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NAFTA's Investment Protections and the Division of Authority for Land Use and Environmental Controls

VICKI BEEN*

The North American Free Trade Agreement (NAFTA)[1] contains various "investor protections," including a provision requiring signatory governments to compensate property owners if the government either expropriates property or takes "measure[s] tantamount to . . . expropriation."[2] That provision, known as Chapter 11, recently was used to force Mexico to pay compensation to Metalclad, an American corporation that owned a hazardous waste facility in the municipality of Guadalcazar, when local and provincial environmental and land use controls prevented the facility from operating.[3] Similarly, the expropriation provisions of Chapter 11 are now the centerpiece of a $1 billion claim by a Canadian corporation that California regulations requiring the phase out of the gasoline additive MTBE effected a "regulatory taking" by reducing the Canadian company's market for methanol, a substance used to produce MTBE.[4]

It is too early to judge just how broadly the arbitral panels will interpret the expropriation provisions of Chapter 11, but

* Professor of Law, New York University School of Law. I benefited enormously from the helpful comments of Richard Briffault, Ricky Revesz, Carol Rose, the participants in NYU School of Law's Globalization and its Discontents Colloquium, participants in the Pace Law School's Symposium on the Advent of Local Environmental Law, and students in NYU's Spring 2002 Advanced Environmental Law Seminar. I also am indebted to Joel Beauvais, Erik Bluemel, Ashley Miller, Melissa Richman and Gabriel Ross for invaluable research assistance and critical analysis. I gratefully acknowledge the support of the Filomen D'Agostino and Max E. Greenberg Research Fund at the New York University School of Law.

1. North American Free Trade Agreement, Dec. 8-17, 1992, pt. 1-3, 32 I.L.M. 289; North American Free Trade Agreement, Dec. 8-17, pt. 4-8, 32 I.L.M. 605 [hereinafter NAFTA].

2. NAFTA, *supra* note 1, art. 1110, 32 I.L.M. at 641. NAFTA's Article 1110 is discussed *infra* Section I. Its expropriation provision is roughly styled after the Fifth Amendment of the U.S. Constitution, which provides in relevant part: "[N]or shall private property be taken for public use, without just compensation." U.S. CONST. amend. V.

3. *See infra* notes 100-134 and accompanying text.

4. *See infra* notes 138-163 and accompanying text.

Metalclad and pending NAFTA regulatory takings claims have the potential to upset many aspects of land use and environmental law. I've explored in another article the ways in which arbitral interpretations of NAFTA's expropriation provisions may pressure Congress and state legislatures, as well as state and federal courts, to interpret the Fifth Amendment's Takings Clause more favorably for property owners.[5] Several scholars have noted the effect the provisions may have in chilling regulators from adopting environmental and land use measures.[6] In this Article, I examine another implication of the provisions–the potential they have to affect the allocation of authority for land use and environmental regulation among the federal, state and local governments, as well as their potential to shift the boundaries between environmental and land use law.

My claim in this Article is a narrow one. I take no stand here on whether the "takings" provisions in NAFTA and other investor protection or free trade agreements are, on balance, wealth maximizing or desirable from some other normative perspective.[7] Nor do I take a position on whether the existing allocation of authority for land use and environmental regulation among federal, state, and local governments is optimal.[8] Instead, my goal is to high-

5. Vicki Been & Joel C. Beauvais, *The Global Fifth Amendment: NAFTA's Investment Protections and The Misguided Quest for an International "Regulatory Takings" Doctrine*, 78 N.Y.U. L. REV. 30 (2003).

6. *See, e.g.*, Lucien J. Dhooge, *The North American Free Trade Agreement and the Environment: the Lessons of* Metalclad Corporation v. United Mexican States, 10 MINN. J. GLOBAL TRADE 209 (2001); David A. Gantz, *Reconciling Environmental Protection and Investor Rights under Chapter 11 of NAFTA*, 31 Envtl. L. Rep. (Envtl. L. Inst.) 10,646 (June 2001); William Greider, *The Right and U.S. Trade Law: Invalidating the 20th Century*, THE NATION, Oct. 15, 2001, at 1.

7. *But see* Been, *supra* note 5.

8. For a flavor of the debate see, for example, Henry N. Butler & Jonathan R. Macey, *Externalities and the Matching Principle: The Case for Reallocating Environmental Regulatory Authority*, 14 YALE L. & POL'Y REV. 23, 31 nn.19, 42-45 (1996) (Symposium Issue); Kirsten H. Engel, *State Environmental Standard-Setting: Is There a "Race" and Is It "To the Bottom"?*, 48 HASTINGS L.J. 271 (1997); Daniel C. Esty, *Revitalizing Environmental Federalism*, 95 MICH. L. REV. 570, 597-98 (1996); James E. Krier, *On the Topology of Uniform Environmental Standards in a Federal System—And Why It Matters*, 54 MD. L. REV. 1226, 1236-37 (1995); Richard L. Revesz, *Federalism And Environmental Regulation: A Public Choice Analysis*, 115 HARV. L. REV. 553 (2001); Richard L. Revesz, *The Race to the Bottom and Federal Environmental Regulation: A Response to Critics*, 82 MINN. L. REV. 535 (1997); Richard L. Revesz, *Federalism and Interstate Environmental Externalities*, 144 U. PA. L. REV. 2341 (1996); Richard L. Revesz, *Rehabilitating Interstate Competition: Rethinking the "Race to the Bottom" Rationale for Federal Environmental Regulation*, 67 N.Y.U. L. REV. 1210, 1233- 44 (1992); Joshua D. Sarnoff, *A Reply to Professor Revesz's Response in "The Race to the Bottom and Federal Environmental Legislation"*, 8 DUKE

light the consequences investor protection provisions could have for that allocation of authority, and thereby seek to ensure that those consequences are taken into account in discussions about the wisdom of including such protections in bilateral and multilateral free trade or investment agreements.

The Article proceeds as follows: Section I provides a brief sketch of the content and reach of investor protection provisions, and of the investor-state dispute mechanism by which private investors can enforce the provisions. Section II reviews the arbitral awards already rendered under NAFTA, as well as pending claims. Section III analyzes how the federal government might respond to awards by seeking to recoup damages from the state or local government responsible for the regulation held to violate NAFTA, and by seeking to dissuade state and local governments from enacting regulations that might trigger NAFTA complaints. Section IV then discusses the implications those federal responses might have for the division of responsibility for land use and environmental law among the federal, state and local governments, and between land use and environmental regulators. Section V addresses how those implications might be considered in current debates about new investor protection agreements.

I. Overview of Investor Protection Provisions in Bi- and Multi-Lateral Trade Agreements

NAFTA is just one component of a vast network of more than 1500 bilateral[9] (BITs) and multi-lateral agreements[10] that have come into force over the past few decades. More than 160 nations have entered into such agreements, including many transitional

ENVTL. L. & POL'Y F. 295 (1998); Joshua D. Sarnoff, *The Continuing Imperative (But Only from a National Perspective) for Federal Environmental Protection*, 7 DUKE ENVTL. L. & POL'Y F. 225, 285-86 (1997); Richard B. Stewart, *Environmental Regulation and International Competitiveness*, 102 YALE L.J. 2039, 2058-59 (1993); Richard B. Stewart, *International Trade and Environment: Lessons from the Federal Experience*, 49 WASH. & LEE L. REV. 1329, 1343-44 (1992); Peter P. Swire, *The Race to Laxity and the Race to Undesirability: Explaining Failures in Competition Among Jurisdictions in Environmental Law*, 14 YALE L. & POL'Y REV. 67, 101 (1996) (Symposium Issue); Stephen Williams, *Panel IV: Culpability, Restitution, and the Environment: The Vitality of Common Law Rules*, 21 ECOLOGY L.Q. 559, 560-61 (1994).

9. Daniel M. Price, *The Management and Resolution of Cross Border Disputes as Canada/U.S. Enter the 21st Century: Chapter 11-Private Party vs. Government, Investor-State Dispute Settlement: Frankenstein or Safety Valve?*, 26 CAN.-U.S. L.J. 107, (2000). "[F]rom the vantage point of the year 2000, . . . more than 1500 bilateral investment treaties [have been signed]. Most of them have provisions nearly identical to those . . . [found] in NAFTA Chapter 11, including the feature of investor-state dispute settlement." *Id.* at 107-08.

economies and developing countries.[11] Although this Article focuses on NAFTA, many of the investor protections NAFTA contains are also found in other bilateral and multi-lateral agreements.

The expropriation provisions of NAFTA's Chapter 11[12] require that:

> [n]o Party may directly or indirectly nationalize or expropriate an investment of an investor of another Party in its territory or take a measure tantamount to nationalization or expropriation of such an investment ("expropriation"), except:
> (a) for a public purpose;
> (b) on a nondiscriminatory basis;
> (c) in accordance with due process of law and Article 1105(1) [providing for minimum international standards of treatment, including fair and equitable treatment]; and
> (d) on payment of compensation in accordance with paragraphs two through six [which require compensa-

10. In addition to NAFTA see, for example, European Energy Charter Conference: Final Act, Energy Charter Treaty, Decisions and Energy Charter Protocol on Energy Efficiency and Related Environmental Aspects, Dec. 17, 1994, 34 I.L.M. 360.

11. UNCTAD, TRENDS IN INTERNATIONAL INVESTMENT AGREEMENTS: AN OVERVIEW 33-34 (1999) (stating more than 1700 treaties at the end of 1998, and only 45% of those concluded in 1998 were between developed countries); *see also* Kenneth J. Vandevelde, *The Political Economy of a Bilateral Investment Treaty*, 92 AM. J. INT'L L. 621, 621 (1998). "The massive and sudden proliferation of bilateral investment treaties (BITs), now constituting a network of more than 1300 agreements." *Id.*

12. For discussions of how NAFTA's investor protection provisions compare with those of other bilateral and multilateral agreements, see UNCTAD, *supra* note 11, at 44-46; Mark S. Bergman, *Bilateral Investment Protection Treaties: an Examination of the Evolution and Significance of the U. S. Prototype Treaty*, 16 N.Y.U. J. INT'L L. & POL. 1 (1983); Richard G. Dearden, *Arbitration of Expropriation Disputes Between an Investor and the State under the North American Free Trade Agreement*, J. WORLD TRADE, Feb. 1995, at 119-20 (considering the "tantamount to expropriation" language an expansion of traditional doctrine); Rudolf Dolzer, *Indirect Expropriation of Alien Property*, 1 ICSID REV. FOREIGN INVESTMENT L.J. 41 (1986); Price, *supra* note 9, at 111-13; Ignaz Seidl-Hoheveldern, *Semantics of Wealth Deprivation and Their Legal Significance*, *in* FOREIGN INVESTMENT IN THE PRESENT AND A NEW INTERNATIONAL ECONOMIC ORDER 218, 238 (Detlev C. Dicke ed., 1987); Thomas Wälde, *Treaties and Regulatory Risk in Infrastructure Investment*, 34 J. WORLD TRADE 1, 15-22 (2000).

For the texts of various existing and proposed multi-lateral agreements see Energy Charter Treaty, *supra* note 10, at 391; Free Trade Agreement of the Americas, Draft Agreement (July 3, 2001), *available at* http://www.ftaa-alca.org/ftaadraft/eng/ngin_e.doc; Multilateral Investment Agreement, Draft Consolidated Text (Apr. 22, 1998), *available at* http://www1.voecd.org/daf/mai/pdf/ng/ng987r1e.pdf. For texts of other bilateral treaties to which the United States is a party, see http://www.state.gov/www/issues/economic/7treaty.html (last visited June 11, 2002) (collecting BIT texts).

> tion at fair market value, to be paid without delay, with interest].[13]

NAFTA mandates that all four requirements must be met: the fact that a measure is a legitimate and nondiscriminatory police power regulation does not exempt the government from the obligation to compensate investors for harm to their property interests.

The investor protection provisions of typical BITs contain several other elements that are important to understanding the limits NAFTA may impose on land use and environmental regulations. The following subsections explore those provisions.

A. The Investor Protections

The investor protections, called "disciplines," begin with two requirements akin to the U.S. Constitution's Equal Protection and Privileges and Immunities Clauses. Article 1102, entitled "National Treatment," requires signatory governments to treat foreign investors "no less favorabl[y]" than they treat domestic investors "in like circumstances."[14] Article 1103, entitled "Most-Favored-Nation Treatment," requires signatory governments to treat foreign investors no less favorably than they treat other foreign investors of either parties or nonparties in like circumstances.[15] For example, if one of the parties has entered into an

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13. NAFTA, *supra* note 1, art. 1110, at 641-42.

14. Article 1102 states:

> 1. Each Party shall accord to investors of another Party treatment no less favorable than that it accords, in like circumstances, to its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.
>
> 2. Each Party shall accord to investments of investors of another Party treatment no less favorable than that it accords, in like circumstances, to its own investors with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.
>
> 3. The treatment accorded by a party under paragraphs 1 and 2 means, with respect to a state or province, treatment no less favorable than the most favorable treatment accorded, in like circumstances, by that state or province to investors, and to investments of investors, of the party of which it forms a part.

Id. art. 1102, at 639.

15. Article 1103 states:

> 1. Each party shall accord to investors of another Party treatment no less favorable than that it accords, in like circumstances, to 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.

agreement with another nonparty country and has given that country's investors advantages over the investors of its NAFTA partners, the investors of the NAFTA parties become entitled to those advantages as well. A party must accord foreign investors the better of "national treatment" and "most-favored-nation treatment."[16]

NAFTA and many BITs also contain a form of due process guaranty: Article 1105 of NAFTA requires signatory parties to "accord to investments of investors of another party treatment in accordance with international law, including fair and equitable treatment and full protection and security."[17] The minimum standard of treatment requirement is not tied to a state's domestic law; even if a state denies its own citizens and investors fair treatment, it may not deny such treatment to foreign investors. Finally, NAFTA's Article 1106 prohibits conditioning foreign investors' rights on performance requirements (such as mandates that the foreign investment have a certain percentage of domestic ownership or control, or that it incorporate a specified percentage of domestic goods or domestic labor in its production processes).[18]

B. The Broad Reach of the Investor Protections

NAFTA's investor protections apply to "measures adopted or maintained by a party relating to . . . investors of another party; [and] investments of investors of another Party in the territory of

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> 2. Each party shall accord to investments of investors of another Party treatment no less favorable than that it accords, in like circumstances, to 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.

Id. art. 1103, at 639. For discussion about the overlooked importance of the national treatment and most-favored-nation provisions of Chapter 11 see Joel C. Beauvais, Note, *Regulatory Expropriations under NAFTA: Emerging Principles & Lingering Doubts*, 10 N.Y.U. ENVTL. L.J. 245 (2002).

16. NAFTA, *supra* note 1, art. 1104, at 639.

17. *Id.* art. 1105, at 639-40.

18. Article 1106, entitled "Performance Requirements," states:

> 1. No Party may impose or enforce any of the following requirements, or enforce any commitment or undertaking, in connection with 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:
> (a) to export a given level or percentage of goods or services;
> (b) to achieve a given level or percentage of domestic content;
> (c) to purchase, use or accord a preference to goods produced or services provided in its territory, or to purchase goods or services from persons in its territory. . ..

Id. art. 1106, at 640.

the Party . . ..”[19] "Measure," in turn, is defined as including "any law, regulation, procedure, requirement or practice."[20] Although some of the disciplines in Chapter 11 do not apply to nonconforming laws and regulations in effect when NAFTA went into force, the expropriation provisions apply even to preexisting measures.[21]

"Investment" is very broadly defined to include any "real estate or other property, tangible or intangible, acquired in the expectation or used for the purpose of economic benefit or other business purposes."[22] It also includes any enterprise (defined as a corporation, trust, partnership, sole proprietorship, joint venture or other association or entity organized under applicable law),[23] equity or debt security of an enterprise, loan to an enterprise, or interest in an enterprise that entitles the owner to a share in income or profits, or a share in the assets upon dissolution. Finally, it includes any "interests arising from the commitment of capital or other resources in the territory of a Party to economic activity in such territory" such as construction or concession contracts.[24] The definition contained in NAFTA is capacious; indeed, one critic asserts that, "it is foreseeable . . . that minimal foreign investments may fund full challenges to environmental measures. For example, a foreign component might be strategically added to an otherwise domestic investment simply to have access to the extraordinary rights and remedies found in Chapter 11."[25]

C. The Investor-State Dispute Mechanism

Chapter 11 establishes an "investor-state dispute resolution mechanism" (ISDM) whereby individual investors may initiate

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19. *Id.* art.1101(1), at 639.
20. *Id.* art. 201, at 298.
21. Article 1108 provides that Articles 1102, 1103, 1106 and 1107 do not apply to:
    (a) any existing non-conforming measure that is maintained by
        (i) a Party at the federal level, as set out in its Schedule to Annex I or III,
        (ii) a state or province, for two years after the date of entry into force of this Agreement, and thereafter as set out by a Party in its Schedule to Annex I in accordance with paragraph 2, or
        (iii) a local government. . ..

Id. art. 1108, at 640-41.
22. NAFTA, *supra* note 1, art. 1139, at 647-48.
23. *Id.* art. 201(1), at 298.
24. *Id.* art. 1139, at 647-48.
25. HOWARD MANN & KONRAD VON MOLTKE, INTERNATIONAL INSTITUTE FOR SUSTAINABLE DEVELOPMENT, NAFTA'S CHAPTER 11 AND THE ENVIRONMENT: ADDRESSING THE IMPACTS OF THE INVESTOR-STATE PROCESS ON THE ENVIRONMENT 24 (1999), *available at* http://www.iisd.org/pdf/nafta.pdf (last visited April 25, 2003).

claims against the host government without the acquiescence or participation of the investor's government.[26] Although investor-state mechanisms had been provided in some BITs, the scope of the investor-state mechanism in Chapter 11 is path breaking for a regional or multi-lateral trade or investment agreement.[27] Indeed, prior to NAFTA, "direct litigation between persons and States was a rarity."[28]

NAFTA's ISDM provisions require that disputes be submitted to arbitration.[29] The arbitral tribunals are composed of three members: one chosen by the investor; one by the host state; and a third presiding member selected by agreement of the disputing parties[30] or, if the parties are unable to agree, by the Secretary

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26. Article 2103(6) specifically subjects general measures of taxation to the provisions on expropriation, but requires that complaints about tax measures be dismissed if the tax authorities of both countries decide within six months of the filing that the tax did not amount to an expropriation. NAFTA, *supra* note 1, art. 2103(6), at 700.

27. MANN & VON MOLTKE, *supra* note 25, at 12.

28. Lawrence Herman, *Sovereignty Revisited: Settlement of International Trade Disputes–Challenges to Sovereignty–A Canadian Perspective*, 24 CAN.-U.S. L.J. 121, 132 (1998). Chapter 20 of NAFTA provides a state-to-state dispute settlement mechanism, but only one state-to-state arbitration has involved Chapter 11's investment protections. *See* In the Matter of Cross-Border Trucking Services (Mex. v. U.S.), USA-Mex-98-2008-01 (2001), *available at* http://www.sice.oas.org/DISPUTE/nafta/english/U98081ae.asp.

29. NAFTA Article 1120 (Submission of a Claim to Arbitration) requires that investors of a signatory government submit claims against another signatory government under one of three specified investor-state dispute mechanisms (ISDMs). NAFTA, *supra* note 1, art. 1120, at 643. The first, the International Center for the Settlement of Investment Disputes Convention (ICSID), is available only if the dispute is between a state that is a party to the Convention and a complaining investor that is a national of another party to the Convention. Convention on the Settlement of Investment Disputes Between States and Nationals of Other States, Mar. 18, 1965, art. 25(1), 17 U.S.T. 1270, 575 U.N.T.S. 159. Although the United States is a party, Canada and Mexico currently are not, so NAFTA claims may not be brought under the Convention. *See* List of Contracting Parties, *at* http://www.worldbank.org/icsid/constate/constate.htm (last visited June 6, 2002). For a discussion of ICSID see Malcolm D. Rowat, *Multilateral Approaches to Improving the Investment Climate of Developing Counties: The Cases of ICSID and MIGA*, 33 HARV. INT'L L.J. 103 (1992).

The second, the ICSID Additional Facility, is available only if either the disputing party or the party of the investor, but not both, are parties to the ICSID Convention. ICSID, Rules Governing the Additional Facility for the Administration of Proceedings by the Secretariat of the International Centre for Settlement of Investment Disputes, art. 2, *available at* http://www.worldbank.org/icsid/facility/3.htm (last visited June 6, 2002).

The third is the United Nations Commission on International Trade Law (UNCITRAL). *See* UNCITRAL Arbitration Rules, *available at* http://www.uncitral.org/english/texts/arbitration/arb-rules.htm (last visited June 1, 2002).

30. NAFTA, *supra* note 1, art. 1123, at 644.

General of the International Center for the Settlement of Investment Disputes.[31]

To take advantage of the ISDM, an investor must consent to the arbitral panel's jurisdiction and waive the right to pursue claims for money damages before any administrative tribunal or court of law.[32] Arbitral awards may be enforced under the ICSID Convention, the New York Convention, or the Inter-American Convention,[33] under which they are to be treated as equivalent to a final judgment in the court of the state party in which they are enforced. There is no appeal mechanism, unlike in domestic courts and other trade-related dispute resolution bodies such as the World Trade Organization.[34] Nor is there any requirement that the proceedings be open to the public.[35] Canada, the United States and Mexico recently agreed to make available to the public all documents submitted to, or issued by a Chapter 11 tribunal, which will be redacted to keep secret any confidential business information.[36] In addition, one of the arbitral panels recently ruled that non-governmental environmental organizations could file amicus briefs in Chapter 11 proceedings.[37] The right is discretionary with each individual tribunal; however, NGOs are not guaranteed a right to participate.[38]

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31. *Id.* art. 1124, at 644.

32. *Id.* art. 1121, at 643. Investors may pursue an injunction, or declaratory relief, or extraordinary relief such as mandamus in parallel domestic proceedings. *Id.*

33. *Id.* art. 1136(6), at 646.

34. *See* Gary N. Horlick & F. Amanda DeBask, *Dispute Resolution under NAFTA: Building on the US-Canada FTA, GATT and ICSID*, 10 J. INT'L ARB. 51 (1993). For the right to appeal WTO rulings see Final Act Embodying the Results of the Uruguay Round of Negotiations, Apr. 15, 1994, Annex 2 - Understanding on Rules and Procedures Governing the Settlement of Disputes, 33 I.L.M. 1225, *available at* http://www.wto.org/english/tratop_e/dispu_e/dsu_e.htm#Top; *see also* Robert E. Hudec, *The New WTO Dispute Settlement Procedure: An Overview of the First Three Years*, 8 MINN. J. GLOBAL TRADE 1, 2 (1999).

35. HOWARD MANN, INTERNATIONAL INSTITUTE FOR SUSTAINABLE DEVELOPMENT & WORLD WILDLIFE FUND, PRIVATE RIGHTS, PUBLIC PROBLEMS: A GUIDE TO NAFTA'S CONTROVERSIAL CHAPTER ON INVESTOR RIGHTS 11 (2001), *available at* http://www.iisd.org/pdf/trade_citizensguide.pdf.

36. *See* NAFTA FREE TRADE COMMISSION, NOTES OF INTERPRETATION OF CERTAIN CHAPTER 11 PROVISIONS (2001), *at* http://www.dfait-maeci.gc.ca/tna-nac/NAFTA-interpr-en.asp.

37. Methanex Corp. v. United States (Mex. v. U.S.), Decision on Authority to Accept Amicus Submissions (Jan. 15, 2001), *available at* http://www.naftalaw.org.

38. MANN, *supra* note 35, at 45; *cf.* Sierra Club & Greenpeace to Intervene in Attorney General v. S.D. Myers (Can. v. U.S.), 2001 F.C.T. 317, *available at* http://decisions.fct-cf.gc.ca/fct/2001/2001fct317.html, *aff'd*, 2002 F.C.A. 39, *available at* http://decisions.fct-cf.gc.ca/fct/2002/2002fca39.html (last visited June 10, 2002) (denying leave for environmental groups to intervene in the proceedings involving S.D. Myers).

II. Arbitral Interpretations of "Takings" Protections

Four arbitral awards have been issued on the merits in NAFTA disputes in which investors claimed that Article 1110's "takings" provisions required compensation.[39] At least a dozen other such claims are now pending before arbitral panels.[40] Under NAFTA's Article 1136, the decision of any arbitral panel "shall have no binding force except between the disputing parties and in respect of the particular case."[41] Nevertheless, the panels in the four decided claims have referred to each other's holdings,[42] and in practice, arbitral awards are given deference by later panels, even if they are not legally binding.[43] The following subsections briefly canvass the decisions and pending claims.

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39. In addition, one tribunal dismissed an expropriation claim as time-barred. *See* Award ¶¶ 60-62, at 75, Mondev Int'l Ltd. v. United States, ICSID (W. Bank) Case No. ARB(AF)/99/2 (Oct. 11, 2002), *available at* http://www.state.gov/documents/organization/14442.pdf (last visited Apr. 25, 2003). At least one claim filed under NAFTA's Chapter 11, Ethyl Corp. v. Canada, 38 I.L.M. 708 (1999), was settled before the arbitral panel reached a decision on the merits. For discussions of *Ethyl* see Julie A. Soloway, *Environmental Trade Barriers Under NAFTA: The MMT Fuel Additives Controversy*, 8 MINN. J. GLOBAL TRADE 55, 56 (1999); Timothy Ross Wilson, *Trade Rules:* Ethyl Corporation v. Canada *(NAFTA Chapter 11)–Part I: Claim and Award on Jurisdiction*, 6 NAFTA L. & BUS. REV. AM. 52 (2000); Timothy R. Wilson, *Trade Rules:* Ethyl Corporation v. Canada *(NAFTA Chapter 11)–Part II: Are Fears Founded?*, 6 NAFTA L. & BUS. REV. AM. 205 (2000). For contrasting views about whether the settlement was driven by the investor protection provisions of NAFTA see, for example, Sanford E. Gaines, *Triangulating Sustainable Development: International Trade, Environmental Protection, and Development*, 32 Envtl. L. Rep. (Envtl. L. Inst.) 10,318 (Mar. 2002).

At least three other claims under Chapter 11 were filed and made public, but were either settled or abandoned. *See* Notice of Intent to Submit a Claim to Arbitration, Ketcham Investments, Inc. and Tysa Investments, Inv. v. Canada (Dec. 22, 2000), *available at* http://www.dfait-maeci.gc.ca/tna-nac/documents/K%26T-e.pdf; Notice of Claim and Demand for Arbitration, Sun Belt, Inc. v. Canada (Oct. 12, 1999), *available at* http://www.cyberus.ca/~tweiler/sun_02.pdf; Notice of Intent to Submit a Claim to Arbitration, Trammel Crow Co. v. Canada (Sept. 7, 2001), *available at* http://www.dfait-maeci.gc.ca/tna-nac/documents/TC_vs_GC.pdf.

40. Because the arbitrations and the arbitral awards are not required to be public, there may be other awards or other pending cases. The most complete listing of both awards and pending arbitrations is maintained by Todd Weiler, Naftalaw.org, at http://www.naftaclaims.com (last updated Apr. 12, 2003).

41. NAFTA, *supra* note 1, art. 1136, at 646.

42. *See infra* note 99 and accompanying text (decision in *S.D. Myers* citing decision in *Pope & Talbot*).

43. *See* Waste Mgmt. Inc. v. United Mexican States, ICSID Case No. ARB(AF)/98/2, 15 ICSID REV.—FOREIGN INVESTMENT L.J. 214, 241 (June 2, 2000) (dissenting opinion) (explaining the need to write a separate dissent because the "precedential significance of this award for future proceedings . . . cannot be underestimated."), *available at* http://www.worldbank.org/icsid/cases/waste_diss.pdf (last visited Apr. 25, 2003); *see also* Daniel M. Price, *An Overview of the NAFTA Investment Chapter: Substantive*

A. Arbitral Awards

1. *Robert Azinian et al (DESONA de C.V.) v. Mexico*

The first decision under NAFTA's Chapter 11, indeed the first decision in any investor-to-state dispute regarding the investor protections of a multi-lateral investment agreement,[44] rejected a claim that the City of Naucalpan had to pay compensation for canceling a contract for the collection and treatment of the City's solid waste.[45] The City approved a fifteen-year concession to DESONA for an "integrated solution" to the City's solid waste problems that called for, among other things, an investment of U.S. $20 million and the construction of a 200-megawatt plant to convert gases from the decomposition of trash to electricity.[46] DESONA, a Mexican corporation whose shareholders were Americans, began operations by collecting trash with two reconditioned garbage trucks, rather than the seventy "state-of-the-art" vehicles called for under the concession contract.[47] Concerned about DESONA's performance of the contract, the Naucalpan City Council sought legal advice, and then asked DESONA to respond to the legal counsel's determination that there were twenty-seven irregularities in the procurement and implementation of the contract.[48] DESONA instead challenged that request in an action before Mexico's State Administrative Tribunal.[49] The City then canceled the concession contract, asserting that the concession was either void due to misrepresentations or rescindable for failure of performance. The Administrative Tribunal upheld the City's right to cancel the contract, and on appeal, the Superior Chamber of the Administrative Tribunal affirmed the decision, holding that the City had

Rules and Investor-State Dispute Settlement, 27 INT'L LAW. 727, 735 (1993); *see generally* Raj Bhala, *The Myth about Stare Decisis and International Trade Law (Part One of a Trilogy)*, 14 AM. U. INT'L L. REV. 845 (1999); Raj Bhala, *The Precedent Setters: De Facto Stare Decisis in WTO Adjudication (Part Two of a Trilogy)*, 9 J. TRANSNAT'L L. & POL'Y 1 (1999); Laurence R. Helfer & Graeme B. Dinwoodie, *Designing Non-National Systems: the Case of the Uniform Domain Name Dispute Resolution Policy*, 43 WM. & MARY L. REV. 141 (2001).

44. Alejandro A. Escobar, Introductory Note to Azinian v. United Mexican States, ICSID Case No. ARB(AF)/97/2 (1999), *available at* http://www.worldbank.org/icsid/cases/awards.htm.

45. *Id.*

46. Award ¶ 27, at 6, Azinian v. United Mexican States, ICSID Case No. ARB(AF)/97/2 (1999), *available at* http://www.worldbank.org/icsid/cases/robert_award.pdf.

47. *Id.* ¶ 33, at 8.

48. *Id.* ¶ 13, at 3.

49. *Id.* ¶ 16, at 4.

proved nine irregularities that were legal bases for annulling the concession.[50] The Federal Circuit Court affirmed that decision.[51] DESONA's American shareholders then instituted arbitral proceedings under NAFTA, seeking up to U.S. $19.2 million for the alleged expropriation of the value of the concession.[52] In rejecting the claim, the panel emphasized that the City's determination that the contract was invalid had been upheld by the courts of Mexico, and reasoned that a "governmental authority surely cannot be faulted for acting in a manner validated by its courts *unless the courts themselves are disavowed at the international level*,"[53] in other words, unless the court decisions themselves violated NAFTA either by "a denial of justice, or a pretense of form to achieve an internationally unlawful end."[54] The investors had not complained about the decisions of the Mexican courts, and "if there is no complaint against a determination by a competent court that a contract governed by Mexican law was invalid under Mexican law, there is by definition no contract to be expropriated."[55] The panel opined, however, that the claimant's failure was not simply one of pleading, and stated that it "views the evidence as sufficient to dispel any shadow over the *bona fides* of the Mexican judgments. Their findings cannot possibly be said to have been arbitrary, let alone malicious."[56] Indeed, the Tribunal stated that the evidence "positively supports the conclusions of the Mexican courts."[57]

2. *Pope & Talbot Inc. v. Canada*

In 1996, the United States and Canada entered into the Softwood Lumber Agreement (SLA), which required Canada to limit the quantity of softwood lumber exported from four of its prov-

50. *Id.* ¶ 17, at 4.

51. *Id.* ¶ 23, at 4.

52. Award ¶ 75, at 20, Azinian v. United Mexican States, ICSID Case No. ARB(AF)/97/2 (1999), *available at* http://www.worldbank.org/icsid/cases/robert_award.pdf.

53. *Id.* ¶ 95, at 27.

54. Award ¶ 99, at 29, Robert Azinian v. The United Mexican States, ICSID Case No. ARB(AF)/97/2, , 14 ICSID Rev.—Foreign Investment L.J. 1 (Nov. 1, 1999) (emphasis in original), *available at* http://www.worldbank.org/icsid/cases/robert_award.pdf.

55. *Id.* ¶ 100, at 29.

56. *Id.* ¶ 103, at 29.

57. *Id.* ¶ 120, at 33.

inces to the United States free of import duties.[58] Canada allocated the quota imposed by that agreement among the four provinces, and among individual producers within those provinces.[59] Pope & Talbot, Inc. is a U.S. corporation; its wholly owned subsidiary owns a Canadian corporation, Pope & Talbot Ltd., which manufactures and sells softwood lumber from facilities in British Columbia.[60] Pope & Talbot, Inc. complained that the share of the quota allocated to British Columbia disadvantaged that province relative to other provinces.[61] Further, Pope and Talbot Ltd's individual quota allocation declined by 6.3% over the first three years of the SLA.[62]

Pope & Talbot, Inc. therefore claimed that Canada's allocation of the quota violated Article 1102's national treatment requirements, Article 1103's most-favored-nation treatment requirements, Article 1105's minimum standards of treatment provisions, Article 1106's prohibition against performance requirements, and Article 1110's compensation requirements.[63] Pope & Talbot's statement of claim defined expropriation expansively as "the act by which governmental authority is used to deny some benefit of property to an investor[,]"[64] including "government action that harms or delays the effective enjoyment of an investment."[65] It sought U.S. $80 million for the expropriation, along with damages for violations of the other provisions of Chapter 11, legal fees, interest and expenses incurred in opposing the effect of Canada's implementation of the SLA.[66]

The arbitral panel rejected Pope & Talbot's Article 1110 claim in June 2000.[67] The Tribunal first agreed with Pope & Talbot that "access to the U.S. market" is a "property interest" subject to protection under NAFTA.[68] Pope & Talbot conceded, however, that

58. Interim Award ¶ 6, at 2, Pope & Talbot, Inc. v. Canada (June 6, 2000), *at* http://www.appletonlaw.com.

59. *Id.*

60. *Id.* ¶ 28, at 6.

61. *Id.* ¶ 45, at 15.

62. *Id.* ¶ 2, at 2.

63. *Id.* ¶¶ 40-45, at 13-15.

64. Statement of Claim ¶ 89, at 24, Pope & Talbot, Inc. v. Canada (1999), *at* http://www.appletonlaw.com/4b3P&T.htm.

65. *Id.* ¶ 90, at 24.

66. *Id.* at 29.

67. The panel also rejected Pope & Talbot's claim that Canada had imposed performance requirements in violation of art. 1106. Interim Award ¶¶ 69-80, at 24-27, Pope & Talbot, Inc. v. Canada (June 26, 2000), *at* http://www.appletonlaw.com.

68. *Id.* ¶ 96, at 33.

the quota allocation measures did not constitute an interference with those property interests substantial enough to constitute an expropriation under customary international law.[69] Pope & Talbot's Article 1110 claim thus rested on the argument that Article 1110's inclusion of the phrase "measure tantamount to expropriation" expanded NAFTA's protection beyond customary international law.[70] The Tribunal rejected that argument: "tantamount" means "equivalent," and "[s]omething that is equivalent to something else cannot logically encompass more."[71] But the Tribunal also rejected Canada's attempt to except all regulatory measures from the reach of Article 1110, stating that "a blanket exception for regulatory measures would create a gaping loophole in international protections against expropriation."[72]

In reaching its decision, the Tribunal relied heavily upon section 712 of the *Third Restatement of the Foreign Relations Law of the U.S.*, which makes a state responsible for expropriation when it "subjects alien property to taxation, *regulation*, or other action that is confiscatory, or that prevents, unreasonably interferes with, or unduly delays, effective enjoyment of an alien's property. . .."[73] The Tribunal interpreted the *Restatement* as recognizing that whether a regulation effects an expropriation "may rest on the degree of interference with the property interest,"[74] "the degree to which the government action deprives the investor of effective control over the enterprise" and whether the regulation makes it "impossible for the firm to operate at a profit."[75] Applying those tests, the Tribunal found that the interference with Pope & Talbot's property interest was not sufficiently substantial to constitute expropriation under customary international law. The Tribunal especially noted that the investor retained control over its business, continued to export substantial quantities of softwood and continued to make substantial profits on those exports.[76]

69. *Id.* ¶¶ 94, 103, at 33, 37-38.

70. *Id.* ¶ 96, at 33-34.

71. *Id.* ¶ 104, at 38.

72. *Id.* ¶ 99, at 35.

73. Interim Award ¶ 99, at 35, Pope & Talbot, Inc. v. Canada (June 6, 2000), *at* http://www.appletonlaw.com (quoting THIRD RESTATEMENT OF THE FOREIGN RELATIONS LAW OF THE U.S. § 712, cmt. (g)) (emphasis added by Tribunal).

74. *Id.* at 35 n.73.

75. *Id.* at 37 n.81.

76. *Id.* ¶¶ 100-01, at 36.

In April 2001, the Tribunal rejected Pope & Talbot's claim that it had not received the same treatment as domestic investors, in violation of Article 1102.[77] It did, however, accept one of Pope & Talbot's claims that it had been denied fair and equitable treatment in violation of Article 1105.[78] In May 2002, the arbitral panel awarded approximately U.S. $400,000 in damages to Pope & Talbot, Inc. for its legal and accounting fees relating to the violation, but found no lost profits or other actual losses from the unfair treatment.[79]

3. *S.D. Myers v. Canada*

S.D. Myers, a U.S. corporation, owned a polychlorinated biphenyl (PCB)[80] remediation facility in Tallmadge, Ohio, about 100 kilometers south of the U.S. and Canadian border. In 1980, the United States banned the import and export of PCB waste. In 1989, Canada signed the Basel Convention, which prohibits both the export and import of hazardous waste to and from states that are not a party to the Convention, unless pursuant to bilateral or other agreements with provisions at least as strict as those of the Basel Convention. The Basel Convention also requires signatory states to reduce the trans-boundary movement of hazardous waste to the minimum level consistent with environmentally sound and efficient management of waste. Accordingly, Canada adopted a policy of destroying PCBs within Canadian borders to the maximum extent possible: its PCB Waste Export Regulations of 1990 banned the export of PCB waste to any country other than the

77. Award on the Merits of Phase 2 ¶ 104, at 46, Pope & Talbot Inc. v. Canada (Apr. 10, 2001), *at* http://www.appletonlaw.com/.

78. The Tribunal focused intensive scrutiny on what it called the "verification review episode" by which Canada's Softwood Lumber Division (SLD) reviewed Pope & Talbot's claim that it had not received the quota allocation to which it was entitled, after the investor had filed notice of its intent to arbitrate under NAFTA. *Id.* ¶¶ 171-81, at 80-87. The Tribunal concluded that SLD's "imperious insistence on having its [own] way," during the review, the "tenor and lack of forthrightness of its internal communications," and the fact that "relations between the SLD and the Investment during 1999 were more like combat than cooperative regulation," added up to a denial of the fair treatment required by NAFTA. *Id.*

79. Award in Respect to Damages ¶¶ 81-88, at 36-40, Pope & Talbot, Inc. v. Canada (May 31, 2002), *at* http://www.appletonlaw.com/. Pope & Talbot had claimed damages of U.S. $80 million. APPLETON & ASSOCIATES, BACKGROUNDER: NAFTA AWARD, POPE & TALBOT, INC. AND CANADA 2 (Apr. 10, 2001), *at* http://www.appletonlaw.com/.

80. Polychlorinated biphenyl, a chemical used primarily in electrical equipment, is highly toxic and biodegrades in the environment very slowly. Partial Award ¶ 94, at 16-17, S.D. Myers, Inc. v. Canada (Nov. 13, 2000), *at* http://www.appletonlaw.com/.

United States, and allowed export to the United States only with prior approval of the U.S. Environmental Protection Agency (EPA).[81] In practice, the only exports to the United States prior to 1997 were of PCB waste owned by U.S. government agencies operating in Canada.[82]

In the early 1990's, Myers decided to try to exploit the Canadian market for PCB remediation, and accordingly incorporated a Canadian affiliate.[83] Through that affiliate, Myers began to market its services to Canadian PCB holders. Because its Ohio facility was located much nearer to many of those sources than the facility of its Canadian competitor, Myers was able to offer remediation at a lower cost. Myers also began to lobby EPA, Environment Canada (Canada's federal environmental protection agency), and various politicians and public officials. In October 1995, Myers was successful in securing an "enforcement discretion" from EPA, which essentially promised not to enforce the ban on the import of PCBs from Canada against Myers and nine other U.S. companies until the end of 1997.[84]

Canada reacted to EPA's action by issuing an Interim Order in November 1995, and a Final Order in February 1996, banning the export of PCBs.[85] In 1997, however, Canada amended its regulations to open the border for PCB exports to the United States. The border remained open for approximately five months, but was closed again when U.S. courts overturned EPA's Import for Disposal Rule, which had replaced its enforcement discretion.[86]

Myers claimed that Canada's Interim and Final Orders prohibiting export to the United States violated NAFTA Article 1102's national treatment obligations by discriminating against Myers; violated Article 1105's requirement of fair and equitable treatment; imposed performance requirements in violation of Article 1106 by effectively forcing it to dispose of PCB waste in Canada; and expropriated Myers' property without just compensation, in violation of Article 1110.[87]

The Tribunal began its analysis of the claims by exploring the intent behind Canada's Interim Order. It found that "there were

81. *Id.* ¶¶ 123-27, at 23-27.
82. *Id.* ¶¶ 114-27, at 21-27.
83. *Id.* ¶ 111, at 20.
84. *Id.* ¶¶ 118-19, at 21-22.
85. *Id.* ¶¶ 123-27, at 23-27.
86. Sierra Club v. EPA, 118 F.3d 1324 (9th Cir. 1997).
87. Statement of Claim ¶ 11, at 4, S.D. Myers, Inc. v. Canada (Oct. 30, 1998), *at* http://www.appletonlaw.com/.

legitimate concerns" raised by the government's deliberations over how to respond to EPA's enforcement discretion, including questions about whether EPA's action was legal; whether the exports to the United States would violate the Basel Convention because the United States was not a signatory party; whether the PCBs would be disposed of in the United States safely; and whether there was a viable Canadian PCB disposal industry in the event that U.S. disposal became unavailable.[88] Nevertheless, the Tribunal found that Canada's policy "was shaped to a very great extent by the desire and intent to protect and promote the market share of enterprises that would carry out the destruction of PCBs in Canada and that were owned by Canadian nationals."[89] The Tribunal was convinced that the Canadian Minister of the Environment was primarily concerned that "PCB waste should be disposed of . . . in Canada by Canadians," as she told officers of Canadian hazardous waste facilities who met with her to lobby for an export ban, and as she announced in the House of Commons in 1995.[90] The Tribunal cited substantial evidence in the record that a wide range of officials in the Department of the Environment and the Department of Foreign Affairs and International Trade had recommended that the border be opened for export of PCBs and had advised that an Interim Order closing the border would violate NAFTA.[91] The Minister's decision nevertheless to forbid exports was

> intended to protect the Canadian PCB disposal industry from U.S. competition. . .. [T]here was no legitimate environmental reason for introducing the ban. Insofar as there was an indirect environmental objective–to keep Canadian industry strong in order to assure a continued disposal capability–it could have been achieved by other measures.[92]

The Tribunal then determined that the protectionist intent, coupled with the "adverse effect on the non-national complainant," constituted a violation of the national treatment obligations of Article 1102.[93] The majority of the Tribunal also found that "on the facts of this particular case the breach of Article 1102 essentially

88. Partial Award ¶ 121, at 22, S.D. Myers, Inc. v. Canada (Nov. 13, 2000), *at* http://www.appletonlaw.com/.
89. *Id.* ¶ 162, at 35.
90. *Id.* ¶¶ 169, 171, at 37-8.
91. *Id.* ¶¶ 164-95, at 35-44.
92. *Id.* ¶¶ 194-95, at 44.
93. *Id.* ¶¶ 254-56, at 63-4.

establishes a breach of Article 1105 as well."[94] Finally, the Tribunal rejected the expropriation claim.

The Tribunal first stated that international law does not generally treat regulations as expropriations, and accordingly, "regulatory conduct by public authorities is unlikely to be the subject of legitimate complaint under Article 1110 . . . although the Tribunal does not rule out that possibility."[95] It explained that "[e]xpropriations tend to involve the deprivation of ownership rights [and] regulations [to] a lesser interference" and that distinction "screens out most potential cases of complaints concerning economic intervention by a state and reduces the risk that governments will be subject to claims as they go about their business of managing public affairs."[96] The Tribunal rejected Myers' argument that the use of the phrase "tantamount to expropriation" was meant to expand Article 1110 beyond the customary meaning of expropriation under international law, agreeing with the *Pope & Talbot* Tribunal that "tantamount" simply means "equivalent."[97] After noting that Canada's closure of the border was temporary, that Canada had realized no benefit from the measure, and that no property or benefit was transferred directly to others, the Tribunal held that the regulation was not an expropriation.[98] The panel left unclear whether a permanent closure of the border would have constituted an exception to its view that regulations generally will not constitute expropriations. The Attorney General of Canada's challenge to the Tribunal's rulings is now pending in the Ontario Federal Court.[99]

94. Partial Award ¶ 266, at 66, S.D. Myers, Inc. v. Canada (Nov. 13, 2000), *at* http://www.appletonlaw.com/. Edward C. Chiasson, the arbitrator chosen by Canada, disagreed with this ruling, believing that a violation of Article 1105 had to be based upon a failure to meet the requirements of international law, not on the violation of some other provision of NAFTA. *Id.* ¶ 267, at 66-67.

95. *Id.* ¶ 281, at 69.

96. *Id.* ¶ 282, at 69.

97. *Id.* ¶ 286, at 69-70.

98. *Id.* ¶ 287-88, at 70.

99. Notice of Application, In the Matter of Sections 5 and 6 of the Commercial Arbitration Act, R.S.C. 1985 C.17 (2d Supp.) & In the Matter of an Arbitration Under Chapter 11 of the North American Free Trade Agreement Between S.D. Myers and the Canada, Attorney General v. S.D. Myers (Can. v. U.S.), Fed. Ct., Trial Div., Ottawa, Ontario, T-255-01 (Feb. 8, 2001). In its challenge, the Attorney General asserts that (1) the Tribunal exceeded its jurisdiction in addressing issues not properly before it, (2) misinterpreted NAFTA by finding that S.D. Myers was an "investor" and that its subsidiary, S.D. Myers (Canada), was an "investment" and (3) misapplied NAFTA's Articles 1102 and 1105. *Id.*

4. *Metalclad Corp. v. Mexico*

Metalclad was the first decision, and to date the only decision, to find a violation of NAFTA Article 1110's expropriation provisions. COTERIN, a Mexican corporation, owned land about seventy kilometers from Guadalcazar, Mexico, in the state of San Luis Potosí (SLP). In 1990, the federal government of Mexico granted a permit to COTERIN to construct and operate a hazardous waste transfer station on the site.[100] About 20,000 tons of waste were deposited at the site untreated, and in 1991, the federal government ordered the closure of the transfer station.[101] The same year, COTERIN applied for, and was denied, a municipal permit to construct a hazardous waste landfill.[102] In 1993, however, COTERIN secured permits to build a hazardous waste landfill from the federal National Ecological Institute (NEI).[103] Shortly thereafter, Metalclad, a U.S. corporation, operating through wholly owned U.S. and Mexican subsidiaries, contracted for a six-month option to buy COTERIN and its permits.[104] The option agreement was subject to the condition that COTERIN obtain either a municipal building permit or a definitive judgment from the Mexican courts that a building permit was not necessary.[105]

SLP then issued a state land use permit to construct the landfill. Metalclad met with the governor of SLP and believed it had obtained his support for the project. Metalclad also secured assurances from the president of the NEI and the general director of the Mexican Secretariat of Urban Development and Ecology that all the permits necessary for the landfill had been issued except for a federal permit for operation of the landfill, and that the federal government would obtain support for the project from Guadalcazar and SLP.[106] The missing federal permit was then issued,

100. Award, Metalclad Corp. v. United Mexican States, ICSID Case No. ARB(AF)/97/1 (Aug. 30, 2000), *at* http://www.worldbank.org/icsid/cases/mm-award-e.pdf.

101. United Mexican States v. Metalclad Corp, [2001] 89 B.C.L.R.3d 664, ¶ 5, *available at* http://courts.gov.bc.ca/jdb-txt/sc/01/06/2001BCSC0664.htm; *see also* United Mexican States v. Metalclad Corporation, [2001] 95 B.C.L.R.3d 169, (supplemental reasons for judgment), *available at* http://www.courts.gov.bc.ca/jdb%2Dtxt/sc/01/15/2001bcsc1529.htm.

102. *United Mexican States*, 89 B.C.L.R.3d ¶ 6, at 664.

103. Award ¶ 29, *Metalclad Corp.*, ICSID Case No. ARB(AF)/97/1 .

104. *Id.* ¶ 30.

105. *United Mexican States,* 89 B.C.L.R.3d ¶ 8, at 664.

106. Award ¶¶ 31-34, 80, *Metalclad Corp.*, ICSID Case No. ARB(AF)/97/1.

and Metalclad exercised its option to purchase COTERIN, the landfill site, and the permits.[107]

Shortly after the purchase, the governor of SLP began to denounce the landfill project. Metalclad then embarked upon negotiations with SLP, and believing that it had secured SLP's support, began construction.[108] Approximately six months later, in October 1994, however, Guadalcazar issued a stop work order because Metalclad had not obtained a municipal building permit for the construction.[109] Metalclad complained to federal officials, who again assured Metalclad that it had all the necessary permits to construct and operate the landfill and that the municipality had no basis for denying a construction permit. The federal officials suggested, however, that Metalclad go through the motions of applying for the building permit in order to appease the municipality.[110] Metalclad did apply for the permit and resumed construction, completing the landfill in March 1995.[111]

The landfill's opening was impeded by demonstrations staged by facility opponents. Further negotiations ensued, and in November 1995, Metalclad, NEI, and the Mexican Federal Attorney's Office for the Protection of the Environment entered into an agreement that allowed the operation of the landfill in exchange for Metalclad's agreement to remediate the previous contamination within the first three years of the landfill's operation and various concessions by Metalclad (such as the designation of a buffer zone for the conservation of some species and a municipal tipping fee).[112] In December 1995, however, Guadalcazar denied Metalclad's application for the building permit on four grounds: it had earlier denied COTERIN's applications for such permits; Metalclad improperly began construction without a permit; the municipality had environmental concerns about the landfill; and Guadalcazar's residents opposed the grant of the permit.[113] Metalclad was neither given notice of, nor provided an opportunity to participate in the meeting at which that decision was made, and its application for reconsideration was denied.[114]

107. *Id.* ¶ 35.
108. *Id.* ¶¶ 37-39.
109. *Id.* ¶ 39.
110. *Id.* ¶¶ 41, 87-89.
111. *Id.* ¶ 45.
112. Award ¶¶ 45-48, *Metalclad Corp.*, ICSID Case No. ARB(AF)/97/1.
113. *United Mexican States,* 89 B.C.L.R.3d ¶ 13, at 664.
114. Award ¶ 54, *Metalclad Corp.*, ICSID Case No. ARB(AF)/97/1.

After attempts to negotiate a solution to the impasse failed, Metalclad filed a claim under NAFTA, alleging that Mexico, through its state and local governments, violated NAFTA's Article 1105, which requires parties to treat investments "in accordance with international law, including fair and equitable treatment and full protection and security"[115]. It also alleged violations of the compensation requirements of Article 1110. Metalclad sought approximately U.S. $90 million for the violations.[116] While the claim was pending and just before he was to leave office, the governor of SLP issued an ecological decree declaring a natural area for the protection of rare cacti that encompassed the landfill site, which had the effect of preventing operation of the landfill.[117]

The *Metalclad* Tribunal found that Mexico had violated Article 1105, which the Tribunal believed was intended to promote "transparency," or the idea "that all relevant legal requirements for the purposes of initiating, completing and successfully operating investments made, or intended to be made . . . should be capable of being readily known to all affected investors."[118] Further, the Tribunal held that if

> the authorities of the central government of any Party . . . become aware of any scope for misunderstanding or confusion in this connection, it is their duty to ensure that the correct position is promptly 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 laws.[119]

The Tribunal reasoned that Metalclad was entitled to rely upon the representations of the federal government that no local construction permit was necessary, and that the municipality would have no legal basis for denying the permit.[120] It held that even if a municipal permit was required under Mexican law, the municipality only had authority over matters related to physical construction or defects in the site.[121] The impropriety of the municipality's denial of the permit, coupled with Metalclad's reasonable reliance on the federal government's representations and the

115. NAFTA, *supra* note 1, art. 1105, at 639-40.

116. Kevin Banks, *NAFTA's Article 1110: Can Regulation be Expropriation?*, 5 NAFTA L. & BUS. REV. AM. 499, 501 (1999).

117. Award ¶¶ 58-59, 96, *Metalclad Corp.*, ICSID Case No. ARB(AF)/97/1.

118. *Id.* ¶ 76.

119. *Id.*

120. *Id.*

121. *Id.* ¶ 86, at 25.

"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," amounted to a failure to "ensure a transparent and predictable framework" for investment in violation of Article 1105(1).[122]

The Tribunal also found that Mexico's actions violated the expropriation provision. That provision, the Tribunal stated, prohibits:

> not only open, deliberate and acknowledged takings of property, such as outright seizure or formal or obligatory transfer of title in favor of the host State, but also 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 or reasonably-to-be-expected economic benefit of property even if not necessarily to the obvious benefit of the host state.[123]

Because the municipality acted outside its limited authority concerning physical construction defects by denying the construction permit in part for environmental reasons, and Metalclad reasonably relied on the representations of the Mexican federal government, Mexico "must be held to have taken a measure tantamount to expropriation."[124]

The Tribunal went on to find that the ecological decree issued by the governor of SLP effectively "barr[ed] forever the operation of the landfill" and therefore constituted an act tantamount to expropriation.[125] It held that the compensation for the violation of Article 1105 and for the expropriation would be the same because both violations negated the possibility of any "meaningful" return on Metalclad's investment.[126] The Tribunal awarded Metalclad U.S. $16.7 million, Metalclad's investment in the project, plus interest, and transferred title to the site to Mexico.[127]

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122. *Id.* ¶¶ 88, 101, at 25-27.

123. Award ¶ 103, at 28, *Metalclad Corp.*, ICSID Case No. ARB(AF)/97/1.

124. The Tribunal based its decision, in part, upon the ruling in Biloune v. Ghana Inv. Ctr., 95 I.L.R. 183, 207-10 (1993), which the Tribunal believed had found an indirect expropriation in similar circumstances when a building permit was not issued. Award ¶¶ 104 & 107, at 26 & 27, *Metalclad Corp.*, ICSID Case No. ARB(AF)/97/1.

125. *Id.* ¶¶ 109 & 112, at 30. The Tribunal noted that its finding regarding the ecological decree was "not strictly necessary for its conclusion." *Id.* ¶ 109, at 30.

126. *Id.* ¶ 113, at 30.

127. *Id.* ¶ 131, at 35.

Mexico challenged the award in the Supreme Court of British Columbia.[128] That court found that the Tribunal's rulings as to Article 1105 had to be set aside because the Tribunal had "misstated the applicable law" to import a transparency obligation into Article 1105.[129] The Tribunal's finding that Mexico had violated Article 1105 by failing to provide transparency therefore exceeded the scope of the matters submitted to it for arbitration.[130] Because the Tribunal's finding that the denial of the building permit had indirectly expropriated Metalclad's property was "infected" by its erroneous view that Article 1105 included a transparency requirement, that finding also had to be set aside as beyond the scope of the submission to arbitration.[131] The Tribunal's finding that SLP's ecological decree amounted to an expropriation was not based upon the Tribunal's erroneous view that Article 1105 included a transparency requirement, however, nor was the Tribunal's finding patently unreasonable.[132] Although the court viewed the Tribunal's definition of expropriation as "extremely broad," that definition was a question of law, and therefore, not reviewable by the court.[133] Accordingly, the court upheld that portion of the Tribunal's award finding the ecological decree to amount to an expropriation as within the scope of the submission to arbitration.[134]

B. Pending Arbitrations

There are approximately one dozen NAFTA arbitrations currently pending[135] that also may result in arbitral interpretations

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128. Because the parties had designated the place of arbitration to be Vancouver, B.C., the International Commercial Arbitration Act, R.S.B.C. 1996, allowed the Supreme Court of British Columbia to set aside the Tribunal's award in limited circumstances, including situations in which the "arbitral award deals with a dispute not contemplated by or not falling within the terms of the submission to arbitration." International Commercial Arbitration Act, R.S.B.C., ch. 233, pt. 7, § 34(2)(iv) (1996) (Can.), *available at* http://www.qp.gov.bc.ca/statreg/stat/I/96233_01.htm.

129. *United Mexican States,* 89 B.C.L.R.3d ¶ 70, at 664.

130. *Id.* ¶¶ 71-73, 76.

131. *Id.* ¶¶ 78-79.

132. *Id.* ¶¶ 94, 97, 99.

133. *Id.* ¶ 99.

134. *Id.* ¶ 105.

135. Arbitrations pending under BITs modeled after NAFTA also raise investor protection claims. Technicas Medioambientales Tecmed, S.A. v. United Mexican States, ICSID Case No. ARB(AF)00/02, filed in September 2000 by a Spanish investor under a Spain-Mexico BIT, for example, appears to closely track the claims in *Metalclad.* MANN, *supra* note 35, at 52 n.54.

of Article 1110's expropriation provisions.[136] The most important pending claims, both in terms of their dollar value, and how broadly they would expand the definition of expropriation if successful, are discussed below.[137]

1. *Methanex Corp. v. United States*

Methanex, a Canadian corporation, indirectly owns a Texas partnership, Methanex Methanol Co. (Methanex U.S.), which manufactures and sells methanol, a substance used to produce methyl-tertiary-butyl ether (MTBE), among other things.[138] MTBE is used in gasoline as a source of octane and as an oxygenate. It was introduced in the late 1970s when various "environmental and public health regulations requir[ed] a substantial reduction in the use of lead in gasoline."[139] Its use became even more widespread when the 1990 Amendments to the Clean Air Act required higher oxygenates to be added to gasoline sold in certain metropolitan areas in the United States with severe ozone or carbon monoxide levels, including southern California.[140] "EPA has classified MTBE, a known animal carcinogen, as a possible

136. The text discusses only those pending arbitrations that raise expropriation claims. For disputes raising other provisions of Chapter 11 see, for example, ADF Group, Inc. v. United States, ICSID Case No. ARB(AF)/00/1 (July 11, 2001), *available at* http://www.worldbank.org/icsid/cases/awards.htm (challenging a "Buy America" clause in a contract with Virginia for the construction of its highways); Mann, *supra* note 35, at 108-09.

137. In addition to the pending claims discussed in the text, notices of intent to arbitrate under NAFTA that allege violations of Article 1110 include Marvin Roy Feldman Karpa (CEMSA) v. United Mexican States (refusing to rebate cigarette excise tax to exporters on the same basis as manufacturers allegedly had the effect of closing Karpa's business and therefore constituted an expropriation) and Waste Mgmt. v. United Mexican States (alleging expropriation arising from dispute over cancellation of Waste Management's concession for street cleaning and other waste related). Several claims, Doman Indus. Ltd. v. United States and Canfor Indus. Ltd. v. United States, challenge duties the United States has imposed upon softwood lumber imports. For descriptions of some of these claims see MANN, *supra* note 35, at 91-92, 100, 105-06. For copies of the documents filed in the disputes that have been made available to the public see http://www.naftalaw.org.

138. Draft Amended Claim at 3-4, Methanex Corp. v. United States (Feb. 12, 2001), *at* http://www.naftalaw.org.

139. Respondent's Statement of Defense ¶ 39, at 11, Methanex Corp. v. United States (Aug. 10, 2000), *at* www.methanex.com/investorcentre/mtbe/statement_of_defense_final.pdf; *see also* Draft Amended Claim at 5-6, Methanex Corp. v. United States (Feb. 12, 2001), *at* http://www.naftalaw.org.

140. Respondent's Statement of Defense ¶¶ 39-40, at 11, Methanex Corp. v. United States (Aug. 10, 2000), *at* www.methanex.com/investorcentre/mtbe/statement_of_defense_final.pdf; *see also* Draft Amended Claim at 5-6, Methanex Corp. v. United States (Feb. 12, 2001), *at* http://www.naftalaw.org.

human carcinogen."[141] MTBE's pronounced taste and odor can render water undrinkable even at very low concentrations. Because of its chemical properties, it contaminates more groundwater, biodegrades more slowly, and is more difficult and expensive to clean up than other ingredients of gasoline.[142]

The market for MTBE in California "represents approximately 6% of the world demand for methanol."[143] In 1997, the California Senate funded a University of California (UC) study of the human health and environmental risks of MTBE.[144] The UC report concluded that there are significant risks and costs associated with MTBE contamination, and recommended that MTBE be phased out of use in gasoline.[145] In March 1999, after studying the report and responses from critics, Governor Gray Davis (D.) concluded that "on balance, there is a significant risk to the environment" from MTBE.[146] The governor accordingly issued an executive order that directed the California Energy Commission (CEC) to develop a timetable for removing MTBE from gasoline no later than December 31, 2002, and directed various state agencies to study the environmental and health risks of substituting ethanol for MTBE in gasoline.[147] The order also required the CEC to evaluate what steps, if any, should be taken to promote the devel-

141. Respondent's Statement of Defense ¶ 51, at 11, Methanex Corp. v. United States (Aug. 10, 2000), *at* www.methanex.com/investorcentre/mtbe/statement_of_defense_final.pdf. *But see* Draft Amended Claim at 6-7, Methanex Corp. v. United States (Feb. 12, 2001), *at* http://www.naftalaw.org (asserting that "most authorities do not consider MTBE to be a carcinogen."); *see also* Julia Ferguson, *California MTBE Contaminated Water: An Illustration of the Need for an Environmental Interpretative Note on Article 1110 of NAFTA*, 11 COLO. J. INT'L ENVTL. L. & POL'Y 499, 509 (2000).

142. Respondent's Statement of Defense ¶¶ 52-55, at 11, Methanex Corp. v. United States (Aug. 10, 2000), *at* www.methanex.com/investorcentre/mtbe/statement_of_defense_final.pdf.

143. Draft Amended Claim ¶ 36, Methanex Corp. v. United States (Feb. 12, 2001), *at* http://www.naftalaw.org.

144. S. 521, 1997-1998 Leg. Sess. (Cal. 1997), *available at* www.leginfo.ca.gov/pub/97-98/bill/sen/sb_0501-0550/sb_521_bill_19971009_chaptered.pdf. The bill required the governor to consider the report, peer-reviews of the report, and testimony at public hearings to decide whether MTBE posed a significant health or environmental risk, and if so, to take "appropriate action." *Id.* § 1.

145. Health & Environmental Assessment of MTBE, Report to the Governor and Legislature of the State of California as Sponsored by S. 521, 1997-1998 Leg. Sess., at 11-14 (Cal. 1998), *at* http://tsrtp.ucdavis.edu/mtberpt.

146. Press Release, Office of the Governor, Governor Davis Announces Decision Regarding MTBE (Mar. 25, 1999), *available at* http://www.governor.ca.gov/state/govsite/gov_homepage.jsp.

147. Exec. Order No. D-5-99, ¶ 4 (Cal. 1999), *available at* http://www.governor.ca.gov/state/govsite/gov_homepage.jsp (last visited Oct. 30, 2002); *see also* Julia Ferguson, *California Concerned about Contaminated Water: Canadian Corporation Files*

opment of ethanol in California if ethanol were found to be an appropriate substitute for MTBE.[148] The relevant agencies accordingly adopted regulations prohibiting the use of MTBE in gasoline after December 31, 2002.[149]

In July 1999, after the issuance of the executive order but before the implementing regulations were scheduled to go into effect, Methanex served notice of its intent to arbitrate a claim under Article 1105 and 1110 of NAFTA.[150] Methanex claimed that the order would have the effect of ending Methanex U.S.'s business of selling methanol for use in MTBE in California, and therefore, would expropriate its property. It also claimed that the manner in which the California Senate and Governor Davis implemented their bills and executive order violated Article 1105's requirement of fair and equitable treatment. Methanex sought damages of U.S. $970 million.

Methanex later amended its complaint to add an Article 1102 claim of discrimination.[151] That claim alleges that during his 1998 gubernatorial campaign, when the future of MTBE was under review, then-candidate, Governor Davis accepted some $160,000 in campaign contributions from the principal U.S. producer of ethanol, the chief competitor of MTBE.[152] It further alleges that Governor Davis received another $50,000 in

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NAFTA Expropriation Claim Against U. S., 1999 COLO. J. INT'L ENVTL. L. & POL'Y 65 (2000).

148. Exec. Order No. D-5-99, ¶ 11 (Cal. 1999), *available at* http://www.governor.ca.gov/state/govsite/gov_homepage.jsp (last visited Oct. 30, 2002). The Senate passed Senate Bill 989, which reinforced the Executive Order by requiring the CEC to develop a timetable for removing MTBE from gasoline as quickly as possible. S. 989, 1999 Leg. Sess. (Cal. 1999).

149. Respondent's Statement of Defense ¶ 84, at 11, Methanex Corp. v. United States (Aug. 10, 2000), *at* www.methanex.com/investorcentre/mtbe/statement_of_defense_final.pdf.

150. Notice of Intent to Submit A Claim To Arbitration Under Article 1119, Section B, Chapter 11 of the North American Free Trade Agreement, Methanex Corp. v. United States (July 2, 1999), *at* www.methanex.com/investorcentre/mtbe/noticeofintent.pdf. For other academic reviews of the Methanex challenge see Ferguson, *supra* note 147, at 125; William T. Waren, *Paying to Regulate: A Guide to* Methanex v. United States *and NAFTA Investor Rights*, 31 Envtl. L. Rep. (Envtl L. Inst.) 10,986 (Aug. 2001).

151. Draft Amended Claim at 1, Methanex Corp. v. United States (Feb. 12, 2001), *at* http://www.naftalaw.org. For discussion of the politics behind the move to substitute ethanol for MTBE see Lizette Alvarez & David Barboza, *Support Grows for Corn-Based Fuel Despite Critics*, N.Y. TIMES, July 23, 2001, at A1.

152. Draft Amended Claim at 1-2, Methanex Corp. v. United States (Feb. 12, 2001), *at* http://www.naftalaw.org.

contributions after he issued the executive order.[153] Methanex asserts that because of the "U.S. ethanol industry's improper influence, the California measures were arbitrary, unreasonable, . . . not in good faith . . . and not the least trade-restrictive method of solving the water contamination problem."[154] It cites as evidence for its claim the fact that "European regulatory authorities, who are not subject to any ethanol industry influence or pressure . . . have concluded that MTBE is not a danger to the environment, that it is not a carcinogen, and that there is no reason to ban its use."[155] It alleges that California's actions on MTBE are the result of a "Baptist-bootlegger coalition" of the ethanol industry and environmentalists that has led to discrimination against foreign investors in the guise of environmental regulation.[156]

The United States contested the panel's jurisdiction over the claims, arguing, among other things, that the alleged damages were too remote to provide a jurisdictional prerequisite, and that neither a customer base nor a particular rate of profit is an "investment" that can be expropriated under Article 1110.[157] The Tribunal issued an award in August, 2002, holding that it had no jurisdiction over Methanex's initial claim because Methanex had not alleged "a legally significant connection" between the challenged measures and the investor.[158] The Tribunal held, however, that certain allegations Methanex advanced in its amended claim and in its briefs and oral arguments relating to the intent behind the California measures might satisfy that requirement, and gave Methanex leave to file a "fresh pleading" and evidence in support of its allegations.[159] Methanex filed an amended statement of claim in November 2002, alleging that an "anti-foreign bias against methanol and its products pervades the U.S. political decisionmaking processes at every level" and played a substantial part in motivating California's measures.[160]

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153. *Id.*

154. *Id.* at 3.

155. *Id.*

156. *Id.* at 39.

157. Respondent's Memorial on Jurisdiction and Admissibility at 15-48, Methanex Corp. v. United States (Nov. 13, 2000), *available at* http://www.naftalaw.org.

158. First Partial Award ¶ 147, at 70, Methanex Corp. v. United States (Aug. 6, 2002), *available at* http://www.state.gov/documents/organization/12613.pdf (last visited Apr. 25, 2003).

159. *Id.* ¶ 169, at 80.

160. Second Amended Claim ¶ 280, at 118, Methanex Corp. v. United States (Nov. 5, 2002) *available at* http://www.state.gov/documents/organization/15035.pdf (last visited Apr. 25, 2003).

Meanwhile, Governor Davis found that it was impossible to meet the December 2002 deadline for phasing out MTBE without seriously disrupting the availability of gasoline in California, and ordered that the prohibition be delayed for one year.[161]

California is not alone in its concern about MTBE. In March 2000, the U.S. EPA issued an advance notice of proposed rulemaking regarding its intent to adopt regulations to eliminate or reduce the use of MTBE.[162] Many states have likewise taken action or are considering proposals to restrict the use of MTBE.[163] The Methanex complaint thus has considerable implications throughout the United States, both by threatening many state regulations and by threatening to expand the notion of the "property" to which the Article 1110 obligations might apply.

2. *Crompton Corp. v. Canada*

In a claim quite similar to Methanex's, Crompton Corp., a Canadian subsidiary of a U.S. company, asserts that Canada's ban on the use of lindane products to treat canola seeds violates Articles 1102, 1105, 1106 and 1110 of NAFTA.[164] Like Methanex, Crompton claims that the ban was motivated not by scientific proof that lindane is harmful, but by a desire to benefit the domestic producers of substitute products. Crompton seeks damages of approximately U.S. $100 million.[165]

161. Exec. Order No. D-52-02 (Cal. Mar. 14, 2002), *available at* http://www.governor.ca.gov/state/govsite/gov_homepage.jsp.

162. Advance Notice of Proposed Rulemaking, 65 Fed. Reg. 16,094 (Mar. 24, 2000). EPA has incorporated recommendations to substantially reduce MTBE use into a draft regulatory proposal, but the proposal has not yet reached the interagency review stage of approval and dissemination to the public, and is unlikely to do so in the near future. Telephone Interview by Erik Bluemel with Mike Shields, U.S. Environmental Protection Agency Office of Transportation and Air Quality (June 13, 2002); *see also* Control of Methyl Tertiary Butyl Ether (MTBE), Unified Agenda, U.S. Environmental Protection Agency, 66 Fed. Reg. 26,148, 26,169 (May 14, 2001); U.S. EPA, ACHIEVING CLEAN AIR AND CLEAN WATER: THE REPORT OF THE BLUE RIBBON PANEL ON OXYGENATES IN GASOLINE (1999), *available at* http://www.epa.gov/otaq/consumer/fuels/oxypanel/blueribb.htm.

163. Thus far, at least fourteen states have restricted or banned MTBE, and many others are considering such measures. *See Impact of Renewable Fuels Standard/ MTBE Provisions of S. 517 1* (2002), *available at* http://www.eia.doe.gov/oiaf/service rpt/mtbe/pdf/sroiaf(2002)07.pdf; *State MTBE Passed and/or Pending Legislation in 2000* (June 6, 2000), *at* http://64.49.216.152/nacs/resource/motorfuels/mtbestatelaws.htm.

164. Notice of Intent to Submit a Claim to Arbitration, Crompton Corp. v. Canada (Nov. 6, 2001), *available at* http://www.naftalaw.org/.

165. *Id.* ¶¶ 28-29, 34, 38-39, 45, 49.

3. *The Loewen Group v. United States*

Loewen is a Canadian company, owned at least in part by Raymond Loewen, a Canadian citizen.[166] Through an American subsidiary, Loewen owns various funeral homes and funeral insurance industries. O'Keefe, a competitor, sued Loewen in a Mississippi state court alleging breach of contract, common law fraud, and violations of Mississippi antitrust laws.[167] During the trial, O'Keefe's attorneys repeatedly referred to Loewen's "foreign" status, as contrasted with O'Keefe's local roots, and sought to portray Loewen as a racist.[168] O'Keefe sought only U.S. $5 million in actual damages,[169] but the jury awarded U.S. $500 million, including U.S. $400 million in punitive damages.[170] Loewen sought to appeal the award, but Mississippi law requires an appeal bond of 125% of the judgment. Although the trial court had discretion to reduce or eliminate the bond for "good cause," it refused to do so, and the Mississippi Supreme Court affirmed that decision. As a result, Loewen alleges, it was forced to settle the case for U.S. $175 million, even though the transactions at issue were worth less than U.S. $5 million.[171]

Loewen charges that by allowing O'Keefe's counsel to make anti-Canadian and pro-American comments, and by refusing to reduce the bond requirement, the trial court violated Article 1102's national treatment requirement and Article 1105's minimum fair treatment requirement.[172] Loewen asserts that those actions, when combined with the excessive verdict and "coerced" settlement, expropriated Loewen's property, in violation of Article 1110.[173] It seeks U.S. $725 million in damages.[174]

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166. Notice of Claim ¶1, at 15-16, Loewen Group v. United States (Oct. 30, 1998), *available at* www.naftalaw.org.

167. *Id.* ¶¶ 2, at 22-34.

168. *Id.* ¶¶ 4, at 35-103.

169. *Id.* ¶ 33.

170. *Id.* ¶¶ 3, at 104-19.

171. *Id.* at ¶¶ 5-6, at 120-27.

172. Notice of Claim ¶¶ 139-61, *Loewen Group.* Loewen bolsters its claims with opinions by Sir Robert Jennings, former President of the International Court of Justice; Richard Neely, former Chief Justice of the West Virginia Supreme Court; Kirk Fordice, then-Governor of Mississippi; and Professor Andreas Lowenfeld of NYU School of Law, all of whom opine that the jury's verdict was outrageous and was based, or possibly based, upon nationalistic or xenophobic discrimination. *Id.*

173. *Id.* ¶¶ 7, 162-67.

174. *Id.* ¶¶ 183-87. The claimant in Adams v. United Mexican States also alleges that judicial actions constitute an expropriation of property. Notice of Arbitration, Adams v. United Mexican States (Feb. 16, 2001), *available at* http://www.naftalaw.org. Although only a notice of arbitration has been filed, and its presentation of facts

The United States contested the arbitral panel's jurisdiction, arguing that judicial acts in litigation between private parties are not "measures" regulated by NAFTA.[175] In January 2001, the panel rejected that argument, however, and deferred consideration of other jurisdictional arguments until hearing the merits of the controversy.[176] The hearing on the merits took place in the fall of 2001, but in March 2002, the United States filed a new objection, arguing that Loewen had restructured itself as an American corporation, thereby destroying the Tribunal's jurisdiction under NAFTA.[177] Those matters are currently under consideration by the panel.

III. Federal Responses to Liability for State and Local Regulations Found to Violate Investor Protections

As noted above, it is too early to predict whether Article 1110 will be interpreted by arbitral panels to require compensation awards for many investor claimants.[178] The threat is sufficiently serious, however, to justify consideration of the responses governments may have to such awards. The federal government could respond to a panel's decision that a state or local regulation expropriated an investment without full, fair and adequate compensation, in violation of Article 1110, in several different ways. First, it could attempt to force the state or locality responsible for the regulation to repay the federal government for the cost of the

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is somewhat confusing, *Adams* appears to involve a claim by U.S. citizens who purchased lots and built vacation homes in a resort they believed belonged to the Mexican government, but which Mexican courts later determined had been unlawfully expropriated from its original owners and accordingly ordered returned to those original owners. *Id.* The American investors have invoked NAFTA Articles 1102 and 1105, claiming that they were treated less favorably than Mexican investors in the litigation over the validity of the Mexican government's expropriation of the land, and because the Mexican courts found in favor of the original Mexican landowners rather than the American investors. *Id.* They also claim that the judicial decrees ordering that the land and improvements be returned to the original landowners expropriates their property in violation of Article 1110. *Id.*

175. Notice of Arbitration, Adams v. United Mexican States (Feb. 16, 2001), *available at* http://www.naftalaw.org.

176. Decision on Hearing of Respondent's Objection to Competence and Jurisdiction at 22, Loewen Group v. United States, ICSID Case No. ARB(AF/98/3) (Jan. 5, 2001), *available at* http://www.naftalaw.org/.

177. Respondent's Memorial on Matters of Jurisdiction and Competence Arising from the Restructuring of the Loewen Group, Inc, Loewen Group v. United States (Mar. 1, 2002), *available at* http://www.state.gov/documents/organization/8744.pdf.

178. For analysis of how the arbitral awards under Article 1110 may give international investors "regulatory takings" protections different from those provided by the Fifth Amendment to the U.S. Constitution, see generally Been, *supra* note 5.

award. It could do so either by suing the state or local government for contribution toward the award or for indemnification for the federal government's liability, or by seeking to recover its outlay for the award by deducting that amount from grants or other funds it would otherwise award to the state or locality.[179] The United States has not yet lost a NAFTA claim, and therefore has not been forced to face the question of how or whether to recoup funds it expends to pay awards. After Mexico was ordered to pay U.S. $16 million in the *Metalclad* dispute, however, the national government missed the deadline to make the payment because of disputes between the national and state governments about dividing the cost of the settlement.[180] The national government eventually paid the award, but has not ruled out the possibility that it will seek to recoup at least part of the funds from the state and local governments involved in the dispute. In Canada, concerns about the national government's ability to pass the costs of NAFTA awards through to state and local governments have led the Federation of Canadian Municipalities to request that the national government "guarantee that it will never penalize municipalities for actions that are valid under domestic law but violate NAFTA. . . ."[181]

Second, if an award would require compensation in the future to the same or other investors if the regulation were left in place, or if the decision suggests that additional claimants will be able to establish that similar uncompensated regulations violate NAFTA's investor protections, the federal government could try to avoid future liability. It could, for example, seek to force the state or locality to change its regulations. More likely, it could tie future federal funding to the state or locality's agreement to rescind or modify the regulation (at least with regard to foreign investors).

179. The federal government could also pass a statute similar to Title VI of the Civil Rights Act of 1964, 42 U.S.C. § 2000d (2000) forbidding state and local governments from discriminating against foreign investors in the expenditure of federal funds, and defining discrimination to include any violation of NAFTA's investment protections. That strategy would be quite cumbersome, however, because it likely would give the federal government only the blunt tool of cutting off all future federal funding to a state or local agency liable for a NAFTA violation. Otherwise, the strategy would raise the same issues as the more finely tuned hypothetical recoupment legislation explored in the text.

180. Anthony DePalma, *NAFTA Dispute Is in Court Once Again*, N.Y. TIMES, Oct. 19, 2001, at W1.

181. FEDERATION OF CANADIAN MUNICIPALITIES, MUNICIPAL QUESTIONS RESPECTING TRADE AGREEMENTS § II(F) (Nov. 5, 2001), *available at* http://www.fcm.ca/newfcm/java/worldtrade1.htm.

Or, the federal government could preempt the state or locality's offending regulation by passing its own regulation and expressly providing that the federal regulation occupies the field and preempts regulation by states or local governments. Any of those tacks has the potential to rearrange the way in which authority for land use and environmental regulation is divided. The following subsections explore the viability of each option in greater detail.

A. Passing on the Cost of Awards

Arbitrations under NAFTA's investor-state dispute resolution mechanism are against the signatory party–the national government. Awards are assessed against that party. In order to pass the cost of the award on to the state or local government responsible for the regulation, the federal government would have to be able to sue the state or locality for contribution or indemnification, deduct the amount of the award from federal monies that would otherwise be granted to the state or locality, or order the state or local government to pay the award directly to the successful claimant.

Nothing in the legislation passed to implement NAFTA clearly authorizes the federal government to sue a state or locality to recover damages imposed upon the federal government for a state or locality's violation of NAFTA, but Congress could pass such legislation. The usual bars to suits against the states[182]

182. Suits by the United States against one of the states fall within the original jurisdiction of the U.S. Supreme Court, so there would be no jurisdictional bar to a suit by the federal government to recover monies spent on NAFTA awards. *See* United States v. Texas, 143 U.S. 621, 646 (1892):

> The submission to judicial solution of controversies arising between these two governments, 'each sovereign, with respect to the objects committed to it, and neither sovereign with respect to the objects committed to the other,' McCulloch v. Maryland, 4 Wheat. 316, 400, 410, but both subject to the supreme law of the land, does no violence to the inherent nature of sovereignty. The states of the Union have agreed, in the constitution, that the judicial power of the United States shall extend to all cases arising under the constitution, laws, and treaties of the United States, without regard to the character of the parties, (excluding, of course, suits against a state by its own citizens or by citizens of other states, or by citizens or subjects of foreign states,) and equally to controversies to which the United States shall be a party, without regard to the subject of such controversies, and that this court may exercise original jurisdiction in all such cases 'in which a state shall be party,' without excluding those in which the United States may be the opposite party. The exercise, therefore, by this court, of such original jurisdiction in a suit . . . brought by the United States against a state . . . so far from infringing in either

would be unlikely to apply to such legislation.[183] First, the U.S. Supreme Court has made clear that the Eleventh Amendment's protection of a state's sovereign immunity does not prevent the United States from suing a state.[184] The Eleventh Amendment protects a state from suit by a foreign nation,[185] or by citizens of a foreign nation.[186] One commentator has argued that the Court would put "substance over form" to hold that an action by the United States to recover an award resulting from a NAFTA complaint filed by a foreign investor is equivalent to a suit against a state by that foreign investor.[187] But form matters in Eleventh Amendment jurisprudence. In holding that Congress could not abrogate a state's Eleventh Amendment immunity by allowing In-

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> case upon the sovereignty, is with the consent of the state sued. Such consent was given by [the State] . . . when [it was] admitted into the Union upon an equal footing in all respects with the other states.

Id. at 646.

183. State or local governments might argue that the Due Process Clause should prevent the federal government from imposing liability for NAFTA awards on state and local governments, because those governments are not parties to the NAFTA arbitration, and therefore may not defend themselves directly against the claim. Presumably, however, the national government could remedy that problem by inviting the state or local government that might bear the eventual liability to participate in the proceedings. Alternatively, due process concerns might be met by affording the state or local government a judicial hearing regarding the validity of the arbitral award before passing the liability for the award back to that government.

184. United States v. Mississippi, 380 U.S. 128, 140 (1965) ("The Eleventh Amendment in terms forbids suits against States only when 'commenced or prosecuted . . . by Citizens of another State or by Citizens or Subjects of any Foreign State.' While this has been read to bar a suit by a State's own citizen as well, Hans v. Louisiana, 134 U.S. 1, 10 (1890), nothing in this or any other provision of the Constitution prevents or has ever been seriously supposed to prevent a State's being sued by the United States."). Although the issue in *Mississippi* was whether the United States could sue a state to enforce the constitutional rights of citizens, in other decisions the United States has been allowed to sue a state to settle disputes over whether the federal government or the state owned particular land. *See* United States v. Texas, 143 U.S. at 646; *see also* United States v. North Carolina, 136 U.S. 211 (1890) (allowing the United States to sue for payment on the interest of bonds issued by North Carolina and held by the United States); United States v. Michigan, 190 U.S. 379 (1903) (allowing the United States to sue state over Michigan's sale of lands the United States had appropriated to Michigan for the construction of a canal); United States v. Minnesota, 270 U.S. 181 (1926) (allowing the U.S. to sue state over the proceeds from the sale of Chippewa lands). As the Supreme Court recently noted: "States, in ratifying the Constitution, did surrender a portion of their inherent immunity by consenting to suits brought by sister States or by the Federal Government ." Fed. Mar. Comm'n v. S.C. State Ports Auth., 535 U.S. 743, 751 (2002).

185. Principality of Monaco v. Mississippi, 292 U.S. 313 (1934); *see also* Breard v. Greene, 523 U.S. 371 (1998).

186. *See Principality of Monaco*, 292 U.S. at 329.

187. Steve Louthan, *A Brave New Lochner Era? The Constitutionality of NAFTA Chapter 11*, 34 VAND. J. TRANSNAT'L L. 1443, 1443-44 (2001).

dian tribes to sue the state, for example, the Court noted in *Seminole Tribe of Florida v. Florida*[188] that there are "other methods of ensuring the States' compliance with federal law: The Federal Government can bring suit in federal court against a State. . .."[189] In *Alden v. Maine*, the Court held that the Eleventh Amendment barred employees from suing a state to enforce provisions of the Fair Labor Standards Act, but noted that the United States could sue on behalf of the employees:

> This case at one level concerns the formal structure of federalism, but in a Constitution as resilient as ours form mirrors substance. . .. The difference between a suit by the United States on behalf of the employees and a suit by the employees implicates a rule that the National Government must itself deem the case of sufficient importance to take action against the State; and history, precedent, and the structure of the Constitution make clear that, under the plan of the Convention, the States have consented to suits of the first kind but not of the second.[190]

Just as the United States can sue a state to enforce federal law, even though the beneficiaries of the suit include employees who could not themselves sue, the federal government should be able to sue a state to recover monies the federal government has been forced to pay because of the state's violation of NAFTA, even though the rights ultimately at stake are those of foreign investors who could not themselves sue the state.

Nor would the Commerce Clause bar federal legislation authorizing the United States to recover damages it suffered as a result of state or local violations of NAFTA. NAFTA and its implementing legislation were designed to further investment within the United States and trade between the states and foreign countries. Investment and trade are quintessential economic activities, both of which have a large impact on interstate commerce, and "[w]here economic activity substantially affects interstate commerce, legislation regulating that activity will be sus-

188. 517 U.S. 44 (1996).

189. *Id.* at 71 n.14; *see also* Alden v. Maine, 527 U.S. 706, 755 (1999) ("Sovereign immunity, moreover, does not bar all judicial review of state compliance with the Constitution and valid federal law. Rather, certain limits are implicit in the constitutional principle of state sovereign immunity. . .. The States have consented, moreover, to some suits pursuant to the plan of the Convention or to subsequent constitutional Amendments. In ratifying the Constitution, the States consented to suits brought by other States or by the Federal Government." (citations omitted)).

190. *Alden*, 527 U.S. at 758-60.

tained."[191] Further, allowing the federal government to pass NAFTA awards through to the states would undoubtedly be viewed as promoting trade by forcing the level of government responsible for interfering with free trade by violating NAFTA to bear the costs of doing so, and thereby potentially deterring further violations.[192]

Finally, the Tenth Amendment would not bar legislation allowing the federal government to sue states to recover costs it incurred as a result of state violations of NAFTA. The Tenth Amendment might bar federal legislation that "commandeered" state and local officials to pay compensation directly to private parties for regulations found to require compensation under Chapter eleven, as discussed further in subsection B.[193] But as long as NAFTA and its implementing legislation are authorized by either the Commerce Clause or the Treaty Power, federal *courts* can require state and local governments to comply with those federal laws under the Supremacy Clause without running afoul of the Tenth Amendment's prohibition on the "commandeering" of state

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191. United States v. Lopez, 514 U.S. 549 (1995); *see also* David M. Golove, *Treaty-Making and the Nation: the Historical Foundations of the Nationalist Conception of the Treaty Power*, 98 MICH. L. REV. 1075, 1306 (2000) ("Given the subject matter with which [NAFTA] deal[s], no one to my knowledge has doubted that all of the provisions in the agreements fall within the subject matter scope of Congress's commerce powers."); *see generally* Deborah Jones Merritt, *Commerce!*, 94 MICH. L. REV. 674 (1995) (exploring the reach of the Commerce Clause after *Lopez*).

192. Cost-internalization is one of the major rationales for requiring governments to compensate property owners when the government expropriates private property. *See, e.g.*, RICHARD A. EPSTEIN, TAKINGS (1985); RICHARD A. POSNER, ECONOMIC ANALYSIS OF LAW 64 (5th ed. 1998); William A. Fischel & Perry Shapiro, *Takings, Insurance, and Michelman: Comments on Economic Interpretations of "Just Compensation" Law*, 17 J. LEGAL STUD. 269-79 (1988); William A. Fischel, *The Political Economy of Just Compensation: Lessons from the Military Draft for the Takings Issue*, 20 HARV. J. L. & PUBL. POL'Y 23, 30 (1996); Michael A. Heller & James E. Krier, *Deterrence and Distribution in the Law of Takings*, 112 HARV. L. REV. 997 (1999); Thomas W. Merrill, Dolan v. City of Tigard: *Constitutional Rights as Public Goods*, 72 DENV. U. L. REV. 859, 882-83 (1995); Thomas J. Miceli & Kathleen Segerson, *Regulatory Takings: When Should Compensation be Paid?*, 23 J. LEGAL STUD. 749, 758-59 (1994); Frank I. Michelman, *Property, Utility, and Fairness: Comments on the Ethical Foundations of "Just Compensation" Law*, 80 HARV. L. REV. 1165 (1967). For judicial endorsement of the theory see, for example, Pennell v. San Jose, 485 U.S. 1, 22 (1988) (Scalia J., concurring in part and dissenting in part).

The cost-internalization rationale is hardly free from criticism. *See* Been, *supra* note 5; Daryl J. Levinson, *Making Government Pay: Markets, Politics and the Allocation of Constitutional Costs,* 67 U. CHI. L. REV. 345 (2000). Nevertheless, it certainly provides a rationale basis for the federal government to believe that passing the cost of NAFTA awards back to the state or local government that caused the violation might promote the free trade objectives of NAFTA.

193. *See* text accompanying notes *infra* 199-213.

legislative or administrative processes.[194] If the implementing legislation authorized the federal government to recover from states[195] the damages it incurred when a state violated Chapter 11, federal courts imposing that remedy for state violations would seem no different from federal courts ordering states to pay damages to the United States under such federal laws as CERCLA.[196]

B. Seeking to Prevent State and Local Regulations that May Violate Chapter 11

The federal government might prefer to try to prevent state and local governments from violating NAFTA *ex ante*, rather than resting on its right to recover its damages *ex post* for a state's or locality's violations. Suing a state to recover damages might be more visible and politically controversial than seeking to influence state regulation.[197] Further, the cost of an arbitral award against a nation includes not just the actual amount of the award, and the national government's expenses in defending against the claim, but also the public relations costs to the national government as it attempts to exert leverage on other countries to treat its investors in those countries well, and to the country as a whole if the judgment dissuades foreign investment. Those "indirect" costs are unlikely to be easily quantified, and are likely to be hard to recover

194. New York v. United States, 505 U.S. 144 (1992).

195. Presumably, the implementing legislation also could authorize the federal government to seek a court order allowing the United States to deduct from federal funds it would otherwise pay to the state any damages the United States had suffered as a result of the state's violation of NAFTA.

196. Comprehensive Environmental Response, Compensation, and Liability Act, 42 U.S.C. §§ 9601(21), 9607 (2000); *see generally* Steven G. Davison, *Governmental Liability Under CERCLA*, 25 B.C ENVT'L AFF. L. REV. 47, 83 (1997).

197. The extent to which the states are able to protect their interests in Congress is the subject of much debate. *See, e.g.*, Larry D. Kramer, *Putting the Politics Back into the Political Safeguards of Federalism*, 100 COLUM. L. REV. 215 (2000); Larry Kramer, *Understanding Federalism*, 47 VAND. L. REV. 1485 (1994); Vicki C. Jackson, *Federalism and the Uses and Limits of Law:* Printz *and Principle?*, 111 HARV. L. REV. 2180 (1998); *see also* Stephen Zamora, *Allocating Legislative Competence in the Americas: The Early Experience Under NAFTA and the Challenge of Hemispheric Integration*, 19 HOUS. J. INT'L. L. 615, 638-39 n.107 (1997) (arguing that the states have become aware of the threat that international law poses to their regulatory programs and have "negotiated an arrangement with the federal government to incorporate state viewpoints and interests both in the legislative process (to determine if states' interests will be compromised by action at the international level), and in the [NAFTA] dispute settlement process (to the extent state laws are involved in a dispute)."). But surely the states have sufficient power to make any move by the federal government to recoup NAFTA awards controversial, especially given the public debates that already swirl around free trade agreements.

from the state or local government responsible for the violation. Finally, the "cost-internalization" achieved by asking state or local governments to pay a takings judgment may be incomplete,[198] so the federal government may prefer to exert direct pressure on regulatory decisions in order to supplement the deterrent value of potential liability.

The federal government cannot directly compel state or local governments to regulate in a manner that minimizes the threat of NAFTA complaints because *New York v. United States*[199] makes it clear that Congress cannot "use the States as implements of regulation," or "require the States to govern according to Congress' instructions."[200] Congress could, however, "encourage" the states to regulate in a way that minimizes the risk of NAFTA violations. *New York* identified several "methods, short of outright coercion, by which Congress may urge a State to adopt a legislative program consistent with federal interests."[201]

Congress could, for example, attach conditions to a state's receipt of federal funds that would encourage states to avoid regulations that might violate NAFTA.[202] There are four basic limitations on conditions on the spending power. First, they must be "in pursuit of 'the general welfare.'"[203] Second, the conditions must be "unambiguously" stated.[204] These two requirements should not be difficult to meet. Courts grant considerable deference to Congress' judgment about what will promote the general welfare,[205] and encouraging free trade and foreign investment and avoiding violations of international agreements easily would satisfy the test. Congress certainly is capable of making the conditions clear. Third, the condition imposed upon federal funds may not violate any independent constitutional bar—that is, spending may not be conditioned, for example, on a state's agreement to take some action that would violate the Equal Protection Clause. Although it is possible that conditioning receipt of federal funds

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198. *See supra* text accompanying note 192.

199. 505 U.S. 144 (1992).

200. *Id.* at 162.

201. *Id.* at 166.

202. Congress could use similar conditional spending techniques to encourage states to agree to pay any damages the federal government incurs as a result of NAFTA awards, if it did not want to rely on suits for contribution or indemnification.

203. South Dakota v. Dole, 483 U.S. 203, 207 (1987) (quoting Helvering v. Davis, 301 U.S. 619, 640-41 (1937)).

204. *Id.* at 207 (quoting Pennhurst State Sch. & Hosp. v. Halderman, 451 U.S. 1, 17 (1981)).

205. *Id.* at 207 n.2; *see also* Buckley v. Valeo, 424 U.S. 1, 90-91 (1976).

on agreements to avoid NAFTA violations might run afoul of other constitutional guarantees, the federal government could structure the conditions to avoid those problems.[206]

The fourth requirement is the most challenging: conditions must relate to the "federal interest;" in particular, national projects or programs.[207] The Court has not specified the degree of relatedness required.[208] In *South Dakota v. Dole*,[209] the Court upheld a statute conditioning states' receipt of federal highway funds on the adoption of a uniform drinking age, finding the relationship between the condition and the highway project sufficient because in states with low drinking ages, young people may drive drunk on federal highways.[210] Similarly, to satisfy the relatedness requirement, the federal government could condition the receipt of, for example, funds to the state's environmental protection agencies upon the state's agreement to refrain from enacting environmental regulations that would violate NAFTA, asserting that NAFTA violations would jeopardize the federal government's ability to fund state's environmental programs, and would create controversy over environmental regulations that would undermine the federal government's funding program. Here, as with the conditional spending upheld in *New York*, the Court would likely find that "both the conditions and the payments embody Congress' ef-

206. The federal government could not condition the receipt of federal funds, for example, upon a state's agreement to give foreign investors better treatment than domestic ones, because doing so presumably would violate the Equal Protection Clause. Nor could a condition require the states to promote free trade even where doing so would result in a taking of the property rights of domestic property owners.

207. *Dole*, 483 U.S. at 207 (quoting Massachusetts v. United States, 435 U.S. 444, 461 (1978)).

208. Since *Dole* was decided in 1987, the Court has shown considerable interest in examining the connection between conditions that local governments place on land-use permissions (exactions) and the "projected impact of the proposed development." *See* Dolan v. City of Tigard, 512 U.S. 374 (1994); Nollan v. Cal. Coastal Comm'n, 483 U.S. 825, (1987). Determining whether such exactions are proportional and congruent to the problems they seek to address is analogous to the relatedness inquiry *Dole* mandates. Both the exaction analysis and the conditional spending analysis search for a nexus between the condition the government imposes and the purpose of its spending or regulatory program. *Dole* allows Congress much greater leeway on the nexus than *Nollan* or *Dolan* permitted state and local governments. *Nollan* and *Dolan* might be driven by the Court's distrust of state and local governments' land use powers, however, and therefore not be deemed relevant to federal conditional spending.

209. 483 U.S. 203 (1987).

210. *Id.*

forts to address the pressing problem" of how to achieve environmental protection in a cost-effective manner.[211]

The second method Congress could use to "encourage" states and localities to avoid regulations that would trigger NAFTA's compensation requirements would be conditional preemption. Congress may "offer States the choice of regulating [an] activity according to federal standards or having state law preempted by federal regulation."[212] Congress undoubtedly has the power to regulate much that is now left to state and local environmental regulators, and even much that is now within the province of state and local land use agencies, because of the impact both environmental and land use decisions have on interstate commerce.[213] Although political, fiscal, and practical constraints limit Congress' credibility in threatening to preempt much state and local environmental and land use regulation,[214] the threat often will nevertheless be sufficiently serious to encourage state and local governments to acquiesce in the federal regulatory scheme rather than risk losing all control over the field.

IV. Potential Implications of Investor Protection Provisions for the Allocation of Authority for Land Use and Environmental Regulation

Even after the Court's recent federalism decisions, therefore, the federal government retains considerable power to either pass back to state and local governments the cost of any awards for Chapter 11 violations, or to seek to influence states and localities to tailor their regulations to avoid triggering Chapter 11 complaints. That power has several significant implications for the

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211. *New York*, 505 U.S. at 172; *see generally* Lynn A. Baker, *Conditional Federal Spending After* Lopez, 95 COLUM. L. REV. 1911, 1954-88 (1995).

212. *New York*, 505 U.S. at 173-74.

213. *But cf.* Solid Waste Agency v. Corps of Eng'rs, 531 U.S. 159, 174 (2001) (holding that U.S. Army Corps of Engineers (Corps) rule extending definition of "navigable waters" under the Clean Water Act (CWA) to include intrastate waters used as habitat by migratory birds exceeded authority granted to the Corps under the CWA, in part to avoid the difficult constitutional question of whether regulation of such intrastate waters "would result in a significant impingement of the States' traditional and primary power over land and water use. . ..").

214. *See* Michael C. Dorf & Charles F. Sabel, *A Constitution of Democratic Experimentalism*, 98 COLUM. L. REV. 267, 425-26 (1998); Roderick M. Hills, Jr., *The Political Economy of Cooperative Federalism: Why State Autonomy Makes Sense and "Dual Sovereignty" Doesn't*, 96 MICH. L. REV. 813, 868 (1998); Carlos Manuel Vazquez, *Breard, Printz, and the Treaty Power*, 70 U. COLO. L. REV. 1317, 1332-36 (1999).

allocation of authority between state and federal regulators, state and local regulators, and land use and environmental regulators.

To the extent that passing the costs of Chapter 11 awards back, or encouraging state and local regulators to avoid triggering Chapter 11 complaints, results in more cautious state and local regulation,[215] NAFTA may allow the federal government to effectively decrease state and local governments' traditional control over land use and the environment. If Congress were to pass legislation requiring state and local governments to compensate domestic property owners for any land use or environmental regulation that reduced the value of property (or reduced its value by some specified percentage), surely state and local governments would protest that the compensation requirement was a back-door attempt to severely limit their ability to regulate.[216] NAFTA's Chapter 11 does essentially the same thing by imposing compensation requirements that may be interpreted by arbitral panels to be more demanding than the U.S. Constitution. Both the hypothetical domestic property rights protection and Chapter 11's foreign investor protections could reduce state and local regulation of the environment and land use considerably. They would not necessarily *increase* federal regulation, because the federal government too might prefer to minimize its potential liability by avoiding regulation altogether. But by applying NAFTA to states and localities in the ways outlined in Section III, the federal government could substantially reduce the willingness and ability of state and local governments to regulate environmental and land use affairs. Similarly, because so much of the environmental regulation (and some land use regulation) in the United States is based upon a system of cooperative federalism, state governments are likely to assert federal mandates (rather than state law) as the basis for their refusal to permit development, in an attempt to minimize their risk of liability for NAFTA violations.

Chapter 11's investor protections also could shift the exercise of regulatory authority from local to state regulators. Generally speaking, local governments are less able than state governments

215. *Cf.* Levinson, *supra* note 192 (exploring reasons to doubt that the cost-internalization model works very well as applied to government regulators).

216. It is noteworthy that the several bills introduced in Congress in the last decade to strengthen property rights imposed stricter takings protections only on federal regulators or state regulators implementing federal statutes. *See, e.g.*, Private Property Rights Act of 2001, S. 1412, 107th Cong. (2001).

to bear the cost of the pass-through of a NAFTA award,[217] or to bear the cost of defending against a NAFTA complaint (although the federal government is the party defending against an investor's complaint, the federal government's defense would inevitably impose costs upon the local officials involved in the regulation, and upon local counsel). Local governments therefore would be more likely than states to settle any investor complaints that arose, and more cautious in regulating when developers threaten Chapter 11 complaints. That caution will affect both the strength of local government's regulatory programs, and the willingness of local governments to assume or retain regulatory authority over a problem. It also may result in strategic positioning–local governments might respond to the threat of liability by attempting to place their permitting processes last in the sequence of reviews, such that the state's regulators would bear the initial responsibility for limiting environmental damage, and therefore bear the initial brunt of the threat of liability. Just as states might seek to insulate themselves by invoking federal mandates as the basis for permit denials, local governments may act strategically in citing state and federal mandates as requiring them to deny development rights.

Finally, investor protections may shift regulation away from land use regulators and toward environmental agencies. Because of the national and most-favored-nation treatment requirements, individual permitting decisions will be more susceptible to investor complaints than broader-brushed regulatory programs. The ad-hoc, highly discretionary nature of much of land use decision-making will leave planning and zoning agencies particularly vulnerable to claims of prejudice. A move from flexible, discretionary systems to more comprehensive command and control schemes may push the already eroding borders between land use and environmental law further toward environmental regulation.

Each of these potential implications–towards greater centralization and less localism, and towards more comprehensive and less discretionary regulatory regimes–carries both risks and benefits. There is enormous controversy about the benefits of more decentralized regimes, and about the tradeoff between flexibility and comprehensiveness. The implications of NAFTA's investor protec-

217. Local governments may also be less able to insure against liability for Chapter 11 violations than state governments, because of their smaller size and budget, and because they would have less of a track record for insurers to use in establishing experience groupings.

tion provisions upon the distribution of authority between the federal, state and local governments and between environmental and land use regulatory schemes therefore are not necessarily undesirable. The implications need to be considered, and debated, however, in any assessment of the desirability of bilateral or multilateral investor protection agreements.

V. Looking Ahead to Future Investment and Trade Agreements

Article 11's investor protections have been the source of considerable controversy over the past year. The expropriation provisions of Article 11 were the subject of debate during Congressional consideration of the Trade Promotion Authority Act,[218] which provides the president with "fast track" authority to negotiate new trade agreements.[219] Debates over proposed trade agreements such as the Free Trade Area of the Americas have, and undoubtedly will continue to, focus on how investor protection provisions should be refined in light of the experience thus far with NAFTA.[220]

This Article has sought to emphasize that discussions about revisions of the NAFTA investor protection provisions must focus not only on clarifying the definition of expropriation, but also on how any compensation requirement (even one supposedly congruent with U.S. takings law) contained in a trade agreement may affect the allocation of power between federal, state, and local land use and environmental authorities. In negotiations over future trade or investment agreements, the U.S. negotiating team should address, for example, whether awards under the agreement will be paid by the federal government, without contribution, indemnification, or set-off from state and local governments involved in the dispute. The right of state and local governments to participate in the investor state dispute proceedings should be clarified.

218. *See* Elisabeth Bumiller, *Bush Signs Trade Bill, Restoring Broad Presidential Authority*, N.Y. TIMES, Aug. 7, 2002, at A5 (discussing enactment of trade promotion legislation).

219. *See, e.g.*, 148 CONG. REC. S4267 (daily ed. May 13, 2002) (discussing the Baucus amendment to the Trade Promotion Authority Act); 148 CONG. REC. S4503 (daily ed. May 16, 2002) (discussing the failed Kerry Amendment to the Act).

220. *See, e.g.*, *Agencies Mull Regulatory Takings Standards in Investment Disputes*, INSIDE U.S. TRADE, Sept. 20, 2002, at 1, 27; *Administration Proposes Higher Thresholds for Investor Suits*, INSIDE U.S. TRADE, Sept. 27, 2002, at 1, 18. *Foreign Investment: Investment Chapters in Future Trade Accords to Differ From NAFTA, Official Says*, 19 Int'l Trade Rep. (BNA) 987 (June 6, 2002).

The relationship between the dispute resolution process and protections normally accorded to state and local decision-makers in litigation, such as Eleventh Amendment immunity and the finality and exhaustion requirements imposed upon takings claimants,[221] also should be thought through. In short, clarifying investor protection provisions is not just a matter of tinkering with the definition of expropriation. Considerable thought must be given to the implications investment and trade agreements have more generally for the levels of government who bear primary decision-making and financial responsibility roles for environmental and land use regulation.

221. *See* Williamson Co. Reg'l Plan. Comm'n v. Hamilton Bank, 473 U.S. 172 (1985).