have existed if that act had not been committed.”³⁸⁵

Metalclad asserted that it had invested \$20.4 million in the Landfill.³⁸⁶ This amount was determined by reviewing Metalclad’s U.S. income tax returns, associated schedules and auditors’ work papers reflecting capitalized costs for the Landfill.³⁸⁷ This amount covered costs arising from the Landfill from 1991 through 1996, including costs associated with the acquisition of COTERIN, personnel, insurance, travel, utilities, professional fees, facilities and equipment.³⁸⁸ The tribunal rejected Mexico’s challenge to these expenses on the basis of a lack of supporting documentation for each claimed expense.³⁸⁹ Rather, the tribunal held that Metalclad’s tax filings, in conjunction with the supporting independent audit documents, were to be accorded substantial evidentiary weight.³⁹⁰ Furthermore, incomplete records preventing the complete verification of certain expenses did not render such expenses fundamentally erroneous and thus unrecoverable.³⁹¹

However, the tribunal determined that there were several expenses that were unrecoverable despite the existence of supporting documentation or were required to be credited against the final award of damages to Metalclad. Initially, the tribunal agreed with Mexico that costs incurred by Metalclad prior to the year in which it purchased COTERIN were too remote from the investment in the Landfill to be recoverable.³⁹² The tribunal thus refused to include expenses incurred by Metalclad with respect to COTERIN or the Landfill for 1991 and

384. *See id.* ¶ 122, at 23.

385. *Id.* ¶ 122, at 24; *see also* Chorzow Factory (Germ. v. Pol.), 1927-1930 P.C.I.J. ANN. REP. (ser. A) No. 17, at 47 (1928).

386. *See* Award, *supra* note 3, ¶ 123, at 24.

387. *See id.*

388. *See id.*

389. *See id.* ¶ 124, at 24.

390. *See id.*

391. *See id.*

392. *See id.* ¶ 125, at 24.

1992.³⁹³ Furthermore, the tribunal refused to include in its award of damages costs related to other investments made by Metalclad in Mexico but aggregated and allocated to the La Pedrera project.³⁹⁴ Finally, the tribunal held that Metalclad would be overcompensated if it were permitted to retain ownership of the Landfill and receive damages.³⁹⁵ COTERIN was ordered to relinquish all claim, title and interest in the Landfill from the date upon which it received payment of the award.³⁹⁶ Furthermore, the estimated cost of environmental remediation of the site was deducted from the final award of damages.³⁹⁷

Finally, the tribunal was required to determine the amount of interest, costs and fees to be included in the award. Citing the holding in a previous ICSID arbitration, the tribunal held that interest is an “integral part of the compensation itself, and should run consequently from the date when the State’s international responsibility became engaged.”³⁹⁸ Despite the existence of multiple dates from which to choose, the tribunal determined that it was reasonable to conclude that Mexico’s international responsibility became engaged on the date on which Guadalcázar wrongfully denied Metalclad’s application for a construction permit.³⁹⁹ This interest was to accumulate from the date of denial of the municipal permit until forty-five days from the effective date of the award.⁴⁰⁰ In order to restore Metalclad to “a reasonable approximation of the position in which it would have been if the wrongful act had not taken place,” the tribunal calculated interest accruing during this period of time at six percent per annum compounded annually.⁴⁰¹ At the end of this period of time, the tribunal ordered that interest accrue on the unpaid award or any unpaid

393. *See id.*

394. *See id.* ¶ 126, at 24-25. The aggregation and allocation of expenses arising from multiple projects is known as “bundling.” *See id.* ¶ 126, at 24. While refusing to apply bundling to the case before it, the tribunal expressly refused to make any decision with respect to the appropriateness of the concept in other situations, such as those involving the development of natural resources. *See id.* ¶ 126, at 24-25.

395. *See id.* ¶ 127, at 25.

396. *See id.*

397. *See id.*

398. *Id.* ¶ 128, at 25; *see also* Asian Agric. Prods. Ltd. v. Sri Lanka, 4 ICSID (W. Bank) 246 (1990).

399. *See* Award, *supra* note 3, ¶ 128, at 25.

400. *See id.*

401. *Id.*

part thereof at the rate of six percent compounded monthly.⁴⁰² The tribunal also determined that it was equitable for each side to bear their own fees and costs attributable to the proceedings.⁴⁰³ Thus, after deducting the amounts previously referenced as credits and adding interest, the tribunal awarded Metalclad \$16.68 million in damages.⁴⁰⁴

Neither party to the *Metalclad* Arbitration was satisfied with the outcome. Despite its vindication, Metalclad characterized the tribunal's decision "as Pyrrhic a victory as any [it had] experienced."⁴⁰⁵ Metalclad criticized the amount of the award as "a token amount of money that doesn't really reflect the value of the project."⁴⁰⁶ Metalclad noted that "the biggest losers of all [were] the people of Mexico who continue to have to live in a country that produces ten million tons of hazardous waste a year and has only one facility in the whole country to handle it."⁴⁰⁷ Mexico expressed disappointment that the tribunal did not accept its contention with respect to the necessity of a municipal construction permit.⁴⁰⁸ Mexican officials insisted that the conclusion reached by the tribunal dismissing the necessity of such a permit intruded upon "the constitutional right of municipalities to require permission for what happens in their territory."⁴⁰⁹ Nevertheless, Mexican officials maintained that NAFTA's investment provisions were operating to their satisfaction and that Mexico would resist any amendment of these provisions for fear of encouraging demands for reopening of other parts of the agreement.⁴¹⁰

402. See *id.* ¶ 131, at 26.

403. See *id.* ¶ 130, at 25.

404. See *id.* ¶ 131, at 26.

405. Anthony DePalma, *Mexico is Ordered to Pay a U.S. Company \$16.7 Million*, N.Y. TIMES, Aug. 31, 2000, at C4 (quoting Grant S. Kesler, president and chief executive officer of Metalclad).

406. *Id.*

407. *Id.* See also Knight, *supra* note 29.

408. See Smith, *supra* note 28, at C2.

409. *Id.* (quoting Mexican Deputy Secretary of Commerce Luis de la Calle).

410. See MANN & VON MOLTKE, *supra* note 43, at 48.

III. METALCLAD CORPORATION V. UNITED MEXICAN STATES: LESSONS LEARNED AND THE FUTURE OF ENVIRONMENTAL REGULATION PURSUANT TO NAFTA

A. THE LESSONS OF *METALCLAD CORPORATION V. UNITED MEXICAN STATES*

As the first arbitration to interpret Chapter Eleven, there are numerous lessons that may be learned from the tribunal's *Metalclad* decision. Although tribunal decisions do not serve as precedent, the *Metalclad* Arbitration will nevertheless undoubtedly have some impact upon future Chapter Eleven cases. At the very least, the tribunal's decision creates a baseline with respect to NAFTA's investor-state provisions from which all future cases may be measured. Thus, it is important to examine the general principles established by the tribunal's decision, their meaning and their potential impact upon future Chapter Eleven arbitrations.

Two general principles may be discerned from the tribunal's decision. First, it is clear that NAFTA arbitration panels will not shirk from interpreting the federal, state and local laws of the parties and from disregarding official interpretations of such laws when it suits their purposes. The *Metalclad* tribunal heard evidence from expert witnesses retained by Metalclad and Mexican government officials with respect to the interrelationship between federal and local law in the area of hazardous waste regulation. Metalclad's expert witnesses opined that state and local governments were powerless with respect to all areas touching upon hazardous waste regulation.⁴¹¹ By contrast, Mexican government officials contended that applicable constitutional and statutory provisions provided for state and local autonomy in the regulation of hazardous waste at least with respect to the issuance of construction permits.⁴¹² The tribunal chose to ignore the official interpretation and instead opted to characterize Guadalcazar's activities as an illegitimate attempt at hazardous waste regulation rather than permitted licensing functions.⁴¹³ Thus, the tribunal held that Guadalcazar exceeded its constitutional authority to the extent that it utilized

411. See Award, *supra* note 3, ¶ 85, at 18.

412. See *id.*

413. See *id.* ¶ 86, at 18.

environmental impact, rather than physical construction considerations to deny Metalclad's permit application.⁴¹⁴ The tribunal expressed no reluctance in so holding and thus construing Mexican law in a manner contrary to the interpretation held by the enacting authority itself.

The second general principle that is clear from the tribunal's decision is its adoption of an American perspective with respect to its interpretation of state and local laws. Specifically, the tribunal grafted upon Mexican law, and presumably would do the same with respect to Canadian law, sanctity for private property rights not contained within either body of law. Mexico and Canada do not have internal protections for private property to the extent recognized in the United States. Private property rights in Mexico are governed by Article Twenty-Seven of the Mexican Constitution, which provides, in relevant part, that "[o]wnership of the lands and waters within the boundaries of the national territory is vested originally in the Nation, which has had, and has, the right to transmit title thereof to private persons, thereby constituting private property."⁴¹⁵ Article Twenty-Seven further provides that "[p]rivate property shall not be expropriated except for reasons of public use and subject to payment of indemnity."⁴¹⁶ However, the government is free to impose restrictions upon the use of private property short of actual transfer of ownership to the state without incurring liability for associated loss of use.⁴¹⁷ Thus, private property rights in Mexico are not absolute but rather serve "a social function," are of "a derivative character" and subject to limitation by the state.⁴¹⁸ These restrictions are equally applicable upon foreign property owners who are required to "consider themselves as nationals in respect to such property and bind themselves not to invoke the protection of their governments in matters relating thereto; under penalty . . . [in the event of noncompliance] of forfeiture of the

414. *See id.*

415. CONSTITUCIÓN POLITICA DE LOS ESTADOS UNIDOS MEXICANOS tit. I, art. 27.

416. *Id.*

417. *See id.* The government may limit the use of private property "to ensure a more equitable distribution of public wealth, to conserve [natural resources], to attain a well-balanced development of the country and improvement of the living conditions of the rural and urban population." *Id.*

418. JUAN JOSÉ GONZÁLEZ MARQUEZ, *NUEVO DERECHO AMBIENTAL MEXICANO (INSTRUMENTOS DE POLÍTICA)* 154 (1997) (quoting Monique Lions, *Expropiación, in Instituto de Investigaciones Jurídicas, DICCIONARIO JURÍDICO MEXICANO* 1389 (1992)).

acquired property to the Nation."⁴¹⁹

The primacy of legitimate government regulation over private property rights is even more pronounced in Canadian law. Canadian courts have refused to order compensation for losses suffered by property owners caused by "a legitimate government regulation unless the regulation actually transfers a benefit from the original owner to the government."⁴²⁰ Specifically, Section Seven of the Canadian Charter of Rights and Freedoms provides, in part, that "everyone has the right to life, liberty and security of the person."⁴²¹ However, unlike the Fifth and Fourteenth Amendments to the U.S. Constitution, the Charter does not assure Canadian citizens of the right to possess, use and freely transfer property.⁴²² Thus, an aggrieved Canadian landowner may only prevail if he can demonstrate a taking of his property by the government for its own use or destruction.⁴²³ Canadian courts have refused to find a compensable taking in the absence of such governmental use or destruction, even when the action at issue prohibits all effective use of the private property.⁴²⁴ Thus, the tribunal's interpretation engrafts the primacy of private property and American views with respect to expropriation and other interference on Mexican and Canadian law. This approach overrides contrary laws and invites abuse by defining the rights of foreign investors too broadly at the expense of state and local control.⁴²⁵

419. CONSTITUCIÓN POLITICA DE LOS ESTADOS UNIDOS MEXICANOS tit. I, art. 27.

420. J. Martin Wagner, *International Investment, Expropriation and Environmental Protection*, 29 GOLDEN GATE U. L. REV. 465, 510 (1999); see also Michelle Swenarchuk, *Stomping on the Earth: Trade, Trade Law, and Canada's Ecological Footprints*, 5 BUFF. ENVTL. L.J. 197, 211 (1998).

421. See CAN. CONST. (Constitution Act, 1982) pt. I (Canadian Charter of Rights and Freedoms), § 7; see also *A&L Invs., Ltd. v. Ontario* [1997] 152 D.L.R.4th 692 in which the Ontario Court of Appeal held that:

the jurisprudence that has developed under the Charter [of Rights and Freedoms] has made clear that economic rights as generally encompassed by the term "property" and the economic right to carry on a business, to earn a particular livelihood, or to engage in a particular professional activity all fall outside the [Section] 7 guarantee.

Id. at 702.

422. See Wagner, *supra* note 420, n.212, at 465-66.

423. See *A&L Invs.*, 152 D.L.R. 4th, at 700; see also *Steer Holdings Ltd. v. Manitoba*, [1993] 2 W.W.R. 146, 149-50 (Man. C.A.).

424. See *Hartel Holdings Co. v. Council of the City of Calgary*, [1984] 8 D.L.R.4th 321, 334; see also *Soo Mill & Lumber Co. v. City of Sault Ste-Marie*, [1975] 2 S.C.R. 78, 83; *Sanbay Devs., Ltd. v. City of London*, [1975] 45 D.L.R.3d 403, 409.

425. See Evelyn Iritani, *Trade Pacts Accused of Subverting U.S. Policies*, L.A. TIMES, Feb. 28, 1999, at A1.

The tribunal's decision also clearly establishes what is not relevant with respect to Chapter Eleven proceedings. The tribunal refused to consider the environmental concerns raised by Mexican government officials with respect to the Landfill. Rather, the tribunal deemed the motivation or intent of the state and municipal governments irrelevant.⁴²⁶ In so holding, the tribunal by implication dismissed the duties of such governments to serve their populaces and the public policy reasons underlying their actions. In addition, the tribunal ignored local opposition to the Landfill. Although non-governmental organizations opposed the Landfill from its onset, local opposition did not crystallize until late 1995.⁴²⁷ Nevertheless, the existence and legitimacy of this opposition was not recognized by the tribunal in any manner whatsoever. Thus, as noted by one commentator, "[t]he question [for the tribunal to decide] was really about which authority should make the final decision and which interests should this decision reflect."⁴²⁸

The tribunal answered this question in a most authoritative manner. The tribunal identified the authority responsible for the decision process in this matter as the Mexican federal government. The primacy of federal power was first established by the tribunal's explicit holding that San Luis Potosi and Guadalcazar lacked constitutional authority with respect to the ultimate decision to construct and operate the Landfill. Implicit in this determination is the tribunal's conclusion that any state or local regulation, including environmental regulation, must substantially advance legitimate local interests. This holding recognizes the exercise of the so-called "police powers" by state and local governments for purposes of protecting the health, safety and welfare of the local citizenry. Environmental regulation may fall within the parameters of such state and local powers. Indeed, it has been noted that "[g]iven the undeniable impact of human activities on environmental health, and the equally obvious relationship between environmental health and human welfare, it is clear that regulations to protect the environment are at least as legitimate as regulations to address . . . other governmental concerns."⁴²⁹

However, purported exercises of state and local police

426. See Award, *supra* note 3, ¶ 111, at 22.

427. See Tamayo, *supra* note 117, at 15.

428. *Id.*

429. Wagner, *supra* note 420, at 528.

powers must conform to limitations upon subnational jurisdiction established by the underlying constitutional scheme. This is not a novel conclusion in any legal system based upon principles of federalism. What is noteworthy about the tribunal's decision is its cordoning off of a vast area of regulation from subnational interference despite the interest of and its undeniable effect upon local populations. The tribunal broadly interpreted Mexico's regulatory scheme with respect to hazardous waste landfills and unilaterally granted the federal government sweeping and exclusive power in this area. According to the tribunal, the authority of state and local governments was limited to the perfunctory issuance of construction permits, the creation of ecological zones and the administration of non-hazardous waste sites.⁴³⁰ Such jurisdiction did not include matters relating in any manner to the regulation, control, generation, handling and disposal of hazardous waste.⁴³¹ Furthermore, federal omnipotence in this field was acknowledged despite the protestations of the Mexican government itself that the tribunal was granting to it powers it did not exclusively enjoy.

It is also clear from the tribunal's holding that the federal governments of the respective NAFTA parties have a legal obligation to intervene pursuant to Articles 1105 and 1110 when dissident subnational components exceed the limits of their police powers. The tribunal's holding with respect to Metalclad's Article 1105 claim stated that, by failing to remedy the flawed procedures associated with the municipal construction permit and allay the confusion surrounding the ultimate repository of responsibility with respect to the opening and operation of the Landfill, the acts of San Luis Potosi and Guadalcazar became the acts of the Mexican federal government.⁴³² With respect to the Article 1110 expropriation claim, the tribunal noted that the federal government had participated, or least acquiesced, in the taking of Metalclad's investment by tolerating Guadalcazar's conduct.⁴³³ The mandate to the national governments of the NAFTA parties could not be more clearly stated. Specifically, national governments must establish the limits of subnational jurisdiction existing through the exercise of the police powers and stringently enforce those limits by taking prompt and

430. See Award, *supra* note 3, ¶ 81, at 17-18 & ¶ 83, at 18.

431. See *id.* ¶ 83, at 18.

432. See *id.* ¶ 100, at 20.

433. See *id.* ¶ 104, at 21.

effective action against non-complying state and local governments. National governments failing to act in a prompt and decisive manner risk being tarred with the same brush that taints the challenged state or local action.

Even assuming the existence of a legitimate subnational interest permitting the exercise of the police powers by state or local government, such exercise was subject to three limitations. Initially, the tribunal's holding subjects such exercise to a reasonableness standard. In the context of the *Metalclad* Arbitration, the environmental risk Guadalcazar sought to guard against was required to be real and substantial.⁴³⁴ This standard serves to eliminate measures camouflaged as environmental regulation but designed to serve other purposes such as the restraint of foreign competition or protection of domestic industries.⁴³⁵ This standard may be met by the existence of scientifically supported environmental risk.⁴³⁶

The tribunal summarily concluded that the bases upon which Guadalcazar objected to the Landfill were not supported by such evidence. Guadalcazar's denial of the construction permit was deemed to be without "any basis"⁴³⁷ or "consideration of, or specific reference to, construction aspects or flaws of the physical facility."⁴³⁸ Rather, the repeated issuance of federal permits to Metalclad and the conclusion and adoption of the Convenio "show clearly that [the Mexican federal government] was satisfied that [the] project was consistent with, and sensitive to, environmental concerns."⁴³⁹ The tribunal did not identify any further sources for its conclusions. Thus, without further explanation, the tribunal determined that Guadalcazar's actions with respect to the Landfill were illegitimate, while the federal conclusions with respect to the environment were scientifically supported. The danger of granting authority to untrained outside bodies unaccountable to local populations to weigh competing scientific theories underlying environmental regulation has been aptly noted.⁴⁴⁰ It

434. See Wagner, *supra* note 420, at 530.

435. See *id.*

436. See *id.* at 531.

437. Award, *supra* note 3, ¶ 106, at 21.

438. *Id.* ¶ 93, at 19.

439. *Id.* ¶ 98, at 20.

440. See Wagner, *supra* note 420, at 534. Wagner specifically noted that:

[i]t is . . . inappropriate for an outside body that is not accountable to a country's residents, such as an arbitral tribunal, to attempt to weigh competing scientific claims to determine whether there is "enough" risk to

is even more indefensible to have such an outside body reach its conclusions with only the slightest bit of disclosure of the evidence upon which it relied.

The second limitation placed upon environmental regulation involved due process. From a substantive standpoint, Guadalcazar, and thus by implication Mexico, failed to consider numerous relevant facts such as Metalclad's efforts to comply with state and local requirements and its ongoing construction and operation of the facility.⁴⁴¹ Furthermore, the tribunal noted that no evidence was presented to any state or local official or body demonstrating the environmental unsuitability of the site or failure to comply with specific construction requirements.⁴⁴² From a procedural standpoint, Guadalcazar, and hence Mexico, failed to afford Metalclad an opportunity to be heard by failing to notify it of the hearing on its permit application.⁴⁴³ Guadalcazar and Mexico further failed to meet the requirements of procedural due process by permitting an excessive period of time to elapse without action on the application, while construction and the resulting injury to Metalclad continued without abatement.⁴⁴⁴ A final procedural failure was the lack of a transparent framework within which Metalclad could readily ascertain the identity of the entities empowered to act in this area and the requirements imposed by each such entity.⁴⁴⁵ It is unclear from the tribunal's decision whether any one of these acts or omissions standing alone would have been sufficient to constitute a violation of due process. What is certain is that the particular combination of events surrounding the construction and operation of the Landfill violated the guarantee of due process through the requirement of fair, just and equitable treatment contained in Article 1105.⁴⁴⁶

The final limitation placed upon environmental regulation was the prohibition upon expropriation set forth in Article 1110. For the first time in the context of an arbitration pursuant to Chapter Eleven's investor-state provisions, a tribunal defined expropriation. In addition to "open, deliberate and

justify the [environmental] measure in question, or whether the measure is supported by the "correct" or "best" or "most accepted" science.

Id.

441. See Award, *supra* note 3, ¶ 51, at 12.

442. See *id.* ¶ 52, at 12.

443. See *id.* ¶ 54, at 12 & ¶ 91, at 19.

444. See *id.* ¶ 90, at 19.

445. See *id.* ¶ 76, at 17 & ¶ 88, at 19.

446. See *id.* ¶ 99, at 20.

acknowledged takings of property” that have always been within the commonly accepted definition of expropriation, such definition also includes “covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use of the reasonably-to-be-expected economic benefit of property even if not necessarily to the obvious benefit of the host state.”⁴⁴⁷ Guadalcazar’s denial of the construction permit in the absence of any supporting evidence, when combined with the lack of an established permitting process and the representations of exclusive federal authority upon which Metalclad relied constituted such a covert or incidental interference.⁴⁴⁸ The effect of this interference was to deprive Metalclad of its investment in the Landfill in its entirety.⁴⁴⁹ As if this were not enough, the implementation of the decree creating the ecological zone standing alone was also a covert or incidental interference prohibited by Article 1110.⁴⁵⁰ In a manner similar to the tribunal’s holding with respect to the requirement of fair and equitable treatment, it remains unclear whether any one of these acts or omissions standing alone, other than the ecological decree, would have been sufficient to constitute an act tantamount to expropriation. What is certain is that similar actions undertaken by a state in the future raise at the least the possibility of a compensable taking pursuant to Article 1110.

After determining the identity of the authority empowered to act in this area, the tribunal then was required to decide whose interests should be served by the authority’s decision. The sole interest identified by the tribunal was that of the investor. According to the tribunal, the investor’s primary interest was its reasonable expectations with respect to the investment, the governmental action allegedly constituting expropriation and the foreseeable impact of such action upon the investment. In applying this reasonable expectations test, the tribunal specifically noted that Metalclad’s sole purpose in acquiring COTERIN was to develop and operate the Landfill.⁴⁵¹ The tribunal further concluded that Metalclad had no reason to foresee difficulty with respect to its investment given the past issuance of federal and state permits and official assurances

447. *Id.* ¶ 103, at 21.

448. *See id.* ¶¶ 104-8, at 21-22.

449. *See id.* ¶ 113, at 22.

450. *See id.* ¶ 111, at 22.

451. *See id.* ¶ 77, at 17.

that exclusive jurisdiction resided with the federal government.⁴⁵² Metalclad relied upon these actions,⁴⁵³ which reliance was, in the view of the tribunal, justifiable.⁴⁵⁴ In deepening its commitment to its investment, Metalclad was “merely acting prudently and in the full expectation that the [municipal construction] permit would be granted.”⁴⁵⁵ As such, it was Metalclad’s reasonable expectation that it would be able to complete construction and operate the Landfill. The denial of the construction permit by Guadalcazar, the intransigence of San Luis Potosi and subsequent backpedaling of federal government officials with respect to the issue of exclusive jurisdiction were unforeseeable and inconsistent with Metalclad’s expectation.

Equally unforeseeable was the severity and duration of the impact upon the investment. Although international tribunals have refused to require compensation if the challenged regulation merely prohibited the most economically optimal use of property, the right to such compensation is clear when the regulation removes all economic value from the property for an extended period of time, thereby rendering the investment useless and nugatory.⁴⁵⁶ In this case, the denial of the municipal permit was issued after the completion of construction activities at the Landfill and immediately following the public announcement of the Convenio providing for its operation.⁴⁵⁷ Operations were further delayed by the filing and lengthy pendency of the amparo proceeding.⁴⁵⁸ Operation of the Landfill was ultimately barred in perpetuity through the creation of the ecological zone.⁴⁵⁹ The result of these actions was “the complete frustration of the operation of the landfill [and] . . . the [negation of] the possibility of any meaningful return on Metalclad’s

452. See *id.* ¶¶ 78-81, at 17-18.

453. See *id.* ¶ 85, at 18.

454. See *id.* ¶ 89, at 19.

455. *Id.*

456. See *Starrett Housing Corp. v. Iran*, 4 Iran-U.S. Cl. Trib. Rep. 122, 154 (1983); see also WAYNE MAPP, *THE IRAN-U.S. CLAIMS TRIBUNAL: THE FIRST TEN YEARS* 152, 155 (1993); Matti Pellonpää, *Compensable Claims Before the Tribunal: Expropriation Claims*, in *THE IRAN-UNITED STATES CLAIMS TRIBUNAL: ITS CONTRIBUTION TO THE LAW OF STATE RESPONSIBILITY* 252 (Richard B. Lillich & Daniel B. Magraw eds., 1997); Rudolf Dolzer, *Indirect Expropriation of Alien Property*, 1 ICSID REVIEW, FOREIGN INV. L.J. 41, 62 (1986); Wagner, *supra* note 420, at 522-25.

457. See Award, *supra* note 3, ¶ 90, at 19.

458. See *id.* ¶ 95, at 20.

459. See *id.* ¶ 109, at 22.

investment.”⁴⁶⁰ This result was severe, permanent and unforeseeable, thereby mandating compensation.

However, serious questions may be raised with respect to this conclusion. It is improbable at best that a highly sophisticated company whose operations, if not carefully monitored, could pose a serious threat to the environment, would not have contemplated that its activities would be subject to controversy and resultant heightened scrutiny. Furthermore, the chaos, delay and risk that may ensue from dealing with regulatory bodies in developing states is undoubtedly known to even the most naïve of foreign investors. Metalclad knew of the mismanagement of the transfer station and its subsequent closure by SEDUE nineteen months prior to the execution of the option agreement between Aldrett, COTERIN and Metalclad in April 1993.⁴⁶¹ Metalclad was also aware that COTERIN's facility had a record of confrontation with officials of San Luis Potosi and Guadalupe, and, most importantly, the local population.⁴⁶² Nevertheless, the company went forward with its investment in La Pedrera.

Thus, it may be concluded that, having entered Mexico voluntarily, knowing of the potential environmental dangers associated with hazardous waste sites, the poor history of the previous operator and the existence of local resistance on multiple fronts, Metalclad should bear the risk of adverse changes in the regulatory environment.⁴⁶³ This conclusion is an affirmation of the principle that, generally speaking, “[i]t should not be the function of the international law to insulate the foreign investor from the regulatory regime of the host state's laws.”⁴⁶⁴ However, by granting an award of damages as a result of the totality of Metalclad's experience in La Pedrera, the tribunal transferred the risk for non-market related aspects of the investment from the company itself to the Mexican government.⁴⁶⁵ Without NAFTA's expansive provisions on expropriation, risks associated with foreign investment would be allocated to the investor itself, who would be required to adequately ascertain their existence, potential impact upon

460. *Id.* ¶ 113, at 22.

461. *See supra* notes 143-162 and accompanying text.

462. *See Tamayo, supra* note 117, at 8.

463. *See M. SORNARAJAH, THE INTERNATIONAL LAW ON FOREIGN INVESTMENTS* 300 (1994).

464. *Id.*

465. *See Aslam, supra* note 30.

operations, and ultimately, acceptability.⁴⁶⁶ NAFTA's expropriation provisions relieve foreign investors of these burdens through outright risk transference to host governments. At the very least, such governments become the de facto guarantors of the success of foreign investors operating within their borders. Governments thus may be held hostage to the threat of liability upon an investment's failure for any reason that may somehow be tangentially connected to governmental action or failure to act. Such a result may impact the manner in which a government chooses to operate and is inimical to its ultimate responsibility to govern in a manner that best serves the interest of its electorate.

Finally, the *Metalclad* Arbitration constitutes the first case in which a tribunal has extensively explored the issue of damages with respect to violations of Chapter Eleven's investor-state provisions. Initially, the tribunal's decision established the formula upon which awards of damages are to be calculated. In this regard, the tribunal adopted the measure of damages set forth by the Permanent Court of International Justice in *Chorzow Factory*⁴⁶⁷ as the measure of damages for violations of Articles 1105 and 1110.⁴⁶⁸ Specifically, the tribunal held that "where the state has acted contrary to its obligations, any award to the claimant should, as far as is possible, wipe out all the consequences of the illegal act and reestablish the situation which would in all probability have existed if that act had not been committed."⁴⁶⁹ The consequences of Mexico's illegal behavior could best be erased by awarding Metalclad an amount of damages equal to its actual investment in COTERIN and the Landfill.⁴⁷⁰ This measure of damages is applicable in cases alleging violations of either Articles 1105 or 1110, assuming that the investor has suffered a complete frustration of its purpose in making the investment and the negation of any meaningful return thereon.⁴⁷¹ The amount of such actual investment is capable of proof through tax filings and supporting independent audit documents, which are to be accorded substantial weight by arbitral panels.⁴⁷²

466. *See id.*

467. *Chorzow Factory* (Ger. v. Pol.), 1927-1930 P.C.I.J. ANN. REP. (ser. A) No. 17, at 47 (1928).

468. *See Award, supra* note 3, ¶ 122, at 24.

469. *Id.*

470. *See id.*

471. *See id.* ¶ 113, at 22.

472. *See id.* ¶ 124, at 24.

The tribunal also itemized those expenses that may or may not be included in the determination of the amount of the actual investment. Included within this award are out-of-pocket expenses arising directly from the investment, including costs associated with acquisition, personnel, insurance, travel, utilities, equipment and professional expenses.⁴⁷³ However, the tribunal made clear that other less direct costs will be subject to stricter scrutiny. For example, preparatory costs incurred by an investor prior to the date of its actual investment in the host state are too remote to be included in the amount of the actual investment.⁴⁷⁴ Furthermore, bundled costs will not be routinely included in the calculation of the actual investment.⁴⁷⁵ Rather, bundling may only be utilized when deemed “appropriate,” although the exact circumstances meeting this requirement remain uncertain.⁴⁷⁶ Equally excludable are damages arising from the loss of share price.⁴⁷⁷ In order to obtain such an award, the investor must be able to demonstrate the existence of a direct causal relationship between the action that negatively impacted the investment and the investor’s share price with an unspecified degree of certainty.⁴⁷⁸ Reductions in share value that are remote or attributable to other factors unrelated to the investment will not be included in an award of damages.⁴⁷⁹

The tribunal’s decision also established guidelines for the inclusion of lost profits as an element of damages. While acknowledging that the fair market value of an investment may include an estimate of future profits utilizing discounted cash flow analysis, the tribunal established three criteria that investors must satisfy in order to receive such an award.⁴⁸⁰ Initially, the investment for which such an award is sought must have operated at a profit to the investor.⁴⁸¹ Second, the investment must have operated for “a sufficiently long time to establish a performance record.”⁴⁸² In one of the few elaborations contained within the portion of the opinion devoted to damages, the tribunal indicated that the investment must have operated

473. See *id.* ¶ 123, at 24.

474. See *id.* ¶ 125, at 24.

475. See *id.* ¶ 126, at 24-25.

476. *Id.* ¶ 126, at 25.

477. See *id.* ¶ 115, at 23.

478. See *id.*

479. See *id.*

480. See *id.* ¶ 119, at 23.

481. See *id.* ¶ 120, at 23.

482. *Id.*

for a minimum of two or three years in order to qualify for an award of future profits.⁴⁸³ Finally, the requested award of future profits must be reasonably ascertainable and not “wholly speculative.”⁴⁸⁴ The tribunal offered no further explanation of this standard or the evidence that would render the amount of such loss reasonably ascertainable.

Two final items with respect to damages may be important to future Chapter Eleven claims arising from environmental regulation. First, with little explanation or fanfare, the tribunal noted that COTERIN would be required to relinquish all claim, title and interest in the Landfill upon satisfaction of the award by Mexico.⁴⁸⁵ The tribunal further noted that, at such time, the Landfill may require environmental remediation.⁴⁸⁶ Thus, any award that failed to take into account the need to remediate the site would serve to ignore COTERIN’s legal obligations and unjustly enrich the company.⁴⁸⁷ As such, the tribunal deducted the anticipated cost of remediation from the final award of damages to Metalclad.⁴⁸⁸ Despite the probability that expenses associated with environmental remediation could constitute substantial credits against awards of damages to investors in future investor-state actions pursuant to Chapter Eleven, the tribunal failed to disclose the amount of such credit or the basis by which it arrived at such amount.⁴⁸⁹

Finally, the tribunal’s holding with respect to interest to be included in an award of damages is worthy of review. First, following accepted international practice, the tribunal held that the accrual date for an award of interest pursuant to NAFTA’s investor-state provisions is the date of engagement of the host state’s responsibility.⁴⁹⁰ In most cases, this date is ascertainable with reasonable certainty. However, Mexico’s liability was founded upon “an accumulation of a number of factors.”⁴⁹¹ Thus, the tribunal was confronted with several dates from which interest could accrue. By selecting December 5, 1995, the date on which Guadalcazar denied Metalclad’s application for a

483. *See id.*

484. *Id.* ¶121, at 23.

485. *See id.* ¶ 127, at 25.

486. *See id.*

487. *See id.*

488. *See id.*

489. *See id.*

490. *See id.* ¶ 128, at 25 (citing *Asian Agric. Prods. v. Sri Lanka*, 4 ICSID (W. Bank) 245, 294 (1990)).

491. Award, *supra* note 3, ¶ 128, at 25.

construction permit, the tribunal selected the most conservative of dates.⁴⁹² Mexico's international responsibility and Metalclad's damages may have accrued far earlier in time. State responsibility may have accrued as early as September 1993 when, relying upon assurances of exclusive federal jurisdiction, Metalclad exercised its option to purchase COTERIN.⁴⁹³ State responsibility also may have attached in October 1994 when federal authorities failed to timely intervene to prevent cessation of construction activities by order of the Guadalcázar Town Council.⁴⁹⁴ Finally, an award of interest from March 1995 would recognize Mexico's liability for its failure to prevent Unzueta's posting of armed protesters at the entrance to the Landfill.⁴⁹⁵ Instead, the tribunal chose a date long after state responsibility had attached and Metalclad had suffered ascertainable injury. This conservative interpretation should serve as a lesson to future Chapter Eleven claimants. Further lessons may be ascertained from the tribunal's failure to elaborate on the method by which it chose the applicable rate.⁴⁹⁶

B. THE METALCLAD ARBITRATION AND THE FUTURE OF ENVIRONMENTAL REGULATION PURSUANT TO NAFTA

There are significant consequences for future environmental regulation in the United States as a result of the *Metalclad* Arbitration. However, serious implications for future environmental regulation may arise from the mere assertion of such claims. The mere assertion of claims such as those advanced by Metalclad may have a drastic impact upon the willingness and ability of state and local governments to adopt environmental regulations that interfere with American, Canadian or Mexican investments or otherwise disrupt their operation or profitability. The threat posed by potential claims may chill future state and local environmental regulation, thereby freezing such regulation in its present state. The resultant regulatory gridlock may prove to be incapable of responding to environmental emergencies as well as scientific advances in an adequate fashion. The *Metalclad* Arbitration and other pending challenges to environmental regulation asserted

492. See *id.*

493. See *supra* notes 159-174 and accompanying text.

494. See *supra* notes 186-192 and accompanying text.

495. See *supra* notes 193-200 and accompanying text.

496. See Award, *supra* note 3, ¶ 128, at 25.

pursuant to NAFTA's Chapter Eleven have opened a proverbial Pandora's Box of unintended and unanticipated consequences for future environmental regulation. Only through the decisive action of the parties themselves may Chapter Eleven be returned to its intended place within NAFTA.

Initially, claims such as those recognized in the *Metalclad* Arbitration have the effect of strengthening the conclusion that NAFTA, and in particular Chapter Eleven, favors trade law over every form of domestic law.⁴⁹⁷ This favoritism comes at the expense of environmental laws, which are subordinated to the right of nationals of the parties to make a profit through unfettered exploitation of their investments in the territories of other parties.⁴⁹⁸ After all, as aptly noted by the Sierra Club of Canada, "[o]ne man's environmental regulation is another man's non-tariff trade barrier."⁴⁹⁹ If environmental regulation is treated as merely another non-tariff barrier to be overcome, NAFTA is truly reduced to "a tool in the hands of corporations desperate to protect their bottom line, no matter what the cost to human health or the environment."⁵⁰⁰ Meaningful environmental measures will be unable to be adopted or enforced if such measures conflict with the profitability of an investment of a national of another party.⁵⁰¹ The right of all parties and their constituencies to significant environmental protection is thus rendered a nullity.

Such an interpretation is inconsistent with the objectives of NAFTA with respect to the environment.⁵⁰² NAFTA's Preamble evidences the parties' intent to "[e]nsure a predictable commercial framework for business planning and investment . . . in a manner consistent with environmental protection and conservation."⁵⁰³ The Preamble also evidences the parties' resolve to "[p]romote sustainable development . . . [and] [s]trengthen the development and enforcement of environmental laws and regulations."⁵⁰⁴ The

497. See Knight, *supra* note 29; see also Knight, *supra* note 31.

498. See Peterson, *supra* note 33, at A1.

499. *Examining Canada's Priority Interests at the WTO/FTAA Negotiations: How Not to Promote Environmental Protection* (Sierra Club of Canada, Ottawa, Ont.), July 1999, at 2 [hereinafter *Canada's Priority Interests*].

500. *Latest NAFTA Lawsuit Proves Threat of Chapter Eleven to Health and Environmental Laws, Again*, *supra* note 35, at 1 (quoting Angela Rickman of the Sierra Club of Canada).

501. See *id.*

502. See MANN & VON MOLTKE, *supra* note 43, at 6-7.

503. NAFTA, *supra* note 24, at pmb1.

504. *Id.*

primacy of the parties' intent with respect to environmental protection is specifically recognized in Article 1114 which provides that "[n]othing in . . . Chapter [Eleven] shall be construed to prevent a Party from adopting, maintaining or enforcing any measure . . . that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental concerns."⁵⁰⁵ These goals are further developed in the North American Agreement on Environmental Cooperation, which promotes environmental preservation and protection, sustainable development and the enhanced enforcement of environmental laws.⁵⁰⁶ The North American Agreement on Environmental Cooperation also entitles the parties to "establish [their] own levels of domestic environmental protection . . . [to ensure] high levels of environmental protection . . ."⁵⁰⁷ However, if environmental measures are subject to challenges pursuant to Chapter Eleven,

505. *Id.* art. 1114(1). However, it bears to note that Article 1114(1) appears on its face to require that the environmental measure be specifically directed at investment activities conducted within the territory of a Party rather than environmental measures of general application. Included within such measures may be such specific regulations as those associated with land use planning, zoning and construction. In any event, all such measures must be consistent with Chapter Eleven's provisions. *See id.*

506. *See* North American Agreement on Environmental Cooperation, Sept. 8, 1993, art. 1 (a-j), 32 I.L.M. 1480. Article 1 specifically provides that the objectives of the Agreement are to:

- (a) foster the protection and improvement of the environment in the territories of the Parties for the well-being of present and future generations;
- (b) promote sustainable development based on cooperation and mutually supportive environmental and economic policies;
- (c) increase cooperation between the Parties to better conserve, protect, and enhance the environment, including wild flora and fauna;
- (d) support the environmental goals and objectives of the NAFTA;
- (e) avoid creating trade distortions or new trade barriers;
- (f) strengthen cooperation on the development and improvement of environmental laws, regulations, procedures, policies and practices;
- (g) enhance compliance with, and enforcement of, environmental laws and regulations;
- (h) promote transparency and public participation in the development of environmental laws, regulations and policies;
- (i) promote economically efficient and effective environmental measures; and
- (j) promote pollution prevention policies and practices.

Id.

For a complete discussion of the North American Agreement on Environmental Cooperation, *see* PIERRE M. JOHNSON & ANDRE BEAULIEU, *THE ENVIRONMENT AND NAFTA: UNDERSTANDING AND IMPLEMENTING THE NEW CONTINENTAL LAW* 119-276 (1996).

507. North American Agreement on Environmental Cooperation, *supra* note 506, art. 3.

it will be inordinately difficult, if not impossible, to achieve NAFTA's goals of strengthening environmental protection while respecting differing levels of such protection.⁵⁰⁸

Furthermore, the challenge posed to environmental regulations by Chapter Eleven were not contemplated by the parties.⁵⁰⁹ Metalclad may have succeeded in expanding the term "expropriation" in directions that were arguably never anticipated by the parties. The United States and Canada viewed Chapter Eleven as serving "to liberalize the investment regime in Mexico, where constraints on foreign investment were widespread and accompanied by a view of the national ability to expropriate foreign investments that reflected a very bifurcated North-South view of the relationship between a state and a foreign investor."⁵¹⁰ By contrast, Mexico viewed Chapter Eleven as a method by which to attract investors through the enhancement of security and predictability.⁵¹¹ Metalclad has thus arguably misappropriated Chapter Eleven through its use as "a potent offensive strategic tool" rather than its intended role as "a defensive investor protection mechanism."⁵¹² Unfortunately, there are no specific drafting records that elaborate upon the intended scope of Article 1110's expropriation provisions.⁵¹³ Arbitral panels are thus left without guidance with respect to the boundaries of expropriation as contemplated by the parties.

The interpretation of Chapter Eleven reached by the *Metalclad* tribunal also unwisely grants adversely affected investors who have failed to thwart environmental regulation at the domestic level an additional avenue of attack utilizing NAFTA.⁵¹⁴ In this regard, the *Metalclad* Arbitration can be characterized as an attempt to utilize NAFTA as a tool to rewrite the decisions of Mexican authorities with respect to the Landfill upon the failure of Metalclad's domestic campaign

508. See MANN & VON MOLTKE, *supra* note 43, at 46.

509. See Brevetti & Nagel, *supra* note 1, at 1375; see also Aslam, *supra* note 30; Knight, *supra* note 29.

510. MANN & VON MOLTKE, *supra* note 43, at 12.

511. See *id.*

512. *Id.* at 15. David Schorr, the Director of the World Wildlife Fund's Sustainable Commerce Program, has noted that, "[i]nstead of protecting investors, NAFTA's rules are being used to attack legitimate environmental policies." *NAFTA Used to Attack California Clean Water Move*, ENV'T NEWS SERVICE, available at <http://ens.lycos.com/ens/jun99/1999L-06-24-04.html> (June 24, 1999).

513. See MANN & VON MOLTKE, *supra* note 43, at 45.

514. See *Canada's Priority Interests*, *supra* note 499, at 2.

against such measures.⁵¹⁵ As noted by Howard Mann and Konrad von Moltke in their study of the impact of Chapter Eleven on environmental regulation for the International Institute for Sustainable Development, “the investor-state process of NAFTA has now become part of a dynamic institutional response by foreign business owners to government action in all public policy areas with an impact on their costs and competitiveness, with a large focus of this activity aimed at environmental measures.”⁵¹⁶

Such an institutional response grants industry an unhealthy privileged access to public policy-making processes and is an unprecedented intrusion upon such processes.⁵¹⁷ Foreign investors, with no interests to consider other than their own operations and profits, possess an undue advantage over host governments with respect to issues of environmental regulation.⁵¹⁸ Rather than raising environmental issues with host governments in the context of balancing public and private interests to reach a compromise acceptable to all, foreign investors may now bring the threat of damages awarded in the context of a Chapter Eleven proceeding to bear upon their host governments during crucial stages of the public policy process.⁵¹⁹ Such threats or perceived threats could significantly interfere with the sovereignty of host states by restricting the ability of democratically elected governments to legislate on critical matters of environmental protection.⁵²⁰ The potential deleterious effects upon state sovereignty in general and environmental regulation in particular are enhanced by the presence of more than 350 million individuals and corporations located throughout the territory of the parties.⁵²¹ Governments at all levels can and should take action with respect to issues concerning environmental protection in their capacity as the caretakers of public safety and the common good. Any government that hesitates or refuses to act because it may have

515. See *NAFTA Used to Attack California Clean Water Move*, *supra* note 512, at 2.

516. MANN & VON MOLTKE, *supra* note 43, at 15.

517. See *id.* at 6.

518. See *id.* at 14.

519. See *id.* at 18.

520. See Michelle Sforza & Mark Vallianatos, *Ethyl Corporation v. Government of Canada: Now Investors Can Use NAFTA to Challenge Environmental Safeguards*, 3 PUBLIC CITIZEN GLOBAL TRADE WATCH 3 (1997), available at <http://www.citizen.org/pctrade/nafta/cases/ethylbri/htm>.

521. See *id.*

to pay compensation to foreign companies is well on its way to abdicating its sovereignty. Chapter Eleven's investor-state provisions are objectionable to the extent they place the constituent governments of the parties on the path toward losing their power to adopt environmental protection measures.

The dispute resolution procedures established by Chapter Eleven are equally inimical to public policy-making processes. Chapter Eleven's dispute resolution processes lack necessary procedural and public interest safeguards. The dispute resolution procedures allow foreign investors "to sidestep [such] safeguards in favour of a non-transparent, secretive system of arbitration with no right of appeal."⁵²² Increasingly complex issues are determined behind closed doors by arbitrators possessing little or no competence to examine the dispute from a scientific, environmental or public health standpoint.⁵²³ Furthermore, Chapter Eleven's procedures ignore the necessity of multi-stakeholder consultations on issues of public interest such as the environment.⁵²⁴ Instead, Chapter Eleven encourages governments to litigate public interest issues in a secretive manner in which the interests of only one party are presented and considered.⁵²⁵ Hence, the wisdom of Mexico's decision to prohibit the operation of the Landfill occurred solely in the context of Metalclad's narrow commercial interests without any input from Guadalupe, San Luis Potosi or any other local Mexican jurisdiction or authority.⁵²⁶ Metalclad thus succeeded in using NAFTA to override all local opposition to the operation of the Landfill. The lack of public access to information and records, the consequent lack of adequate public knowledge of ongoing arbitration proceedings and absence of national judicial review are further evidence of the need for procedural and public interest safeguards.⁵²⁷ Although such procedures are well accepted in commercial arbitration between private parties, they are as yet uncommon, and should remain so, in areas where significant public policy issues are at stake.⁵²⁸ The effect of transplantation of such procedures to public policy issues substitutes the authority of international panels established for

522. MANN & VON MOLTKE, *supra* note 43, at 3.

523. See *Canada's Priority Interests*, *supra* note 499, at 2.

524. See MANN & VON MOLTKE, *supra* note 43, at 6.

525. See *id.*

526. See Brevetti & Nagel, *supra* note 1, at 2; see also Knight, *supra* note 29.

527. See MANN & VON MOLTKE, *supra* note 43, at 18.

528. See *id.* at 14.

the primary purpose of defending the private interests of foreign investors for the provisions of constitutional governance.⁵²⁹ This substitution serves to undermine the democratic legitimacy of the dispute resolution process.⁵³⁰

Chapter Eleven's dispute resolution procedures also create an unfair advantage for foreign investors at the expense of domestic companies. Although foreign investors are permitted to mount full-scale assaults upon a potentially limitless number of measures adopted by their host states, domestic companies are prohibited from engaging in such attacks through their exclusion from Chapter Eleven's protections. NAFTA's creation of a right for foreign investors to seek damages arising from the adoption of measures, including environmental laws and regulations, by a host state raises the issue of equivalent rights for domestic investors.⁵³¹ In the case of the Landfill, similarly situated Mexican companies could not seek compensation pursuant to NAFTA such as may be sought by their American and Canadian counterparts. If one of the purposes of Chapter Eleven's investor-state provisions was to level the field of play for foreign investors, it may be legitimately questioned whether a drastic and powerful procedural weapon provided to foreign investors should not also be provided to domestic investors. Although this would be an equitable result, such an extension would have potentially disastrous consequences for regulation at all levels of government, would overwhelm already overcrowded administrative and judicial dockets, and could require the payment of hundreds of millions of dollars in compensation.

Adoption of the *Metalclad* tribunal's interpretation of Chapter Eleven's investor-state provisions also imperils the long-assumed right of the general public to a clean and healthy environment.⁵³² Chapter Eleven creates a right for a foreign investor to be compensated when measures adopted by its host state negatively affect its operations, profitability or share value. In the case of environmental measures, this right to compensation "is treated as the moral equivalent of the public's

529. See Sforza & Vallianatos, *supra* note 520, at 2-3.

530. See MANN & VON MOLTKE, *supra* note 43, at 7.

531. See *id.* at 16.

532. See Peterson, *supra* note 33, at A1. Daniel E. Seligman, a trade policy analyst for the Sierra Club, has noted that "[b]efore these trade rules came along, we thought it was our right to have clean air and clean water. [These cases] show that we have to pay foreign companies to maintain that right." *Id.*

right not to be harmed by industrial toxins.”⁵³³ It has been aptly noted that this equivalency further encourages attacks upon environmental measures by sending a “strong message to investors that demanding compensation from the public for the inconvenience of complying with environmental regulations constitutes a legitimate and lucrative business strategy.”⁵³⁴

However, it is inappropriate to require the payment of compensation for regulatory adjustments in environmental regulation. Such a result would amount to utilization of public funds to pay for the government’s right to regulate the environment. Such a state of affairs has been accurately characterized as “an entirely perverse result in light of the ascendancy of the polluter-pays principle in national and international environmental law.”⁵³⁵ Since first elaborated upon by the Organization for Economic Cooperation and Development in 1972,⁵³⁶ the “polluter-pays principle” provides that the general public effectively owns the environment.⁵³⁷ Those persons who cause injury to the environment must compensate the public for the damage they cause.⁵³⁸ However, Chapter Eleven’s investor-state provisions reverse this principle by requiring the public to pay for the right to regulate the environment.⁵³⁹ This right only extends to the depths of the government’s coffers.⁵⁴⁰ Thus, Chapter Eleven effectively transfers ownership of the environment to the polluter, who may thus use and pollute it with impunity.⁵⁴¹ Such a result is indeed perverse and is a reversal of almost thirty years of accepted international environmental practice.

Additionally, the certainty for foreign investors provided by Chapter Eleven has come at the expense of certainty and predictability for environmental regulators.⁵⁴² Regulators must consider each potential Chapter Eleven claim with very limited ability to predict the likelihood of their success.⁵⁴³ Such

533. Sforza & Vallianatos, *supra* note 520, at 2.

534. *Id.*

535. MANN & VON MOLTKE, *supra* note 43, at 5.

536. *See generally* ORG. FOR ECON. COOPERATION AND DEV., THE POLLUTER PAYS PRINCIPLE: OECD ANALYSES AND RECOMMENDATIONS (1992).

537. *See* John Moffet & Francois Bregha, *The Role of Law Reform in the Promotion of Sustainable Development*, 6 J. ENVTL. L. & PRAC. 1, 8 (1996).

538. *See id.*

539. *See id.*

540. *See* Sforza & Vallianatos, *supra* note 520, at 3.

541. *See* Moffet & Bregha, *supra* note 537, at 8.

542. *See* MANN & VON MOLTKE, *supra* note 43, at 2.

543. *See id.* at 19-20.

uncertainty and the burden associated with considering every potential claim may dissuade governments from adopting environmental measures in the future.⁵⁴⁴ The democratic decision-making process is derailed to the extent that the threat of Chapter Eleven claims dissuades governments from acting to protect the environment.⁵⁴⁵ At the very least, the threat of litigation pursuant to Chapter Eleven significantly increases the actual cost of the regulatory process and potential cost through the payment of future claims.⁵⁴⁶ Such dissuasion and increase in the cost of environmental regulation have the potential to result in regulatory freeze.⁵⁴⁷ Settlements of claims by national governments only serve to deepen this regulatory freeze at the state and local level as well as legitimize the further use of the investor-state provisions to challenge environmental laws. Such a regulatory freeze is unacceptable given the ever-increasing body of scientific knowledge, including the impact of industrial processes and natural resource exploitation on the environment, as well as evolving public perceptions.⁵⁴⁸ At the worst, existing environmental standards may be eroded or completely erased, thereby leading to the creation of "pollution havens" and "a general race to the bottom" for environmental standards.⁵⁴⁹

Finally, the interpretation of Chapter Eleven reached by the *Metalclad* tribunal threatens to undermine public perceptions of NAFTA. Already besieged by controversy on a number of fronts by a diverse coalition of interests, the dismantling of environmental regulation at the behest of foreign investors, whether perceived or actual, threatens public support for NAFTA as well as future efforts to liberalize trade and investment.⁵⁵⁰ The need for this public support is even more crucial given the growing tide of opposition to further globalization as evidenced by the inability of the Clinton Administration to obtain "fast-track" negotiating authority, the collapse of negotiations on the Multilateral Agreement on Investment in October 1998 and the disruptions at the World Trade Organization's meeting in Seattle in November 1999.⁵⁵¹ The adoption of the *Metalclad* tribunal's interpretation of

544. See Aslam, *supra* note 30; see also Knight, *supra* note 29.

545. See Sforza & Vallianatos, *supra* note 520, at 2.

546. See MANN & VON MOLTKE, *supra* note 43, at 17.

547. See *id.* at 5.

548. See *id.* at 46.

549. *Id.* at 3.

550. See *id.* at 7.

551. See *id.* at 62-63.

Chapter Eleven or, at the very least, the failure to address the relationship between domestic environmental regulation and the investor-state provisions of NAFTA renders it “unlikely that . . . public mistrust and antipathy . . . can be reversed to develop the needed public support for continued trade liberalization in the World Trade Organization and [NAFTA], and the launching of new investment negotiations.”⁵⁵² There is no better time for the parties to address this relationship than the present rather than await the filing of new claims and further erosion of public support.

IV. CONCLUSION

Regardless of whether one accepts the line of reasoning and conclusions reached in this article, it is abundantly clear that there is no simple formula for distinguishing between compensable and non-compensable regulatory activities.⁵⁵³ Such uncertainty may undermine effective investor protection as well as place legitimate government regulatory activity at risk.⁵⁵⁴ It thus comes as no surprise that numerous non-governmental organizations, including the Council of Canadians, Public Citizen, the Sierra Club and the World Wildlife Fund, have called for renegotiation of NAFTA’s investor-state provisions.⁵⁵⁵ The parties themselves also have admitted that this uncertainty requires their immediate attention. Canada has acknowledged that the present use of Chapter Eleven is a significant problem that must be addressed through limitations upon definitions and access by private industry.⁵⁵⁶ The United States also appears willing to consider the removal of public health, safety and welfare measures from the scope of Article 1110.⁵⁵⁷ Only Mexico has expressed reluctance to consider such limitations, perhaps due to concerns about damaging the country’s improving foreign investment image.⁵⁵⁸ This reluctance may

552. *Id.* at 63.

553. *See id.* at 47.

554. *See id.*

555. *See* Robert Collier, *Canadian Firm Sues California Over MTBE*, S.F. CHRON., June 18, 1999, at A1; *see also Environmentalists Press for Broad Review of NAFTA Handling of Cases*, *supra* note 34, at 1-2; *Latest NAFTA Lawsuit Proves Threat of Chapter 11 to Health and Environmental Laws, Again*, *supra* note 35, at 1; Peterson, *supra* note 33, at A1.

556. *See* Iritani, *supra* note 425, at A1.

557. *See* MANN & VON MOLTKE, *supra* note 43, at 48.

558. *See id.*

weaken if Mexico is subjected to a growing number of Chapter Eleven claims. In any event, regardless of the positions of non-governmental organizations and the parties, it is certain that “[a]s long as Chapter Eleven . . . allows companies to directly sue governments over laws they feel jeopardize their profits, the numbers of these cases and the severity of their impact will only increase.”⁵⁵⁹

There are numerous alternatives by which the operation of Chapter Eleven’s investor-state provisions may be limited. Initially, the parties may wait for the formation of case law through the accumulation of decisions of arbitration panels. However, this option is unattractive for several reasons. Initially, this option assumes that arbitration panels confronted with claims of private investors will limit the scope of the investor-state provisions. Such an assumption is a risky proposition given the broad sweep of Chapter Eleven’s language, as reaffirmed by the *Metalclad* tribunal, and the uncertainties inherent in any adversarial proceeding. Second, it has been aptly noted that the uncertainties created by Chapter Eleven are inherent in its scope and language.⁵⁶⁰ Pending arbitrations are not likely to significantly reduce these uncertainties given their endemic nature within the Agreement itself.⁵⁶¹ Furthermore, panel interpretations and decisions do not establish precedent, and future panels confronting similar issues are free to adopt differing interpretations.⁵⁶² The risk of panels adopting conflicting interpretations is exacerbated by the confidentiality of final decisions pursuant to the provisions of the various procedural rules applicable to such arbitrations.⁵⁶³ As such, interpretations reached by previous panels may not be available for consideration by future panels.⁵⁶⁴ Finally, the process of creation of a body of case law is time-consuming and may prove costly to the parties if for no other reason than the cost of defense and payment of claims. The costs associated with such delays simply cannot be afforded given the burgeoning number and size of claims asserted by private investors

559. *Latest NAFTA Lawsuit Proves Threat of Chapter 11 to Health and Environmental Laws, Again*, *supra* note 35, at 1.

560. *See* MANN & VON MOLTKE, *supra* note 43, at 20.

561. *See id.*

562. *See* NAFTA, *supra* note 24, art. 1136(1) (providing that “[a]n award made by a Tribunal shall have no binding force except between the disputing parties and in respect of the particular case.”).

563. *See* MANN & VON MOLTKE, *supra* note 43, at 20.

564. *See id.*

pursuant to Chapter Eleven.⁵⁶⁵

Other options to limit the scope of Chapter Eleven would limit the availability of the dispute resolution processes to private investors. Specifically, resort to such processes by private parties could be prohibited where important public policy issues are at stake.⁵⁶⁶ Instead of resort to Chapter Eleven's investor-state provisions, aggrieved parties would be required to utilize Chapter Twenty's government-to-government dispute resolution processes.⁵⁶⁷ A related option is to require preliminary government approval of Chapter Eleven challenges that present public policy issues.⁵⁶⁸ A third option would be to adapt NAFTA's "gatekeeper" model with respect to taxation issues to Chapter Eleven challenges.⁵⁶⁹ This option would require private parties to submit their claims to competent authorities designated within each party for a determination of whether the challenged governmental action violates Chapter Eleven's investor protections.⁵⁷⁰ The private claimant could proceed pursuant to Chapter Eleven upon receiving a determination from the designated authorities that the challenged measure is an unreasonable interference with its investment or upon the failure of such authorities to reach a determination within a reasonable time.⁵⁷¹ Conversely, resort to Chapter Eleven would be prohibited if the designated authorities determine that the measure does not violate Chapter Eleven. In such an event, the sole course of action for an aggrieved party would be resort to the government-to-government dispute resolution processes set forth in Chapter Twenty.

However, these approaches may prove as unattractive as awaiting the development of case law. Initially, all of these

565. At the time of preparation of this article, there were twelve pending or threatened claims of private investors arising from Chapter Eleven's investor-state provisions, including Metalclad's claim. *See* MANN & VON MOLTKE, *supra* note 43, at 65-70. Canada and Mexico were named as defendants in five claims each, and the United States was a defendant in two claims. *See id.* The claims asserted against the United States totaled \$1.7 billion, while the claims asserted against Canada and Mexico totaled \$433 million and \$192 million respectively. *See id.*

566. *See id.* at 58; *see also* Lawrence Herman, *Settlement of International Trade Disputes - Challenges to Sovereignty - A Canadian Prospective*, 24 CAN.-U.S. L.J. 121, 135-37 (1998).

567. *See* NAFTA, *supra* note 24, arts. 2003-20.

568. *See* MANN & VON MOLTKE, *supra* note 43, at 58.

569. *See id.*; *see also* NAFTA, *supra* note 24, art. 2103(6).

570. *See* NAFTA, *supra* note 24, art. 2103(6) & annex 2103.6.

571. *See id.* art. 2103(6).

approaches would require amendment of NAFTA itself, which may prove to be politically unachievable.⁵⁷² Additionally, even assuming that the parties were amenable to amendment, they would be confronted with the difficult task of ascertaining what public policy issues should be immunized from Chapter Eleven's dispute resolution procedures or subject to preliminary review by the designated "gatekeepers." The standards to be applied by such "gatekeepers" may also present irreconcilable issues for the negotiators confronted with the task of revamping Chapter Eleven. The "gatekeeper" approach also may be criticized for serving to concentrate excessive authority with respect to expropriation issues in the hands of a small and immutable group of designated experts. In addition, any amendment utilizing the "gatekeeper" approach would have to designate the amount of time available for review. Time is a crucial issue in this regard as unreasonable delays may raise due process issues and cause further injury to claimants, thereby potentially increasing the amount of damages for which a host state may be liable. In any event, the amendment process may prove to be chronologically impracticable given the growing number and size of the claims asserted pursuant to Chapter Eleven.

Given the inadequacy of the above-noted remedies, perhaps the most favorable approach for the parties to adopt is the issuance of an interpretive statement addressing the issues raised by Chapter Eleven's investor-state provisions.⁵⁷³ Such an interpretive statement would not be an amendment to NAFTA but rather would serve as a clarification of the parties' intent with respect to the provisions contained within Chapter Eleven. Interpretive statements have long been a recognized part of treaty interpretation. Article 31(3) of the Vienna Convention on the Law of Treaties recognizes that interpretive statements issued by the parties may be utilized in construing disputed treaty provisions.⁵⁷⁴ The role of interpretive statements in treaty

572. For example, the Canadian government has long sought a narrowing of the scope of Chapter Eleven, claiming that it was not intended to allow private companies to overturn domestic policy through the dispute resolution process. See Iritani, *supra* note 425, at A1; see also Ian Jack, *Mexico First Partner to Lose NAFTA Case*, FIN. POST, available at http://www.google.com/search?q=cache:205...tl_mexico.html (Sept. 1, 2000). However, Mexico has expressed reservations about any amendment, claiming that the investor-state provisions are working as intended and fearing that renegotiation of Chapter Eleven will lead to pressure to renegotiate other portions of the agreement. See Jack, *supra*.

573. See MANN & VON MOLTKE, *supra* note 43, at 47.

574. See Vienna Convention on the Law of Treaties, May 23, 1969, 8 I.L.M. 679, 692 (entered into force Jan. 27, 1980). Article 31 (3) specifically provides that:

construction is recognized in Chapter Eleven of NAFTA, which provides that “[a]n interpretation by the [Free Trade] Commission of a provision of this Agreement shall be binding on a Tribunal established under this Section.”⁵⁷⁵ Thus, unlike the decisions of arbitral panels, an interpretive statement construing the scope of Chapter Eleven’s investor-state provisions would be binding upon future panels considering such issues.⁵⁷⁶ Furthermore, an interpretive statement does not require modification of NAFTA, thereby bypassing the protracted, and perhaps ultimately fruitless, amendment process. The issuance of a carefully worded interpretive statement limited solely to the reach of provisions within Chapter Eleven also would not impact or imperil any other chapters or sections of the Agreement.

As noted by Canadian Trade Minister Sergio Marchi, any interpretive statement issued by NAFTA’s Free Trade Commission should strive for greater openness and the development of a “common understanding on the investor-state provisions to ensure that government’s ability to legislate and regulate in the public interest is protected.”⁵⁷⁷ As such, an interpretive statement should eliminate the uncertainty confronting regulators with respect to environmental issues as a result of the potential breadth of Chapter Eleven.⁵⁷⁸ However, this need for predictability should not come at the expense of investors seeking protection from malicious, arbitrary or discriminatory governmental measures or those deemed to be expropriation in the classic sense of dispossession.⁵⁷⁹ These goals can best be achieved by an interpretive statement that provides for procedural reform and substantive certainty.

From a procedural standpoint, any interpretive statement

There shall be taken into account, together with the context:

- (a) any subsequent agreement between the parties regarding the interpretation of the treaty or the application of its provisions;
- (b) any subsequent practice in the application of the treaty which establishes the agreement of the parties regarding its interpretation;
- (c) any relevant rules of international law applicable in the relations between the parties.

Id. art. 31(3).

575. NAFTA, *supra* note 24, art. 1131(2).

576. *See id.* art. 1131(2).

577. Sergio Marchi, *Address to the NAFTA Fifth Anniversary Luncheon*, reprinted in MANN & VON MOLTKE, *supra* note 43, at 10.

578. *See* MANN & VON MOLTKE, *supra* note 43, at 21.

579. *See id.*

should provide for greater transparency with respect to the dispute resolution process. Greater transparency may be accomplished by two separate means. Initially, the parties should favor transparency and public access to the dispute resolution process in every circumstance where such issue is committed to their discretion. For example, there is no obligation within NAFTA preventing the publication of notices of claim. Procedures exist in the United States and Canada for the public disclosure of such filings, and private claimants are free to disclose such filings on their own initiative. Furthermore, there are no secrecy provisions with respect to the consultative process prior to the actual initiation of arbitration, thereby permitting the parties to disclose the occurrence, if not the actual content, of discussions between the investor and the host state. Furthermore, Article 1126(10) of NAFTA mandates public disclosure of notices of arbitration actually received by the parties by requiring delivery of such notices to the Free Trade Commission's Secretariat for placement in a public register of documents.⁵⁸⁰ Finally, Article 1137(4) and Annex 1137.4 grant Canada and the United States discretion with respect to the publication of final awards issued by arbitration panels.⁵⁸¹ The discretion of the parties in all of these instances should be exercised in favor of disclosure and public access.

However, not all portions of the dispute resolution process may be opened to the public at the discretion of the parties. For example, the constitution of the arbitral panels, the treatment of written submissions and pleadings and the potential for outside participation are not addressed in NAFTA and are thus left to the procedures of the applicable arbitral body acting with the consent of the parties themselves. However, the parties are not without some authority to influence the arbitral bodies and disputing investors with respect to public disclosure of such matters. In these instances, the interpretive statement should call upon the parties to actively seek public disclosure and access. In this regard, the presumption in favor of confidentiality at the behest of the disputing investor should be

580. See NAFTA, *supra* note 24, art. 1126(10). Article 1126(10) requires a disputing party to deliver a copy of the notice of arbitration to the Free Trade Commission's Secretariat within fifteen days of its receipt. See *id.*

581. See *id.* art. 1137(4) and annex 1137.4. Annex 1137.4 provides that, where the United States or Canada is the disputing party, the respective government or a disputing investor that is a party to the arbitration may make an award public. See *id.* When Mexico is the disputing party, Annex 1137.4 provides that the applicable arbitration rules determine whether the award is subject to publication. See *id.*

removed. In its stead, the burden of maintaining confidentiality and limiting public access should be placed upon the individual investor seeking such relief.

Providing substantive certainty for environmental regulators in an interpretive statement is a much less onerous task than attempting procedural reform. In this regard, the interpretive statement should seek to restrict the reach of Chapter Eleven's provisions into environmental regulation.⁵⁸² The reach of these provisions may be restricted by two separate means. Initially, non-discriminatory measures based upon a public purpose consistent with a legitimate objective as defined in Article 915(1)⁵⁸³ and adopted in accordance with due process of law should be specifically excluded from challenge pursuant to Chapter Eleven.⁵⁸⁴ In the event that an otherwise permissible environmental measure is alleged to be discriminatory, the arbitral panel should be permitted to review a number of factors before concluding that the measure is in violation of Chapter Eleven. These factors include the location of the investment, the impact generated by the investment including the ability of the environment to continue to absorb such impact, the characteristics of the product sought to be regulated and its environmental implications, changes in environmental standards, scientific information and regulatory policy and the necessity of governments to act in a precautionary fashion with respect to environmental decision-making.⁵⁸⁵ Application of these standards may serve to transform what otherwise appears to be a discriminatory confiscation of a foreign investment into

582. See MANN & VON MOLTKE, *supra* note 43, at 9.

583. Chapter Nine of NAFTA establishes standards with respect to the creation, maintenance and operation of technical regulations and sanitary measures by the parties. See NAFTA, *supra* note 24, arts. 901-15. Article 915(1) defines legitimate objectives to be served by such regulations and measures. Specifically, a "legitimate objective" supporting the creation, maintenance or operation of a technical regulation or sanitary measure is defined as:

- (a) safety,
- (b) protection of human, animal or plant life or health, the environment or consumers, including matters relating to quality and identifiability of goods or services, and
- (c) sustainable development,
- (d) considering, among other things, where appropriate, fundamental climatic or other geographical factors, technological or infrastructural factors, or scientific justification but does not include the protection of domestic production.

Id. art. 915(1).

584. See MANN & VON MOLTKE, *supra* note 43, at 73.

585. See *id.* at 72.

one justified on environmental, scientific and public policy bases.

Regardless of the option selected by the parties, it is clear that taking no action whatsoever is simply unacceptable. The governments of the respective parties owe an obligation to their component state and local governments and, ultimately, to their constituencies, to clarify their intent with respect to the application of NAFTA's investor-state provisions to environmental measures. This obligation is especially urgent if the interpretation urged upon the member states by the *Metalclad* tribunal was unanticipated or unintended when the parties entered into the free trade agreement eight years ago. Nevertheless, until such time as reform, interpretation or amendment occurs, whether unknown, overlooked or unanticipated, NAFTA is part of the parties' respective legal systems, and the right of investors such as Metalclad to bring claims is clearly found within its provisions.

