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Sovereignty by Subtraction: The Multilateral Agreement on Investment

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Sovereignty by Subtraction: The Multilateral Agreement on Investment

Robert Stumberg*

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Introduction

The proposed Multilateral Agreement on Investment (MAI) represents a major step in the evolution of "sovereignty," which includes the power of a nation-state to govern without external controls.¹ A panelist at the 1998 *Cornell International Law Journal Symposium* introduced the MAI as an example of "multilateral sovereignty" to achieve commonly held goals of global economic integration.² This perspective posits that the MAI is an exercise in sovereignty by subtraction, aiming to limit governing power rather than promote its joint exercise.

1. See WEBSTER'S NEW INTERNATIONAL DICTIONARY OF THE ENGLISH LANGUAGE 2179 (3d ed. 1971).

2. Rainer Geiger, Deputy Director of Financial, Fiscal and Enterprise Affairs, Organisation for Economic Co-operation and Development (OECD), Remarks at the Cornell International Law Journal Symposium, *The International Regulation of Foreign Direct Investment: Obstacles & Evolution*, Cornell Law School (Mar. 6, 1998).

Its critics call the MAI a "slow motion *coup d'état*,"³ a "bill of rights for investors,"⁴ a threat to sovereignty,⁵ and a "corporate rule treaty,"⁶ because it (1) empowers foreign investors to challenge the law-making authority of nation states and subnational governments, (2) is composed of a fifty-page text of fourteen investor-protection standards that exceed the scope of any existing agreement,⁷ (3) and acts through an international forum with the power to award monetary damages against the offending government.⁸ U.S. negotiators counter that the MAI protects foreign investors from discrimination by giving them rights analogous to those they already enjoy under the U.S. Constitution.⁹ In addition, U.S. negotiators maintain that an agreement that poses significant limits on U.S. sovereignty is unacceptable.¹⁰

This Article suggests a more modest analogy than a virtual *coup d'état*. It simply seeks to explain that the MAI would have a greater impact on U.S. law making power than acknowledged by MAI supporters, who claim that it merely repeats domestic principles of non-discrimination. For example, the MAI aims to limit U.S. States' traditional powers to discriminate.

The first objective of this article is truth in advertising: the MAI would disrupt state and local lawmaking capacity. The capacity of cities, counties, and states to serve as our "laboratories of democracy"¹¹ hangs in the balance. States act as successful laboratories for testing future national

3. Lori Wallach & Ralph Nader, *Forward to MAUDE BARLOW & TONY CLARKE, THE THREAT TO AMERICAN FREEDOM* vii (1998).

4. Scott Nova & Michelle Sforza-Roderick, *M.A.I. Culpa*, *THE NATION*, Jan. 13-20, 1997, at 5. The attorney representing an investor in the first NAFTA investment case posits that, "[t]he MAI investment provisions have quietly created a looming economic constitution that protects the rights of foreign MAI investors. . . ." BARRY APPLETON, *MUNICIPALITIES AND THE MAI* 8 (1998).

5. See TONY CLARK & MAUDE BARLOW, *THE MULTILATERAL AGREEMENT ON INVESTMENT AND THE THREAT TO CANADIAN SOVEREIGNTY* 3 (1997).

6. TONY CLARK & MAUDE BARLOW, *THE CORPORATE RULE TREATY* 1 (1977).

7. See Directorate for Financial, Fiscal and Enterprise Affairs, Organisation for Economic Co-operation and Development (OECD), *Multilateral Agreement on Investment: The MAI Negotiating Text* arts. III-IV (last modified Dec. 14, 1998) <<http://www.oecd.org/daf/cm/mai/negtext.htm>> [hereinafter *MAI Negotiating Text*].

8. See *id.* art. V.

9. For example, "[t]he fundamental principle underlying this and other investment agreements is the principle of non-discrimination. Such agreements do not generally call into question the sovereign right of governments to regulate so long as the regulation does not single out or discriminate against investors based on their nationality." *Multilateral Agreement on Investment: Win, Lose or Draw for the U.S.?: Hearing Before the House Subcomm. on Int'l Econ. Policy and Trade, of the Comm. on Int'l Relations*, 104th Cong., available in 1998 WL 110860, USTESTIMONY database, Mar. 5, 1998 (statement of Alan Larson, Assistant Secretary of State for Economic and Business Affairs, U.S. Department of State).

10. See Interview by Derrick McGinty with Amb. Jeffrey Lang, Deputy U.S. Trade Representative, Washington, DC on the DERRICK MCGINTY HOUR (tape transcription at 2) (NPR radio broadcast, Jan. 10, 1997).

11. "It is one of the happy incidents of the federal system that a single courageous State may, if its citizens choose, serve as a laboratory; and try novel social and economic experiments without risk to the rest of the country." *New State Ice Co. v. Liebmann*, 285 U.S. 262, 311 (1932) (Brandeis, J., dissenting).

policy in virtually every sector of governance, including banking regulation, economic development, government purchasing, consumer protection, working conditions, health and medical insurance, and environmental law.¹²

The second objective is to bring some order to the MAI sovereignty debate. Previous writers have brought conceptual order to the comparison of state sovereignty and international law under NAFTA and the WTO agreements.¹³ This article extends the analysis to the MAI to (1) inform the bottom-up view of the MAI from the perspective of those who would lose power if it is implemented, and (2) shape positive policy options to maintain the constitutional balance between federalism and private investor protection.

Synopsis

Part I provides context, summarizing the "sovereignty" trade-offs inherent in the parties' expressed negotiating goals. It then defines sovereignty interests in constitutional terms, addressing, in particular, the balance of state power within the federal system. Part I also summarizes the main features of the MAI and how they may affect constitutional limits on state power. After reviewing the arguments that MAI implementing legislation can preserve state sovereignty or that legal conflicts are not likely to occur, Part I summarizes the elements of the MAI threat to state sovereignty in terms of: (1) expanding the coverage of state and local governments under international agreements; (2) removing investment disputes from U.S.

12. See Sandra Day O'Connor, *Testing Government Action: The Promise of Federalism*, in *ETHICAL VALUES IN CONSTITUTIONAL LAW* 41 (1993); INT'L CTR. OF THE ACADEMY FOR STATE & LOCAL GOVERNMENT AND THE NAT'L COUNCIL FOR URBAN ECON. DEV., *MAI May Jeopardize Local Development Programs*, in *ECONOMIC DEVELOPMENT ABROAD* 1, 6 (Oct. 1997). See generally DAVID OSBORNE, *LABORATORIES OF DEMOCRACY* (1988) (discussing economic development and industrial policy).

13. See John H. Jackson, *The Great 1994 Sovereignty Debate: United States Acceptance and Implementation of the Uruguay Round Results*, 36 COLUM. J. TRANSNAT'L. LAW 157, 188 (1997); Matt Schaefer, *Are Private Remedies in Domestic Courts Essential for International Trade Agreements to Perform Constitutional Functions with Respect to Sub-Federal Governments?*, 17 N.W. J. INT'L L. & BUS. 609 (1996-97); Charles Tiefer, *Free Trade Agreements and the New Federalism*, 7 MINN. J. GLOBAL TRADE 45 (1998).

For other perspectives on the definition and importance of sovereignty interests, see generally CLARK & BARLOW, *supra* note 5; CLARK & BARLOW, *supra* note 6; Steven P. Croley & John H. Jackson, *WTO Dispute Procedures, Standard of Review, and Deference to National Governments*, 90 AM. J. INT'L L. 193 (1996); Claudio Cocuzza & Andrea Forabosco, *Are States Relinquishing their Sovereign Rights? The GATT Dispute Settlement Process in a Globalized Economy*, 4 TUL. J. INT'L & COMP. L. 161 (1996); William J. Aceves, *Lost Sovereignty? The Implications of the Uruguay Round Agreements*, 19 FORDHAM INT'L L.J. 427 (1995); Julie Long, Note, *Ratcheting up Federalism: A Supremacy Clause Analysis of NAFTA and the Uruguay Round Agreements*, 80 MINN. L. REV. 231 (1995); Samuel C. Straight, Note, *GATT and NAFTA: Marrying Effective Dispute Settlement and the Sovereignty of the Fifty States* 45 DUKE L.J. 216 (1995); Earl H. Fry, *Sovereignty & Federalism: U.S. and Canadian Perspectives*, 20 CAN.-U.S. L.J. 303 (1994); *The Uruguay Round GATT Agreement: Hearings Before the Senate Commerce Comm.*, 103d Cong., 201-04 and Annex A (F.C.D.H. Oct. 13, 1994) (testimony of Ralph Nader); Louis Henkin, *The Mythology of Sovereignty*, AM. SOC'Y INT'L L. NEWSL., Mar.-May 1993, at 1.

courts, which maintain a constitutional deference to state interests; (3) constraining the role of the U.S. government as a buffer between states and the international legal system; and (4) shifting power in the legislative process through the economic leverage of investor remedies.

Part II analyzes how the MAI departs from the fundamental values of federalism in the U.S. Constitution. This departure is manifest in the following:

- *Balancing tests* that enable courts to uphold state legislation that protects the environment, public health, and local economic needs, even when the legislation burdens foreign commercial interests. Without a test that balances purpose with effect, the MAI would empower investors to challenge state lawmaking capacity.
- *National Treatment, limits on performance requirements, and General Treatment*, in such areas as: ownership of private land; gambling and casino licenses; traditional or resident fishing rights; local business ownership; franchise encroachment; recycled material markets; packaging requirements; and community reinvestment policy.
- *Compensation for expropriation*, in such areas as: use of wetlands, coastal land, and surface mines; mandates on health service providers; law enforcement through civil penalties; and destruction of property for military or public health purposes.
- *Subsidy exceptions* to rules against discrimination, which enable states to discriminate in favor of state residents when dispensing the largesse of taxpayer-funded resources. Absent this exception, MAI National Treatment and General Treatment would empower foreign investors to challenge subsidy programs that strengthen domestic competitiveness such as: financing incentives; venture capital investments; targeted and customized workforce training; and business recruitment screening criteria.
- *Market participation exceptions* to rules against discrimination, which enable states to enjoy the same freedom as private market actors to do business as a purchaser and seller according to public moral values or the economic self-interest of their residents. Absent this exception, MAI National Treatment, Most-Favored-Nation Treatment and General Treatment would empower foreign investors to challenge market activities that strengthen domestic competitiveness such as: use of public land; domestic procurement preferences; minority procurement preferences; environmental procurement preferences; and selective purchasing that avoids doing business with companies based on human rights, labor rights, or other noneconomic criteria.

Part III addresses whether the United States can shield its sovereignty interests unilaterally by providing exceptions for subsidies, minority affairs, procurement, social services, and other functions that the MAI does not contain. This Part explains the three reasons why this is a difficult task: (1) the high degree of specificity required to effectively take a country-specific exception; (2) the fact that exceptions would become the targets for future “ratcheting” back to MAI compliance through a process

called “standstill and rollback;” and (3) the likelihood that MAI dispute panels would not recognize the application of exceptions that contravene the purpose and objectives of the MAI.

The conclusion responds to the risk of relying on country-specific exceptions by presenting positive options for maintaining the constitutional balance between federalism and private investor protections. The options include:

- *Stronger congressional oversight*, which includes a legal impact statement and disclosure of the real legislative history of the MAI.
- *Implementing legislation*, which includes appropriations and implementing language to limit enforcement of the MAI against states without congressional involvement or approval.
- *Multilateral downsizing of the MAI*, which would reduce the number or scope of investor protections, carve out significant areas of domestic policy, create internal balancing tests with general exceptions, or limit the availability of investor-to-state remedies.

The appendix outlines these options in much greater detail.

I. Overview of the MAI Sovereignty Debate

A. Trade-Offs in the MAI Sovereignty Debate

The MAI negotiations focus on “sovereignty” in terms of national objectives. The countries negotiating the MAI are members of the Organisation for Economic Co-operation and Development (OECD).¹⁴ They are asking each other to give up *government* authority in exchange for *private* investor rights and market access. However, what one country defines as a barrier to market access another country defines as an essential sovereignty interest. This clash of values has placed the MAI on an indefinite work schedule.¹⁵ In addition, the WTO may pursue the MAI agenda as part of its Millennial Round of negotiations. Investment is also part of the work plan for negotiating the Free Trade Area of the Americas.¹⁶

The United States seeks to use the MAI to dissolve subsidies and preferences that prevent U.S. corporations from establishing themselves in the European market. For example, the United States defines European “cultural industry” subsidies as a barrier to market access for Hollywood

14. OECD member nations include: Australia, Austria, Belgium, Canada, Czech Republic, Denmark, Finland, France, Germany, Greece, Hungary, Iceland, Ireland, Italy, Japan, Korea, Luxembourg, Mexico, Netherlands, New Zealand, Norway, Poland, Portugal, Spain, Sweden, Switzerland, Turkey, United Kingdom, and the United States. See OECD, *OECD Member Countries* (last modified Nov. 23, 1998) <<http://www.oecd.org/about/general/member-countries.html>>.

15. See *Multilateral Agreement on Investment: Win, Lose or Draw for the U.S.?*, *supra* note 9 (statement of Alan Larson, Assistant Secretary of State for Economic and Business Affairs, U.S. Department of State).

16. See *Work Program for FTAA Negotiating Groups*, INSIDE U.S. TRADE, July 3, 1998, at 20.

movie and television producers.¹⁷ French-speaking countries defend cultural industries as the epicenter of their language and culture. They maintain that the subsidy is a financing program.¹⁸ Furthermore, the United States desires to limit preferences designed to strengthen regional economies. Most notable is the European Union's system of mutual preferences, which the EU defines as a cornerstone of its emerging federal system.¹⁹

The most visible controversies involve U.S. sanctions on Iran, Libya, Cuba,²⁰ and Burma.²¹ Europeans argue that U.S. sanctions reveal a preference for following international rules only when it suits the United States.²² The United States responds that, like any treaty, the MAI contains inherent limits regarding national interests.²³

Furthermore, the EU wants the MAI to constrain the power of U.S. "subnational" governments and, consequently, to interfere with the complex U.S. federal system.²⁴ Even though federalism is part of America's constitutional balance of power, the U.S. government is willing to compromise. According to U.S. negotiators, if they succeed in providing U.S. inves-

17. See UNITED STATES TRADE REPRESENTATIVE, 1998 NATIONAL TRADE ESTIMATE REPORT ON FOREIGN TRADE BARRIERS 116-17 (1998) (radio and television broadcast quotas by language and national origin).

18. Professor Patrick Julliard, Universite de Paris I (Pantheon-Sorbonne), Remarks at the Cornell International Law Journal Symposium, *The International Regulation of Foreign Direct Investment: Obstacles & Evolution*, Cornell Law School (Mar. 6, 1998).

19. See *Multilateral Agreement on Investment: Win, Lose or Draw for the U.S.?*, *supra* note 9 (statement of Alan Larson, Assistant Secretary of State for Economic and Business Affairs, U.S. Department of State).

20. See, e.g., Paul Blustein & Anne Swardson, *U.S. Vows to Boycott WTO Panel: Move Escalates Fight with European Union Over Cuba Sanctions*, WASH. POST, Feb. 21, 1997, at A1; Paul Blustein & Thomas Lippman, *Trade Clash on Cuba Is Averted: U.S.-Europe Pack Seeks to Ease Helms-Burton*, WASH. POST, Apr. 12, 1997, at A1; Brian J. Welke, Comment, *GATT and NAFTA v. The Helms-Burton Act: Has the United States Violated Multilateral Agreements?*, 4 TULSA J. COMP. & INT'L L. 361, 367 (1997).

21. See generally Memorandum of the European Union in Support of Plaintiff's Motion for Summary Judgement, *National Foreign Trade Council (NFTC) v. Baker*, 26 F. Supp. 2d 287 (D. Mass. 1998) (involving state-level procurement preferences that discriminate against companies that do business in Burma).

22. For example:

In July [1996], the Act [Helms-Burton] achieved what Brussels officials find rare in European Union foreign policy, which was to firmly unite all EU ministers in condemning it as a piece of unnecessary extraterritorial legislation.

....

[Also,] EU governments denounced the U.S. anti-terrorist law (Iran/Libya Act) as unfairly imposing American rules on foreign companies. France vowed quick retaliation if its companies are affected by U.S. sanctions for investing in the two countries.

EU/US: EU Resists US Sanctions Laws on Cuba, Iran and Libya, EUROPEAN REPORT, Sept. 5, 1996, at 1.

23. U.S. officials argued that the WTO had no competence to judge a foreign policy matter under the Helms-Burton law, and thus, the United States would simply not show up at panel proceedings if the EU proceeded with a WTO complaint against the law. See Blustein & Swardson, *supra* note 20, at A1.

24. See EUROPEAN COMMISSION, REPORT ON UNITED STATES BARRIERS TO TRADE AND INVESTMENT—1994, at 55 (Apr. 1994) [hereinafter EU TRADE REPORT—1994]; EUROPEAN COMMISSION, REPORT ON UNITED STATES BARRIERS TO TRADE AND INVESTMENT—1997, at 19-20 (Apr. 1997) [hereinafter EU TRADE REPORT—1997].

tors with "access to substantial new markets, [they] are prepared to bind the states and their subdivisions . . ."25 The United States plans to resolve the MAI standoff, in part, by diminishing subnational powers in exchange for greater market access.

B. Defining Sovereignty as the Balance of Power

Participants in the U.S. sovereignty debate concerning trade and investment agreements use "sovereignty" justifications to fortify their positions on issues, such as economic nationalism,²⁶ unilateral enforcement of fair trade,²⁷ environmental protection,²⁸ and labor standards.²⁹

This article focuses on a more constitutional version of U.S. sovereignty interests, involving the allocation of lawmaking power between the federal government and the states. As John Jackson points out, there are many sovereignty interests involving the allocation of power, such as vertical allocation between national and international decision-makers or horizontal allocation between legislative, executive, and judicial branches of

25. DIRECTORATE FOR FINANCIAL, FISCAL AND ENTERPRISE AFFAIRS, ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT (OECD), MULTILATERAL AGREEMENT ON INVESTMENT (MAI) 3 (Sept. 1997).

26. Pat Buchanan, former Presidential Candidate, stated:

This is the constitution of the United States. The reason the founding fathers went to Philadelphia was because there was chaos in internal and external trade and they gave the Congress of the United States full authority to regulate trade and commerce . . . You [Congress] are supposed to represent us when these deals are brought back by the President. Why don't you tell Clinton, 'negotiate what you want, but we're not giving up our right to amend it.'

. . . .

. . . [I]n 1994, the President came home with a 23,000-page General Agreement on Tariffs and Trade treaty . . . the first 20 pages brought in something brand new — a world trade organization suddenly created a UN of world trade where America lost its veto power and had no weighted voting. Now, if you [Congress] had all the authority to amend, you could have said we will take that big fat treaty, but we're not giving up our sovereignty.

Pat Buchanan, Remarks on CNN CROSSFIRE 5, 10 (Sept. 18, 1997).

27. See *The World Trade Organization (WTO) Dispute Settlement Review Commission Act: Hearing on S.16 Before the Senate Comm. on Fin.*, 103d Cong. 11, 13-16 (1995) (statements of Jerry Junkins, President and CEO of Texas Instruments; Curtis Barnett, Chairman and CEO of Bethlehem Steel Corporation; and George Scalise, Senior Vice President of the National Semiconductor Corporation and Chairperson of the Public Policy Committee, Semiconductor Industry Association).

28. See Letter from 13 environmental organizations to Charlene Barshevsky, U.S. Trade Rep. (Feb. 10, 1998) (The organizations included the Center for International Environmental Law, Community Nutrition Institute, Defenders of Wildlife, Earth Island Institute, Friends of the Earth, Greenpeace, National Audubon Society, National Environmental Trust, National Wildlife Federation, Pacific Environment & Resources Center, Rainforest Action Network, The Sierra Club, and Western Ancient Forest Campaign) (on file with author). See also *All Hail the Multinationals!: The secret trade deal that corporations hope you never hear about*, SIERRA, July-Aug. 1998, at 16-17.

29. See Joint Non-governmental Organizations (NGO) Statement on the Multilateral Agreement on Investment (MAI) to the Organisation for Economic Co-operation and Development (1997) (on file with author). Five hundred organizations and sixty-seven countries endorsed the Joint NGO Statement. See also *The Uruguay Round of GATT*, *supra* note 13, at 208, annex (testimony of Ralph Nader).

government.³⁰ Professor Matt Schaefer anticipated the objectives of the MAI when he wrote that “constraining sub-federal actors in the U.S., Canada and other economically powerful federations may be more important to world welfare than constraining central government action in smaller nations.”³¹ He describes such limits on state-level power as a supranational “constitutional function” that are necessary in the absence of sufficient limitations in the national Constitution.³²

In 1991, a GATT panel ruled that the constitutional allocation of power between the U.S. federal government and states is irrelevant in an international trade dispute.³³ The EU posits that state law creates “market fragmentation”³⁴ in violation of the WTO Agreement on Technical Barriers to Trade.³⁵ In short, while U.S. state sovereignty is only part of a broader framework, it is a central issue in MAI negotiations.

State sovereignty arguments against international agreements are politically popular because many advocates for policy change believe that citizens maintain greater access to subnational and even national governments than they do to international bodies.³⁶ Barriers to access include weakened constituent relationships (e.g., voter accountability); lengthened physical distances; increased structural distances (multiple layers of government); and conflicting jurisdictions, missions, cultures, and values. Critics may dismiss this affinity for defining sovereignty as access to power as politically convenient. Nonetheless, the essential balance underlying U.S. principles of federalism is maintained by advocacy groups that respond to conflicts while protecting individual rights.³⁷

However, the weight of this essential balance has not deterred U.S. negotiators from offering to bind the states so long as U.S. investors receive a *quid pro quo* — access to new markets. Negotiators maintain that they

30. John Jackson sets the tone for this article with his advice to “those who use sovereignty objections against policy proposals to make such objections more concrete and explicit so that they can be better compared to contrasting arguments.” Jackson, *supra* note 13, at 188. Jackson creates a taxonomy of sovereignty issues based upon (1) general implications of accepting substantive treaty norms, (2) institutional decision-making procedures, (3) dispute settlement process, and (4) domestic constitutional or legal traditions. *See id.* at 171-87.

31. Schaefer, *supra* note 13, at 614. Schaefer notes that states like California and New York have economies larger than all but a handful of nations in the world. *See also* Fry, *supra* note 13, at 308-09.

32. *See* Schaefer, *supra* note 13, at 610, 620-21, 651.

33. United States: Measures Affecting Alcoholic Malt Beverages, June 19, 1991, GATT B.I.S.D. (39th Supp.) at 206 (1993) [hereinafter *Alcoholic and Malt Beverages*].

34. EU TRADE REPORT—1994, *supra* note 24, at 9.

35. *See* EU TRADE REPORT—1997, *supra* note 24, at 19, which states:

There are more than 2700 State and municipal authorities in the US which require particular safety certifications for products sold or installed within their jurisdictions. These requirements are not always uniform or consistent with each other, or even transparent. In particular, individual States sometimes set environmental standards going far beyond what is provided for at [the] Federal level. Agricultural and food imports are also often confronted with additional state-level requirements, which may lead to obstacles to trade.

36. *See* Jackson, *supra* note 13, at 171.

37. *See* O'Connor, *supra* note 12, at 39-42.

can trade state sovereignty for market access under the federal treaty power.³⁸

During the WTO debate in 1994, Lawrence Tribe argued before the Senate Commerce Committee that approving NAFTA and the Uruguay Round agreements under the "fast-track" process was a violation of the treaty approval requirements under the Constitution.³⁹ Both houses of Congress approved these agreements upon a simple majority vote despite the Constitutional requirement that the Senate approve a treaty by a two-thirds supermajority.⁴⁰ Tribe argued that the treaty process is designed to protect the sovereignty of U.S. states and the Senate, with two votes per state, is the historical and political body with the constitutional capacity to protect state interests.⁴¹ Bruce Ackerman counters this argument with his theory that, out of sheer dint of multiple deviations from the Treaty Clause, Congress passed through a "constitutional moment" when it effectively amended the Constitution through acceptance of its own practice.⁴²

The import of presenting the MAI to Congress as a treaty goes beyond political considerations concerning which house is most likely to give the MAI favorable attention.⁴³ Providing treaty status to the MAI may strengthen Congress ability to trump the deference it must give state law when it adopts an agreement under the fast-track process. The power to preempt state law under the Treaty Clause is well established.⁴⁴ Thus, a

38. See U.S. CONST. art. II, § 2, cl. 1.

39. See *GATT Implementing Legislation: Hearings on S.2467, Before the U.S. Senate Commerce, Science and Transp. Comm.* 103d Cong. 290-339 (1994) (statements and remarks of Lawrence H. Tribe and Bruce Ackerman) [hereinafter *GATT Implementing Legislation Hearings*].

40. See U.S. CONST. art. II § 2, cl. 1.

41. See *The World Trade Organization and the Treaty Clause: The Constitutional Requirement of Submitting the Uruguay Round of GATT as a Treaty*, Hearing Before the Senate Comm. on Commerce, Science and Transp., 103d Cong. 10, 24-26 (Oct. 18, 1994) (Testimony of Lawrence Tribe).

42. See Bruce Ackerman & David Golov, *Is NAFTA Constitutional?*, 108 HARV. L. REV. 4 (1995).

43. The House now appears to be a more hostile environment for consideration of the MAI than the Senate. As a barometer, the House recently defeated fast-track negotiating authority on September 25, 1998, by a vote of 180 "for" to 243 "against." The bipartisan opposition to fast-track included 71 Republicans who voted "against" and all but 29 Democrats who voted "for." See *Special Report, Bipartisan Opposition Leads to 180-243 House Defeat of Fast Track*, INSIDE U.S. TRADE, Sept. 28, 1998, at 1. Peter Beinart tracked the political support curve for pre-1998 fast-track votes in the House:

The original vote to grant [fast-track authority] was 323 to 36. When the authority expired in 1979, Congress renewed it by a vote of 395 to 7 and, in 1988 the margin was 376 to 45. By 1991 . . . fast track faced its first serious opposition passing by only 40 votes. In 1993, it was renewed again, 295 to 126. The authority expired in 1994 and is probably dead for the rest of the century.

Peter Beinart, *The Nationalist Revolt: Fast Track Is Only the Beginning*, NEW REPUBLIC, Dec. 1, 1997, at 20.

44. See *Missouri v. Holland*, 252 U.S. 416 (1920); *Asakura v. Seattle*, 265 U.S. 332 (1924); *Ware v. Hylton*, 3 U.S. 199 (1769). See also LOUIS HENKIN, *FOREIGN AFFAIRS AND THE UNITED STATES CONSTITUTION* 157 (2d ed. 1996); John H. Jackson, *US Constitutional Law Principles and Foreign Trade Law and Policy*, in *NATIONAL CONSTITUTIONS AND INTERNATIONAL ECONOMIC LAW* 65, 73-78 (Meinhard Hilf & Ernst-Ulrich Petersmann eds., 1993).

treaty may imply a lower standard of accountability than the preemption power under the Commerce Clause or the 14th Amendment. Consequently, the Supreme Court recently required Congress to make a clear statement of its intent to preempt State law.⁴⁵

C. Main Features of the MAI

MAI standards are different than constitutional standards for balancing the interests of private investors with the power of government. The starting point is the MAI definition of "investment," which covers "every kind of asset."⁴⁶ The MAI protects investors and their investments with fourteen substantive investor protections, the most significant of which include the following:⁴⁷

- *National Treatment and Most-Favored-Nation Treatment*⁴⁸ protect foreign investors from treatment that is "less favorable" than treatment of domestic or any other foreign investors. The MAI definition of investment extends the reach of these investor protections beyond current trade agreements to include investments in non-MAI countries.⁴⁹ They are analogous to the dormant commerce clause doctrine that limits the authority of U.S. states to impose burdens on interstate and international commerce.⁵⁰ While analogous, the commerce clause doctrine provides a major exception when states act as market participants, rather than market regulators. Nor does the analogy hold with respect to the balancing test that U.S. courts have developed under the last sixty years of Supreme Court precedent.
- *Limits on performance requirements*⁵¹ under the MAI are analogous to the National Treatment limits, except that discriminatory effect is not at issue. An investor need only prove that prohibited requirements are involved, such as export performance (in all cases) or hiring local residents (unless the investor receives a state subsidy).⁵² The MAI omits

45. See e.g., *Boerne v. Flores*, 521 U.S. 507, 520 (1997) (no preemption of state law under 14th Amendment authority to protect religious freedom); *Wisconsin Public Intervenor v. Mortier*, 501 U.S. 597, 603-08 (1991) (no preemption of state law under commerce clause authority to regulate the field of pesticide use). See also Elena S. Rutrick, *Local Pesticide Regulation Since Wisconsin Public Intervenor v. Mortier*, 20 *Env. Aff.* 65, 68-71 (1993).

46. *MAI Negotiating Text*, *supra* note 7, art. II(2).

47. The MAI includes 2 "relative" and 12 "absolute" provisions that could affect state sovereignty. The relative provisions include National Treatment and Most Favored Nation Treatment. The absolute provisions include Transparency, Temporary Entry, Nationality Requirements, Employment Requirements, Performance Requirements, and Monopolies/State Enterprises. They also include General Treatment, Expropriation, Protection from Strife, Transfers, Information Transfer and Data Processing, and Subrogation. There are a number of others, such as Investment Incentives, which negotiators may defer for later rounds of negotiation or have yet to define.

48. See *MAI Negotiating Text*, *supra* note 7, art. III(National Treatment and Most Favoured Nation Treatment).

49. See *infra* Part II.A, notes 102-07.

50. See *infra* Part II.B.3.

51. See *MAI Negotiating Text*, *supra* note 7, art. III(Performance Requirements)(1).

52. See *infra* Part II.C.1.

significant NAFTA exceptions to promote domestic economic development and trade-related performance requirements.⁵³

- *Expropriation and Compensation*⁵⁴ provisions of the MAI are analogous to Fifth and Fourteenth Amendment limits on taking of property without just compensation. However, the definition and scope of expropriation under the MAI are indeterminate compared to the highly developed body of U.S. law.
- *General Treatment* under the MAI includes a nearly *verbatim* translation of substantive due process limits on state regulation that “impairs” the use or enjoyment of an investment.⁵⁵ This standard is not broader than National Treatment, and it does not require any showing of *de facto* discrimination. The Supreme Court abandoned its own similar doctrine more than 60 years ago.⁵⁶ Moreover, General Treatment provides a foreign investor with “treatment no less favorable than that required by international law.”⁵⁷ As suggested by an OECD Working Group, this language could open the door for investors to use the MAI dispute process to enforce standards set in WTO agreements.⁵⁸

Like the WTO agreements, the MAI would provide enforcement through state-to-state dispute settlement,⁵⁹ but unlike the WTO, the enforcement mechanism under the MAI would provide monetary damages paid by the offending national government.⁶⁰ The major enforcement clout is that the MAI would privatize the dispute settlement process. It would empower investors to protect themselves by seeking monetary damages from any “competent” domestic tribunal or from international arbitration.⁶¹ The applicable law in investor-to-state disputes would be the MAI text and applicable rules of international law, not the horizontal and vertical checks and balances of the Constitution, which have resulted in nuanced balancing tests after 210 years of interpretation by U.S. courts.⁶²

In short, the MAI’s fourteen investor protections, investor-to-state remedies, and international dispute forum could create a system that rivals the

53. See *infra* Part II.C.1, notes 427-31.

54. See *MAI Negotiating Text*, *supra* note 7, art. IV(Expropriation and Compensation)(2).

55. See *id.* art. IV(Investment Protection)(1.2).

56. See *infra* Part II.C.3.

57. *MAI Negotiating Text*, *supra* note 7, art. IV(General Treatment)(1.2).

58. There seems to be agreement that the MAI should in no way [undermine] rights of the contracting parties or the investor contained in other international treaties. However, there is controversy as to what extent such other treaty rights should be incorporated into the MAI because such incorporation may have the consequence that the MAI dispute settlement mechanism would be available with regard to such rights irrespective of whether these other treaties provide for arbitration or not.

WORKING GROUP C, ORGANISATION FOR ECONOMIC CO-OPERATION AND DEVELOPMENT, INVESTMENT PROTECTION, OECD DOCUMENTS: TOWARDS MULTILATERAL INVESTMENT RULES 134, 146 (1996) [hereinafter OECD DOCUMENTS].

59. *MAI Negotiating Text*, *supra* note 7, art. V(State-State Procedures)(C).

60. See *id.* art. V(Proceedings and Awards)(C)(6)(c).

61. See *id.* art. V(Investor-State Procedures)(D)(2).

62. See *id.* art. V(Applicable law)(D)(14)(a).

more deferential U.S. constitutional limits on the lawmaking power of states regarding foreign investment.

D. Sovereignty Preservation Arguments

In terms of state sovereignty, the legal effect of adverse international decisions against non-conforming federal or state law in the United States is not automatic.⁶³ While the complaining nation may seek countermeasures such as trade sanctions (under the WTO)⁶⁴ or monetary damages against the U.S. government (under the MAI),⁶⁵ the U.S. federal government can act as a buffer by seeking a negotiated solution or by choosing to endure the sanction (a tariff increase on U.S. goods or services) rather than change the law. Federal officials used this authority as a key argument to assuage sovereignty concerns regarding the MAI⁶⁶ and the WTO agreements.⁶⁷ The United States has already played the role of buffer and negotiator in response to an EU complaint against a government procurement law in Massachusetts⁶⁸ and in a dispute involving state treasurers and Swiss banks.⁶⁹ In contrast, the MAI empowers private investors to directly sue for monetary damages,⁷⁰ which complicates and reduces the intermediary role for national governments.

While not "automatic," the impact of the MAI on state and local authority could prove significant at the following three stages of the policy-making process: preemption by federal courts, administrative implementation, and legislation.

1. Preemption by Federal Courts

MAI negotiators have offered to protect state sovereignty by denying foreign investors or governments standing to sue states in federal courts. NAFTA⁷¹ and the WTO agreements⁷² utilized this approach. Both imple-

63. See Jackson, *supra* note 13, at 172.

64. See Understanding on Rules and Procedures Governing the Settlement of Disputes art. 22 Apr. 15, 1995, Marrakesh Agreement Establishing the World Trade Organization, ANNEX 2, LEGAL INSTRUMENTS — RESULTS OF THE URUGUAY ROUND vol. 31, 33 I.L.M. 1226 (1994) [hereinafter DSU].

65. See MAI *Negotiating Text*, *supra* note 7, art. V(Disputes Between an Investor and a Contracting Party)(D).

66. For example, Ambassador Jeffrey Lang said that, "... even if we disagree with the results of a [MAI] dispute settlement process, we are free to continue to do what we were doing before. There may be consequences for that, but we're not going to agree to anything that limits our ability to take any action we want, at the state level or at the federal level." MCGINTY, *supra* note 10, at 2.

67. See The World Trade Organization and U.S. Sovereignty Hearings Before the Senate Comm. on Foreign Relations, 103d Cong. 7-8 (June 14, 1994) (testimony by Rufus Yerxa).

68. See Robert Greenberger, *States, Cities Increase Use of Trade Sanctions, Troubling Business Groups and U.S. Partners*, WALL ST. J., Apr. 1, 1998, at A20.

69. See David Sanger, *How a Swiss Bank Gold Deal Eluded a U.S. Mediator*, N.Y. TIMES, July 12, 1998, at A1-6.

70. See MAI *Negotiating Text*, *supra* note 7, art. V(Disputes Between an Investor and a Contracting Party)(D).

71. See 19 U.S.C. § 3312(c) (1993); 19 U.S.C. § 102(c) (1994).

72. See 19 U.S.C. § 102(c) (1994); 19 U.S.C. § 3512(c) (1994).

menting laws provide that only the U.S. federal government has standing to sue states in U.S. courts to enforce the agreements. If applied to the MAI, this limitation would prevent investors from suing in a domestic forum, an option that the MAI explicitly provides.⁷³ By the same token, the U.S. government would have standing to enforce the MAI against states in federal court and need not wait for an adverse ruling by an international arbitration panel.⁷⁴

In this regard, the NAFTA/WTO model places state law in an inferior position to federal law. Namely, "no provision of the Agreement, nor the application of any such provision to any person or circumstance, which is inconsistent with any *law of the United States* shall have effect."⁷⁵ In other words, even if the United States loses a WTO case against a federal law, there are no *domestic* legal grounds to strike down the federal law. Nevertheless, the U.S. government could sue to preempt state law in federal court because of a conflict with NAFTA, WTO agreements, or the MAI.

2. Administrative Implementation

Trade and investment agreements may constrain agency implementation of laws or executive orders. The U.S. Environmental Protection Agency ceased its efforts to implement an executive order that included use of eco-labels to promote procurement of environmentally preferable goods. Inter-agency disputes seemed to cause the EPA's suspension of work on the aforementioned executive order.

3. Legislation

The United States and foreign governments are lobbying against proposed state legislation on the grounds that it conflicts with WTO agreements or NAFTA. Specifically, they argue that proposed state laws risk future trade sanctions.⁷⁶ Corporate lobbyists are fortifying their political clout by arguing that proposed legislation violates trade agreements.⁷⁷

73. See *MAI Negotiating Text*, *supra* note 7, art. V(Means of Settlement)(D)(2)(a) (providing that if a case is not settled, "the investor may choose to submit it for resolution: a. to any competent courts or administrative tribunals of the Contracting Party to the dispute.").

74. Referring to federal action to preempt state law under the WTO agreements, Matt Schaefer observes that: "[w]hile U.S. federal government authority does not depend on the existence of an adverse panel report, political considerations almost certainly make an adverse panel report a precondition to a federal suit." Schaefer, *supra* note 13, at 643-44. The MAI would increase the pressure for pre-panel preemption of states if there is a significant threat of monetary damages: "[s]uch a scenario [the threat of retaliation] would put pressure on the U.S. government to ensure that the state whose measures were held to be inconsistent with NAFTA or WTO commitments changes its laws." *Id.* at 645.

75. 19 U.S.C. § 3312(a) (1993); 19 U.S.C. § 3512(a) (1994); 19 U.S.C. § 102(a) (1994) (emphasis added).

76. See Robert E. Pierre, *Md. Bill Targeting Nigeria Stirs Ire; State Dept. Opposes Sanctions Proposal*, WASH. POST, Mar. 27, 1998, at B1; Fred Hiatt, *Commentary: Foreign Affairs in Annapolis*, WASH. POST, Mar. 30, 1998, at A25.

77. The Illinois Retail Dealers Association successfully lobbied against Illinois legislation that sought to replicate labeling standards based on the model of California Prop-

While one can dismiss the impact of lobbying as merely a political trend of the corporate age, it is a trend with significant legal teeth.⁷⁸ First, lobbying based on international agreements carries the inherent prestige of an international agreement, and it provides a legal rationale for legislators' votes that might well be cast for political reasons. Second, lobbying based on international agreements carries the implied threat of retaliation from another country or preemption by the U.S. federal government, particularly when the message is carried by federal officials. Third, lobbying based on NAFTA Chapter 11 or the MAI is based on the explicit threat of litigation seeking monetary damages, particularly when the message is carried by investors with the legal capacity to file a claim. The first investor claim filed under NAFTA succeeded in convincing Canada to settle for monetary damages and repeal a federal law.⁷⁹

The magnitude of corporate monetary relief may diminish the role of the federal government as a buffer. Moreover, the leverage that the risk of monetary damages may create against the federal government may transform the federal role from neutral buffer into active partisan on behalf of the investor.

In sum, the U.S. negotiators seek to avoid a direct confrontation with the U.S. Constitution by interposing the U.S. government as a buffer. By proposing to block investor standing to use U.S. courts, they can block the "automatic" effect of the MAI on state and local law. Nevertheless, this preemption empowers the federal government at the expense of states. This shift in the balance of power is a meaningful change in state sovereignty.⁸⁰

A second kind of sovereignty protection is to include state law in country-specific exceptions. Using NAFTA as a model, the negotiators propose two kinds of exceptions that relate to states. The first is a blanket excep-

osition 65. They argued that the Uruguay Round Agreements would pre-empt state authority. See 1993 IL H.B. 2181, 88th Gen. Assembly, Reg. Sess. (Ill. 1993-94).

78. See Schaefer, *supra* note 13, at 621 (stating that even non-enforceable rights are worth strengthening because they can be tools of persuasion in the domestic political process).

79. Most prominently, the Ethyl Corporation of Richmond, Virginia lobbied against legislation that banned cross-border transportation of its gasoline additive, MMT, in the Canadian Parliament. Ethyl cited both the NAFTA standards of investor protection in its complaint seeking \$251 million in monetary damages through the investor-state dispute process. Canada settled the case for \$13 million to cover Ethyl expenses, lost profits, and agreed to repeal the law. See *Canada Settles NAFTA Dispute by Lifting Ban on Gasoline Additive*, INSIDE U.S. TRADE, July 24, 1998, at 19; MICHELLE SFORZA & MARK VALIANATOS, PREAMBLE CENTER FOR PUBLIC POLICY, *ETHYL CORPORATION V. GOVERNMENT OF CANADA: CHEMICAL FIRM USES TRADE PACT TO CONTEST ENVIRONMENTAL LAW* (1998).

80. Disturbingly, federal constraints upon state action grow even as states are increasingly acknowledged as innovators in public policy. To revitalize federalism, the three branches of the national government should carefully examine and refrain from enacting proposals that would limit the ability of state legislatures to exercise discretion of basic and traditional functions of state government.

NATIONAL CONFERENCE OF STATE LEGISLATURES, *POLICY ON FEDERALISM 1* (1997) [hereinafter NCSL *POLICY ON FEDERALISM*].

tion for all existing nonconforming state measures. This strategy "grandfathers" only existing law, while constraining future lawmaking capacity. The second exception covers future lawmaking at both the federal and state levels within a few key areas, such as procurement, subsidies, social services, and minority affairs.

The question is to what degree the United States must negotiate limits on the scope or duration of these exceptions. The Europeans, for example, propose taking similar exceptions for the policies that the United States targets as a high priority for the negotiations.⁸¹ To the extent that these exceptions survive the negotiating process, there are several factors that significantly limit their viability. As explained in Part III.C, these factors include (1) the high degree of specificity required to effectively take a country-specific exception; (2) the fact that exceptions would become the targets for future "ratcheting" back to MAI compliance through a process called "standstill and rollback;" and (3) the likelihood that MAI dispute panels would not recognize the application of exceptions that contravene the purpose and objectives of the MAI.

Finally, a third kind of sovereignty protection, the option to withdraw, was prominently discussed in the WTO sovereignty debate.⁸² However, the option to withdraw is notably diminished by the MAI. The United States may withdraw from the WTO after giving six months notice.⁸³ While this may not be a practical option, it makes Congressional oversight a more significant concern for dispute resolution panels that might otherwise interpret vague MAI terms against U.S. sovereignty interests.⁸⁴ In comparison, the MAI would require nations to wait at least five years from the date the MAI enters into force before they could give a six-month notice to withdraw, but the MAI would continue to apply for fifteen years to any investment that exists at the time of notice.⁸⁵ It may take less time to amend the U.S. Constitution than to withdraw from the MAI.

E. Likelihood of Conflict Arguments

1. Trade Is Not Investment

There are two other arguments that relate to the likelihood of MAI/state law conflict other than sovereignty defenses. The first is a legal argument that many of the state laws cited below should be challenged under NAFTA

81. See *Foreign Investment: Environmental Discussions Top Agenda of OECD Investment Treaty Negotiations*, Int'l Trade Rep. (BNA) 1918, 1919-20 (Nov. 5, 1997).

82. See *The World Trade Organization (WTO) Dispute Settlement Review Commission Act*, *supra* note 27, at 11-20 (statements of Amb. Alan Wolff, former General Counsel and Deputy United States Trade Representative; and Amb. Alan Holmer, former Deputy United States Trade Representative). See also Jackson, *supra* note 13, at 172.

83. See Agreement Establishing the World Trade Organization, Apr. 15, 1994, art. XV(2), 33 I.L.M. 1125 [hereinafter WTO Agreement].

84. See Jackson, *supra* note 13, at 186 (discussion of proposal by Sen. Dole to create a WTO Dispute Settlement Review Commission); see also *A Bill to Establish a Commission to Review the Dispute Settlement Reports of the World Trade Organization and for Other Purposes*, S. 16, 104th Cong. (1995).

85. See *MAI Negotiating Text*, *supra* note 7, art. XII(Final Provisions).

or WTO trade agreements rather than under an investment agreement. However, the jurisdictions of trade and investment agreements are not mutually exclusive. For example, Canada failed in its attempt to dismiss the NAFTA investment complaint of the Ethyl Corporation on jurisdictional grounds. The case involved a challenge against a Canadian law that banned the inter-provincial transport of a gasoline additive.⁸⁶ Canada argued that the trade measure was not appropriate for investor-to-state dispute resolution. After the NAFTA panel rejected this argument, the Canadian government promptly settled the case for \$13 million in damages and a commitment to repeal the federal law.⁸⁷

The issue regarding the laws cited in Part II is not whether they could be attacked under a trade agreement, but whether they are also vulnerable to challenges under the MAI because an investor can prove damages to an investment.⁸⁸

2. *History of Investment Disputes*

Advocates of the MAI argue that the MAI is not likely to threaten state lawmaking powers because NAFTA and bilateral investment agreements (BITs) include many MAI provisions, and in the history of NAFTA and BITs, no one has challenged U.S. law.⁸⁹ There are two errors in this argument. First, as a matter of economics, the United States has negotiated its BITs to protect U.S. investors in developing countries, which are unlikely to have investors with investments in the United States on any meaningful scale. As for NAFTA Chapter 11, the first case was only recently settled in favor of the investor. Not surprisingly, the attorney representing the investor in that case believes that the success of his strategy will set a precedent that other trade lawyers will follow.⁹⁰ Shortly after the Ethyl settlement was announced, another major NAFTA complaint was filed against Canada, this one involving regulation of hazardous waste.⁹¹

NAFTA and the BITs do not equate with the MAI. The MAI contains much broader investor protections. For example, even though NAFTA Chapter 11 is the model for the MAI, the MAI adds a sweeping new

86. The Ethyl complaint was based on three investor protections in Chapter 11: (1) national treatment; (2) performance requirements; and (3) expropriation. See *Proposed Canadian Ban of Gas Additive Violates NAFTA, Says US-Based Ethyl Corp.*, Int'l Trade Rep. (BNA) 1409 (Sept. 11, 1996).

87. See *Canada Settles NAFTA Dispute by Lifting Ban on Gasoline Additive*, Inside U.S. Trade, July 24, 1998, at 19. The NAFTA complaint by the Ethyl Corporation of Richmond, Virginia sought \$251 million in damages. See Neville Nankivell, *Ottawa May Live to Regret Decision to Ram Through Law on MMT*, FIN. POST, July 11, 1998, at 17; SFORZA & VALLIANATOS, *supra* note 79, at 1.

88. See *MAI Negotiating Text*, *supra* note 7, art. II(Scope and Application)(2).

89. See *Multilateral Agreement on Investment, Win, Lose, or Draw for the U.S.?*, *supra* note 9 (statement of Alan Larson, Assistant Secretary of State for Economic and Business Affairs, U.S. Department of State).

90. See *Ethyl Corp. files NAFTA claim over passage of MMT legislation*, Daily Envtl. Rep. (BNA) 2 (Apr. 16, 1997).

91. The U.S. company, S.D. Meyers, is seeking \$10 million from Canada for its ban on the export of PCB waste between 1995 and 1997. See *Company to Sue Canada Over Alleged Breach of NAFTA Rules*, INSIDE U.S. TRADE, Sept. 4, 1998, at 9.

“impairment of use” provision to the NAFTA scope of General Treatment.⁹² Unlike the MAI, neither NAFTA Chapter 11 nor the WTO Agreement on Government Procurement cover local government. The BITs have a much more limited scope for application of National Treatment and MFN Treatment.⁹³ The scope of the MAI contracting parties, definition of investment, and investor protections is unique in legal history.

F. Gears of the Power Shift

The shift in the balance of power in the federal system directly effects the capacity of the federal government to preempt state law that conflicts with MAI investor protections. While this is certainly possible, it is the least likely scenario for how the MAI could constrain state lawmaking powers. To summarize the foregoing review, the MAI is most likely to affect state sovereignty at the following four levels, all of which are explained in Part II:

- *International law.* The MAI significantly expands the coverage of state and local governments under existing international agreements.⁹⁴ For example, it would expand investor protections under NAFTA to cover local government and procurement, and it would expand NAFTA General Treatment to include protection from “impairment” of use or enjoyment of an investment.
- *Dispute settlement and constitutional law.* The MAI would take investment disputes out of U.S. courts, which constitutionally defer to state interests.
- *Buffering role of the U.S. government.* The MAI’s investor-to-state remedies would short-circuit the state-to-state buffering role of the U.S. government to restrain a complaint against state law for political or policy reasons.⁹⁵ The threat of MAI monetary damages would also create a much more direct fiscal disincentive as compared with WTO trade sanctions.⁹⁶
- *Power-shift in the legislative process.* MAI investor protections would further empower the lobbying clout of multinational corporations in the federal, state, and local legislative process. Not only could foreign inves-

92. See *MAI Negotiating Text*, *supra* note 7, art. IV(General Treatment)(1.2).

93. For example, U.S. BITs do not apply National Treatment to air transportation, ocean and coastal shipping, banking, insurance, government grants, government insurance and loan programs, energy and power production, custom house brokers, ownership of real property, ownership and operation of broadcast or common carrier radio and television stations, ownership of shares in the Communications Satellite Corporation, common carrier telephone and telegraph services, submarine cable services, use of land and natural resources, mining on the public domain, primary dealership in U.S. government securities, and maritime or maritime-related services. Nor do U.S. BITs apply MFN Treatment to mining on the public domain maritime or maritime-related services, primary dealership in U.S. government securities, and ownership of real property. See, e.g., Annex to the Russian Federation-United States Treaty Concerning the Encouragement and Reciprocal Protection of Investment, 31 I.L.M. 794 (June 17, 1992); Protocol to United States-Argentina Treaty Concerning the Reciprocal Encouragement and Protection of Investment, 31 I.L.M. 124 (Nov. 14, 1991).

94. See *infra* Parts II.A., II.B., and II.C.

95. See Schaefer, *supra* note 13, at 627.

96. See Parts I.D and II.C.

tors claim that laws inconsistent with the MAI violate international standards, they could threaten to seek damages under the MAI and cite the taxpayer burden that the new remedies would create. The magnitude of this threat could also induce the federal government to lobby against state legislation.⁹⁷

II. The MAI vs. the Current Balance of State/Federal Powers

Some MAI investor protections are analogous to constitutional provisions against discrimination. In particular, two MAI "relative" treatment provisions are analogous to the dormant commerce clause of the Constitution. The analogy, however, does not convey at least four major differences between the MAI and U.S. constitutional norms.

- *Relative provisions.* First, the MAI discrimination provisions (National Treatment and Most-Favored-Nation Treatment) do not contain the sovereignty exceptions and balancing tests that the Supreme Court has articulated under the U.S. Constitution.
- *Absolute provisions.* Second, the MAI would create "absolute" investor protections (such as General Treatment and limits on performance requirements) that go far beyond the "relative" investor protections against discrimination.
- *Indeterminate language.* Third, the most important investor protections of the MAI are expressed in vague, indeterminate language. For example, some commentators have described the MFN language (where it appears in WTO agreements) as "political theatre"⁹⁸ and an "oratory wish list."⁹⁹ The MAI empowers dispute panels to interpret such broad language. While U.S. constitutional norms are also broad, the Supreme Court has interpreted them over the past 210 years into a highly nuanced system of precedent.
- *Judicial deference to legislative purposes.* Fourth, U.S. constitutional norms are interpreted within a legal framework that separates power vertically (federal/state) and horizontally (judicial/legislative/executive). Except for some types of discrimination, courts will give substantial deference to legislative purposes through balancing economic and non-economic interests. MAI panels would likely apply MAI provisions with a singular purpose of investor protection.

This part of the Article summarizes (1) selected MAI provisions; (2) the most likely areas of potential conflict with state or local law; (3) the sovereignty issues raised by that conflict; and (4) the significance of proposed MAI provisions for mitigating the subtraction of state sovereignty. The purpose of this analysis is not to endorse the wisdom or timeliness of the state law examples. Rather, it is to illustrate how the MAI could create

97. See Part II.C.

98. Robert E. Hudec, *International Economic Law: The Political Theatre Dimension*, 17 U. PA. J. INT'L ECON. L. 9 (1996).

99. Yong K. Kim, *The Beginnings of the Rule of Law in the International Trade System Despite U.S. Constitutional Constraints*, 17 MICH. J. INT'L L. 967, 1006-07 (1996).

legal standards for lawmaking that would rival constitutional standards and change the balance of power in the U.S. federal system.

A. National Treatment

1. MAI Provisions

The MAI would require Contracting Parties to give investors from another MAI country “no less favorable” treatment in a range of investment activities. Treatment of another MAI investor must be “no less favorable than the treatment it accords [in like circumstances] to its own investors and their investments with respect to the establishment, acquisition, expansion, operation, management, maintenance, use, enjoyment and sale or other disposition of investments.”¹⁰⁰ The MAI forbids not only explicit discrimination, but also discrimination in effect (“*de facto*” discrimination).¹⁰¹ MAI negotiators have not decided whether National Treatment requires subfederal jurisdictions to treat foreign investors at least as favorably as in-state or out-of-state investors.¹⁰²

In addition to “no less favorable” treatment, the MAI provides a General Treatment requirement that, “[i]n no case shall a Contracting Party accord treatment less favourable than that required by international law.”¹⁰³ This means that courts and policymakers should interpret MAI National Treatment by using the National Treatment text and panel decisions under other international agreements such as GATT, NAFTA, WTO agreements and perhaps European Community law where relevant.¹⁰⁴

100. *MAI Negotiating Text*, *supra* note 7, art. III(Treatment of Investors and Investments)(1). The “[in like circumstances]” language is not part of the consensus text.

101. See OECD, *The Multilateral Agreement on Investment: Commentary to the MAI Negotiations Text* (last modified Dec. 14, 1998) <<http://www.oecd.org/daf/cmisis/negtext.htm>> [hereinafter *MAI Commentary*].

102. Two alternatives exist. First, a state could treat a foreign investor at least as favorably as it would treat an U.S. investor from another state. Alternatively, the state could treat the foreign investor at least as favorably as it would treat investors from that same state. See *id.* art. III, ¶ 7. A proposal from one OECD country would resolve this question in favor of “in-state” treatment:

1.4 If a subfederal entity of a Contracting Party accords to its own investors and their investments treatment more favourable than to investors and investments of other sub-federal entities of the same Contracting Party it shall in accordance with paragraphs 1 to 3 extend the more favourable treatment to investors of other Contracting Parties and to their investments.

MAI Negotiating Text, *supra* note 7, Annex 1. Even if negotiators do not address the question of favorable investor treatment in subfederal jurisdictions, such “in-state” treatment is likely to result if MAI panels follow previous GATT panels that dealt with subfederal measures. See *Alcoholic and Malt Beverages*, *supra* note 33, at 274.

103. *MAI Negotiating Text*, *supra* note 7, art. IV(Investment Protection)(1). General Treatment is discussed in greater detail in Part II.C, *infra*.

104. In the recent *Shrimp/Turtle* case before a WTO dispute panel, the United States argued for the broadest possible scope of “customary international law.” Countries challenging U.S. law argued the scope should include only international agreements ratified by all parties in the dispute. The United States argued that the scope of “customary international law” should also include “international conventions; international custom, as evidence of a general practice accepted as law; general principles of law recognized by nations; judicial decisions; and scholarly writings.” WTO Secretariat, *United States: Import Prohibition of Shrimp and Certain Shrimp Products*, WT/DS58/R, at

Interpretation using international law expands the following standards of National Treatment:

- “*Investors and their investments*” - *definition and location*. The MAI applies National Treatment to “every kind of asset,” ranging from ownership shares in an enterprise to concessions and revenue-sharing contracts.¹⁰⁵ An investor¹⁰⁶ is also entitled to National Treatment even if his investment is located outside the country or state allegedly not providing National Treatment.¹⁰⁷ This expands the National Treatment doctrine in trade agreements.
- “*No less favorable*” – *investor benefits*. MAI negotiators rejected a proposal to provide the “same” or “comparable” National Treatment in favor of “no less favorable” treatment. The rationale for the “comparable” standard was “to prevent unlimited competition for international investment funds with consequential costs and distortions of investment flows.”¹⁰⁸ However, most delegations to the MAI considered that a “comparable” standard would unacceptably weaken the standard of treatment from the investor’s viewpoint.¹⁰⁹ Investor protection appears as the MAI objective, although this protection distorts the free flow of investment capital at taxpayer expense.
- “*No less favorable*” - *explicit discrimination*. GATT panels have ruled that parties cannot use the defense that an explicitly discriminatory practice is minimal in its effect.¹¹⁰
- “*No less favorable*” - *effects test*. GATT Panels have interpreted the GATT National Treatment language¹¹¹ to require an effects test,¹¹² to determine whether domestic laws violate National Treatment by creating a

99 (May 15, 1998) [hereinafter *Shrimp Report*] (citing the United States as quoting article 38(1) of the Statute of the International Court of Justice).

105. The MAI defines “investment” as “every kind of asset owned or controlled, directly or indirectly, by an investor,” including an enterprise, ownership shares or stocks, contract rights and property rights such as leases. *MAI Negotiating Text, supra* note 7, art. II(Scope and Applications)(2).

106. The MAI defines “investor” as (i) a “natural person having the nationality of, or who is permanently residing in, a Contracting Party . . .” and (ii) “a legal person or any other entity constituted or organized under the applicable law of a Contracting Party, whether or not for profit, whether private or government owned or controlled, and includes a corporation, trust, partnership, sole proprietorship, joint venture, association or organisation.” *Id.* art. II(Scope and Applications)(1).

107. See *MAI Commentary, supra* note 101, art. III(Treatment)(2). Compare *MAI Negotiating Text, supra* note 7, art. III(National Treatment)(1) (prescribing no territorial limit) with *MAI Negotiating Text, supra* note 7, art. III(Performance Requirements)(1), and *MAI Negotiating Text, supra* note 7, art. IV(General Treatment)(1) (both limited investments “in its [the Contracting Party’s] territory”).

108. *MAI Commentary, supra* note 101, art. III(Privatization), ¶ 3.

109. *Id.*

110. See *Alcoholic and Malt Beverages, supra* note 33, at 270-71. See also *United States: Taxes on Petroleum & Certain Imported Substances*, June 17, 1987, GATT B.I.S.D. (34th Supp.) at 156 (1988) (stating “the impact of a measure inconsistent with the General Agreement is not relevant for a determination of nullification or impairment by the Contracting Parties”).

111. GATT states that imported products “shall be accorded treatment no less favourable than that accorded to like products of national origin in respect of all laws, regulations and requirements” affecting their internal sale. General Agreement on Tariffs and

risk of discrimination.¹¹³ The General Agreement on Trade in Services (GATS) also creates an explicit effects test, providing that, “[f]ormally identical or formally different treatment shall be considered to be less favourable if it modifies the conditions of competition in favor of services or service suppliers of the Member compared to like services or service suppliers of any other Member.”¹¹⁴

- “*In like circumstances*” - *basis of comparison*. MAI negotiators have yet to decide whether to include or exclude the phrase “in like circumstances.” The arguments on either side are similar. The main dispute concerns whether the MAI text should explicitly recognize exceptions allowing *de facto* discrimination.¹¹⁵ However, interpretation under the relevant international law makes the presence of the phrase in “like circumstances” inconsequential. For subnational measures, NAFTA uses the similar phrase, “like product,” in connection with the terms “directly competitive or substitutable.”¹¹⁶ The use of the term “like product” would not support many non-market based classifications to distinguish investors. For example, the United States tried to defend a Minnesota tax benefit for microbreweries that Canada challenged as a violation of National Treatment under GATT. The panel agreed with Canada that classification of companies on the basis of size is not a relevant basis of comparison for taxation of beer. Microbeer competes with macrobeer, or as the panel put it, “beer is beer.”¹¹⁷ Nor was it relevant that the tax treated companies the same, regardless of nationality. The fact that Canadian companies selling beer in Minnesota were large firms meant that the state law was a *de facto* violation of National

Trade, Oct. 30, 1947, 61 Stat. A-11, T.I.A.S. 1700, 55 U.N.T.S. 194 at III.4 [hereinafter GATT].

112. See Japan: Customs Duties, Taxes & Labeling Practices on Imported Wines & Alcoholic Beverages, Nov. 10, 1987, GATT B.I.S.D. (37th Supp.) at 119 (1988).

113. See EEC: Payments & Subsidies Paid to Processors & Producers of Oilseeds & Related Animal-Feed Proteins, Jan. 25, 1990, GATT B.I.S.D. (35th Supp.) at 125 (1991).

114. General Agreement on Trade and Services (GATS), Apr. 15, 1994, Marrakesh Agreement Establishing the World Trade Organization, Annex 1B, The Results of the Uruguay Round of Multilateral Trade Negotiations, the Legal Texts 325 (GATT Secretariat 1994), 33 I.L.M. 1167 (1994) [hereinafter GATS].

115. The argument for *not including* the phrase is that: “National treatment and MFN treatment are comparative terms. They permit fair and equitable difference in treatment justified by relevant differences of circumstances. In this context, nationality is not relevant.” The argument for including the phrase is that:

[g]overnments may have legitimate policy reasons to accord differential treatment to different types of investments.

In like circumstances’ ensures that comparisons are made between investors and investments on the basis of characteristics that are relevant for the purposes of the comparison. The objective is to permit the consideration of all relevant circumstances, including those relating to a foreign investor and its investment, in deciding to which domestic or third country investors and investments they should appropriately be compared, while excluding from consideration those characteristics that are not germane to such a comparison.

MAI Commentary, *supra* note 101, art. III, ¶ 6.

116. North American Free Trade Agreement, Dec. 17, 1992, Can.-Mex.-U.S., art. 301, 32 I.L.M. 296-456, § 605-800 [hereinafter NAFTA].

117. Alcoholic and Malt Beverages, *supra* note 33, at 297.

Treatment.¹¹⁸

In sum, National Treatment under the MAI protects investors from explicit discrimination, regardless of the purpose or economic significance of the discriminatory measure. Even if a measure is not discriminatory on its face, the MAI protects investors from treatment that places them at a competitive disadvantage. The MAI may tolerate some "relevant" differences of treatment, but the MAI not has defined policy objectives to determine relevancy.

2. *Potential for Conflict*

The following categories of state law are likely to violate National Treatment under the MAI. The categories are drawn from a broader survey conducted in early 1997.¹¹⁹ The examples begin with the most explicit forms of discrimination and then move on to laws that might place foreign investors at a competitive disadvantage. For reasons discussed below in subpart III.A.3, those regulatory statutes that discriminate on the basis of citizenship would probably not survive a constitutional challenge. The more interesting state sovereignty questions arise regarding market participation (procurement and use of state-owned land) and laws that may create *de facto* disadvantages for foreign investors because of constitutionally permissible environmental or social objectives.

— *Ownership of private assets.* At least nineteen states restrict in some way the ownership of private assets, including real estate, the use of public lands, and business licenses based on residency or citizenship. In two states (Nebraska and Oklahoma), the restrictions are based in the state constitution.¹²⁰ Eight states (Iowa, Kentucky, Minnesota, Mississippi, Nebraska, North Dakota, Pennsylvania, and Wisconsin)¹²¹ limit ownership of land by nonresident foreign citizens. Six states (Colorado, Indiana, Missouri, Nebraska, Oklahoma, and South Dakota)¹²² limit foreign ownership of land without reference to residency. Other limits on foreign ownership include sale of state land (Arizona, Colorado, Montana, and Oregon),¹²³ mining claims (Nevada),¹²⁴ water rights (Oregon),¹²⁵

118. See *id.* at 296.

119. For the full survey, see WESTERN GOVERNORS' ASS'N, MULTILATERAL AGREEMENT ON INVESTMENT: POTENTIAL EFFECTS ON STATE & LOCAL GOVERNMENT (1997) [hereinafter WESTERN GOVERNORS' REPORT].

120. See NEB. CONST. of 1875 art. I, § 25 (1920); OKL. CONST. art. XXII, § 1 (1981). See also WESTERN GOVERNORS' REPORT, *supra* note 119, at 10.

121. See IOWA CODE ANN. § 567.3(1) (West 1995); KY. REV. STAT. ANN. § 381.300 (Banks-Baldwin 1996); MINN. STAT. ANN. § 500.221 (West 1966); MISS. CODE ANN. § 89-1-23 (1995); NEB. REV. STAT. ANN. §§ 76-408 to 409 (Michie 1995); N.D. CENT. CODE § 47-10.1-02 (1995); 68 PA. CONS. STAT. ANN. §§ 41, 43, 44, and 46 (West 1996); WIS. STAT. ANN. § 710.02 (West 1995).

122. See COLO. REV. STAT. § 36-1-124 (1990); IND. CODE ANN. § 32-1-8-2 (Michie 1966); MO. REV. STAT. § 442.571 (West 1995); NEB. REV. STAT. §§ 76-402 to 406 (1995); OKLA. STAT. tit. 60, §§ 121-124 (1995); S.D. CODIFIED LAWS ANN. §§ 43-2A-2 to 43-2A-7 (Michie 1997).

123. See ARIZ. REV. STAT. ANN. §§ 37-610 (West 1995); COLO. REV. STAT. § 36-1-124 (1990); MONT. CODE ANN. §§ 77-2-306, 77-2-334 (1975); OR. REV. STAT. § 273.255 (1995).

- and public utilities (Alaska and Hawaii).¹²⁶
- *Use of public land.* Nine states restrict use of public land according to residency or citizenship. These restrictions include permits for mineral extraction (Alaska, Montana, and Wyoming),¹²⁷ oil or gas extraction (Arizona),¹²⁸ logging (Arizona, Idaho, and Oregon),¹²⁹ and preferences to adjoining property owners for leasing state land (Oregon and Wyoming).¹³⁰
 - *Limits on gambling and casino licenses.* At least eight states limit gambling and related interests on the basis of residency. Alaska,¹³¹ North Dakota,¹³² Oregon,¹³³ Nebraska,¹³⁴ and South Dakota¹³⁵ limit gambling licenses to state residents or require an in-state preference for amusement or gambling concessions and services. These laws could affect a range of business owners from the corner pub to large hotels and riverboat casinos. Texas¹³⁶ and Wisconsin¹³⁷ make state residence a requirement to own a racetrack where pari-mutual wagering is conducted. North Dakota requires corporations with an ownership interest in a race horse to have a place of business within the state.¹³⁸
 - *Preferences for traditional and resident fishing rights.* A number of states explicitly discriminate in favor of state residents in the allocation of commercial fishing rights in coastal waters. These policies include significantly higher fees for nonresidents (Alaska, California, and Oregon)¹³⁹ and limits on permits for cultivating oysters (Maryland)¹⁴⁰ and harvesting lobsters (Massachusetts).¹⁴¹ Other states set limits that do not explicitly discriminate, but create *de facto* conservation limits on

124. See NEV. REV. STAT. § 517.010 (1995).

125. See OR. REV. STAT. §§ 543.050, 543.260 (1995).

126. See ALASKA STAT. § 42.20.010 (Michie 1995); HAW. REV. STAT. ANN. § 269-17.5 (Michie 1995).

127. See ALASKA STAT. §§ 38.05.045, 38.05.135, 38.05.140, 38.05.185, 38.05.190 (Michie 1995); MONT. CODE ANN. § 77-3-305A (1975); WYO. STAT. §§ 36-3-102(b), 36-6-101(a) - 36-6-101(c) (1995); State of Wyoming Board of Land Commissioners and Wyoming Farm Loan Board Rules and Regulations Governing Leasing of Sub-Surface Resources, Ch. 6, §§ 5, 13(b) (effective Mar. 1, 1982), Ch. 7, §§ 3(c), 7.

128. See ARIZ. CODE ADMIN. 12-5-503, 12-5-515, 12-5-705B, 12-5-801(c), 12-5-1101(1), 12-5-2102 (1994); ARIZ. REV. STAT. § 37-291(A) (Michie 1997).

129. See ARIZ. ADMIN. CODE 12-5-1001 (1994); ARIZ. REV. STAT. § 37-291(A) (West 1997); IDAHO CODE § 58-1004 (1995); OR. CONST. art. VIII, § 7 (1995).

130. See OR. REV. STAT. § 273.825 (1995); WYO. STAT. ANN. § 36-5-105(a) (Michie 1996).

131. See ALASKA STAT. § 43.35.030 (Michie 1995).

132. See N.D. ADMIN. CODE § 99-01-20-03, 05 (1995).

133. See OR. REV. STAT. § 461.215 (1995).

134. See NEB. REV. STAT. § 9-614 (1995).

135. See S.D. CODIFIED LAWS ANN. §§ 42-7A-43 and 42-7B-25 (Michie 1995).

136. See TEX. REV. CIV. STAT. ANN. art. 179e, § 6.06(a)(12),(b),(d) (West 1998); 16 TEX. ADMIN. CODE § 301.1 through § 305.102 (West 1995).

137. See WIS. STAT. ANN. § 562.05(3)(w)(a) (West 1995).

138. See N.D. ADMIN. CODE § 69.5-01-05-16(1) (1995).

139. See ALASKA STAT. § 16.43.160(b) (Michie 1996); CAL. FISH & GAME CODE § 7852(a) and (c) (West 1998); OR. REV. STAT. § 508.285 (1995).

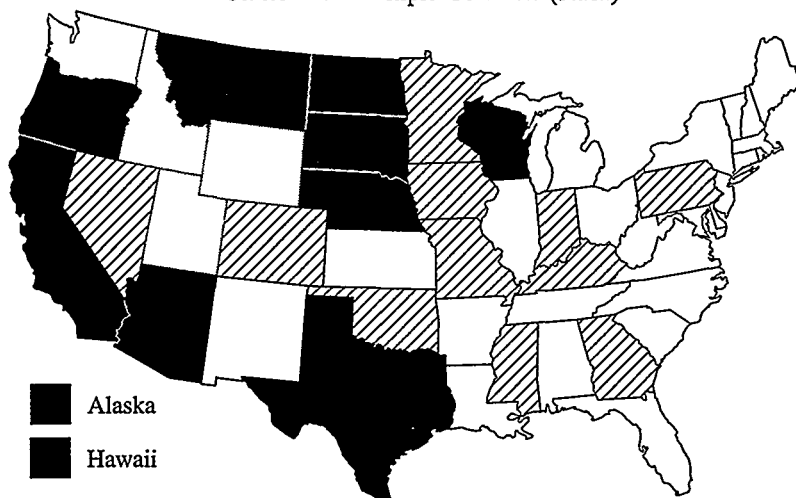
140. See MD. CODE ANN., NAT. RES. §§ 4-11A-09, 4-11A-05 (1990).

141. See MASS. ANN. LAWS ch. 130, § 38 (Law. Co-op. 1989).

commercial fishing licenses based on size of the fleet (California)¹⁴² and priority for traditional fishing families when stocks are depleted (Washington).¹⁴³ These limits would clearly tend to limit access by foreign fishing fleets.

Examples of National Treatment Conflicts:

- 19 States with Limits on Ownership of Private Land (*striped - this limit only*)
- 9 States with Limits on Sale or Use of State Land (*triangles - this limit only*)
- 8 States with Limits on Fishing Rights (*grey checker - this limit only*)
- 8 States with Limits on Gambling/Casino Licenses (*black - multiple*)
- 10 States with Multiple Conflicts (*black*)



- *Protection of local business ownership.* A number of states have laws that protect local ownership of businesses. Maryland,¹⁴⁴ Florida,¹⁴⁵ and New Hampshire¹⁴⁶ forbid petroleum refiners from owning more than a maximum percentage (e.g., five percent) of the service stations in the state. All of these laws have been tested and upheld by federal courts.¹⁴⁷ Minnesota forbids out-of-state bank holding companies from acquiring more than a thirty percent market share of retail commercial banks within the state.¹⁴⁸
- *Franchise encroachment.* Several states may adversely affect the rights of foreign franchisors or franchisees to purchase, sell, or control ownership interests by increasing bargaining power of local franchisees. Iowa requires a franchisor that wants to open a franchise near an existing one to give the existing businesses a prior right to either buy the proposed

142. See CAL. FISH & GAME CODE § 8230(b)(4) (West 1998).

143. See WASH. REV. CODE ANN. § 75.28.720 (West 1997).

144. See MD. CODE ANN. art. 56, § 157E (1992).

145. See FLA. STAT. ch. 526.151(1) (West 1991).

146. See N.H. REV. STAT. ANN. §§ 339-C:1 and 339-C:21 (1995).

147. See *Maryland v. Exxon*, 437 U.S. 117 (1978); *State ex rel. Gas Kwick v. Donner*, 453 So. 2d 863 (Fla. Dist. Ct. App. 1984); *Opinion of the Justices*, 117 N.H. 533 (1977).

148. See MINN. STAT. § 48.61 (1996).

outlet or receive compensation for diverted market share.¹⁴⁹ Massachusetts empowers an existing franchisee to ask a state court to enjoin a new franchise on the grounds that the new franchise is unwarranted given anticipated market conditions, endangers the permanent investments of the existing franchisee, or fails to increase competition to the benefit of the public.¹⁵⁰

- *Recycled material markets.* Private and public sectors promote recycled-content markets through procurement strategies. Thirteen states use private market regulation or tax benefits to promote a market for recycled newsprint, glass, or plastic.¹⁵¹ Twenty-nine states use public procurement preferences to do the same.¹⁵² California,¹⁵³ Oregon,¹⁵⁴ and Connecticut¹⁵⁵ are leaders among the eight states that mandate a minimum percentage of recycled content in newsprint. California¹⁵⁶ and Wisconsin¹⁵⁷ are among the states that mandate a minimum percentage of recycled content in glass or plastic containers. From the perspective of foreign firms, the minimum recycled-content requirements for newsprint and containers represent the most problematic laws. If a foreign producer of newsprint or beer bottles, for example, does not have efficient access to the recycled content, it is placed at a comparative disadvantage in gaining access to that market. There is little doubt that these laws are effective in influencing investment decisions. In 1989, there was one Canadian paper mill that could process recycled paper; today there are twenty-three.¹⁵⁸ Other Canadian companies have shifted their capital investments for production into the United States, prompting a company executive to complain that “[r]ecycled-content laws have single-handedly changed the economics of location of the industry.”¹⁵⁹ Canada officially cites state recycled content laws as a

149. See IOWA CODE §523H.6(1) (1995); see *Holiday Inns Franchising v. Branstad*, 537 N.S. 2d 724 (Iowa 1995).

150. See MASS. GEN. LAWS CH. 93B, § 4(3)(1) (1995). See also *Heritage Jeep-Eagle v. Chrysler Corp.*, 655 N.E. 2d 140 (1995).

151. The 13 states include Arizona, California, Connecticut, Florida, Illinois, Maryland, Michigan, Missouri, North Carolina, Oregon, Texas, West Virginia, and Wisconsin. See RAMOND COMMUNICATIONS, STATE RECYCLING LAWS UPDATE 9 (Year-End ed. 1995).

152. The 29 states include Arizona, Arkansas, California, Colorado, Connecticut, Florida, Hawaii, Illinois, Iowa, Kansas, Kentucky, Maine, Maryland, Michigan, Mississippi, Missouri, Nebraska, New York, Oklahoma, Oregon, Pennsylvania, Rhode Island, South Dakota, Tennessee, Texas, Utah, Vermont, Wisconsin, and Wyoming. See *id.* at Purchasing Preferences for Recycled Products (chart).

153. See CAL. PUB. RES. CODE § 42760 (West 1996).

154. See OR. REV. STAT. § 459.505 (1994).

155. See CONN. GEN. STAT. § 229-256n (1995).

156. See CAL. PUB. RES. CODE § 4549 (West 1996).

157. See WIS. STAT. ANN. § 100.297 (West 1997).

158. See Paul Bagnell, *Recycled Paper Running Short: Pulp and Paper Makers Urge Canadians to Recycle More So They Can Stop Importing So Much from the U.S.*, FIN. POST, Oct. 31, 1996, at 13.

159. Geoffrey Elliot, *quoted in Countries Can't Use Trade to Promote Environmental Action, Conference Told*, Int'l Trade Rep. (BNA) 901 (May 20, 1992).

- leading barrier to U.S. market access.¹⁶⁰
- *Packaging requirements.* In addition to federal requirements for packaging, at least twelve states regulate the content of packaging materials, eleven of which do so for environmental and public health purposes.¹⁶¹ In addition, some of these states regulate packaging content as part of hazardous waste reduction or disposal programs,¹⁶² sales of agricultural goods,¹⁶³ or state recycling initiatives.¹⁶⁴ Investors may challenge intrastate variation under National Treatment as placing foreign firms at a commercial disadvantage because of the additional cost of compliance.¹⁶⁵
 - *Domestic procurement preferences.* Forty-three states engage in explicit discrimination in favor of government purchasing from domestic producers or suppliers. This comprises a major portion of the foreign complaints about U.S. barriers to trade.¹⁶⁶ Three examples of domestic preferencing include: thirty-seven states with "buy local" programs;¹⁶⁷

160. See CANADIAN DEP'T OF FOREIGN AFFAIRS AND INTERNATIONAL TRADE, REGISTER OF UNITED STATES BARRIERS TO TRADE 15 (Jan. 1999); *U.S. Barriers Still in Place, Says 1995 Canadian Register*, Int'l Trade Rep. (BNA) 625 (Apr. 5, 1995).

161. See ALA. CODE § 41-9-195 (1995); ALASKA STAT. § 46.06.090 (Michie 1977); ARIZ. REV. STAT. § 49-922 (1997); CAL. PUB. RES. CODE § 42310 (West 1997); CONN. GEN. STAT. § 22a-255j (1997); 415 ILL. COMP. STAT. 60/8 and 5/21.5 (West 1998); IOWA CODE § 455D.19 (1997); ME. REV. STAT. ANN. tit. 32, § 1737 (West 1997); N.J. STAT. ANN. 13:1E-99.1 (West 1999); N.Y. ENVTL. CONSERV. LAW § 15-0514 (McKinney 1998); and OR. REV. STAT. § 459.005 (1997).

162. See, e.g., N.Y. ENVTL. CONSERV. LAW § 27-1510 (McKinney 1998) (regulating packaging for disposal of medical waste); ME. REV. STAT. ANN. tit. 32, § 1731 (1997) (regulating hazardous waste due to packaging content); ALASKA STAT. § 46.06.031 (Michie 1977) (regulating hazardous waste due to packaging content, among other sources of waste).

163. See, e.g., MINN. STAT. § 239.093 (West 1997) (requiring information identifying manufacturer, price, net weight, etc. for food packages); N.J. STAT. § 4:10-35 (1998) (requiring specified packaging for potatoes).

164. See, e.g., N.J. STAT. ANN. 13:1E-99.1 (West 1999) (tax on sale of litter-generating products); N.Y. ENVTL. CONSERV. LAW § 27-0717 (McKinney 1990) (bureau of waste reduction and recycling); ALA. CODE § 41-9-195 (Michie 1996); ARIZ. REV. STAT. § 49-834 (West 1997); FLA. STAT. ANN. § 403.7195 (West 1997); D.C. CODE ANN. § 6-3419 (West 1997).

165. See EU TRADE REPORT - 1997, *supra* note 24, at 19-20.

166. See, e.g., EUROPEAN COMMISSION, REPORT ON UNITED STATES BARRIERS TO TRADE AND INVESTMENT 36-37 (1994); CANADA DEPARTMENT OF FOREIGN AFFAIRS AND INTERNATIONAL TRADE, REGISTER OF UNITED STATES BARRIERS TO TRADE 13 (1996); JAPAN SUBCOMMITTEE ON UNFAIR TRADE POLICIES AND MEASURES, INDUSTRIAL STRUCTURE COUNCIL, REPORT ON UNFAIR TRADE POLICIES 19 (1994).

167. The 40 states that have "buy local" programs include Alabama, Alaska, Arkansas, Connecticut, Florida, Georgia, Hawaii, Idaho, Illinois, Indiana, Iowa, Illinois, Indiana, Iowa, Kansas, Louisiana, Maine, Massachusetts, Michigan, Mississippi, Missouri, Montana, Nevada, New Mexico, North Carolina, North Dakota, Ohio, Oklahoma, Oregon, Rhode Island, South Carolina, South Dakota, Tennessee, Texas, Utah, Vermont, Virginia, West Virginia, Wisconsin, and Wyoming. See James D. Southwick, *Binding the States: A Survey of State Law Conformance with the Standards of the GATT Procurement Code*, 13 U. PA. J. INT'L BUS. L. 57, 79 (1992).

sixteen states with "buy America" programs;¹⁶⁸ and fourteen states that have both.¹⁶⁹ There is considerable variety amongst the domestic preference. States can apply them to products (which does not exclude all foreign bidders), to bidders (which does not exclude all foreign products), or to both.¹⁷⁰ Most states use additional rules to ensure that domestic preferences promote economic development without creating a net loss for taxpayers. For example, Oregon,¹⁷¹ Kansas,¹⁷² and Texas¹⁷³ are among twenty-five states that apply their domestic preferences in the case of a tie bid.¹⁷⁴ All things being equal, these states prefer to enjoy the multiplier effect of spending tax dollars at home. Other states, including California,¹⁷⁵ Wisconsin,¹⁷⁶ and Minnesota,¹⁷⁷ require state agencies to purchase U.S.-made goods or produce.

- *Minority procurement preferences.* In addition to the domestic preferences, which are explicit violations of National Treatment, there are other preferences that are probably *de facto* violations. While neutral in their language, these preferences might have an adverse or anticompetitive impact on foreign companies. The most popular among these are minority procurement preferences. For example, Washington¹⁷⁸ requires bidders for public contracts to meet goals for inclusion of sub-contracts with minority and women-owned businesses. Wisconsin¹⁷⁹ has a preference for minority contractors or subcontractors in terms of a minimum percentage of annual construction work during each fiscal year. High-volume preferences like these have drawn complaints from foreign governments.¹⁸⁰ The domestic preferences noted above would also violate the WTO Agreement on Government Procurement

168. The 16 states that have "buy America" programs include Georgia, Hawaii, Iowa, Kansas, Louisiana, Massachusetts, Minnesota, Mississippi, Missouri, New Mexico, Ohio, Oklahoma, Pennsylvania, South Dakota, Texas, and Wisconsin. See *id.* at 75.

169. The 14 states that have both include Georgia, Hawaii, Iowa, Kansas, Louisiana, Massachusetts, Mississippi, Missouri, New Mexico, Ohio, Oklahoma, South Dakota, Texas, and Wisconsin. See *id.* at 75, 79.

170. See *id.*

171. See ORE. REV. STAT. § 279.021 (1994).

172. See KAN. STAT. ANN. § 75-3740 (1995).

173. See TEX. REV. CIV. STAT. ANN. § 903(c) (West 1995).

174. Ten states have a local preference for tie bid cases on products only: Connecticut, Florida, Georgia, Idaho, Massachusetts, Michigan, North Carolina, Oregon, Rhode Island (food products only), and South Carolina. Three states have a preference for local bidders in the case of a tie bid: Louisiana, Kansas, and Tennessee. Twelve states have a local preference in case of a tie involving in-state bidders and products: Alabama, Illinois, Iowa, Maine, Mississippi, Missouri, Nevada, North Dakota, South Dakota, Texas, Virginia, and Utah. See Southwick, *supra* note 167, at 79-82.

175. See CAL. GOV'T CODE § 4331 (West 1996).

176. See WIS. STAT. ANN. § 16.754 (West 1996) (only when it is "economically feasible").

177. See MINN. STAT. ANN. § 16B.101 to 103 (West 1966) (only when it is "economically feasible").

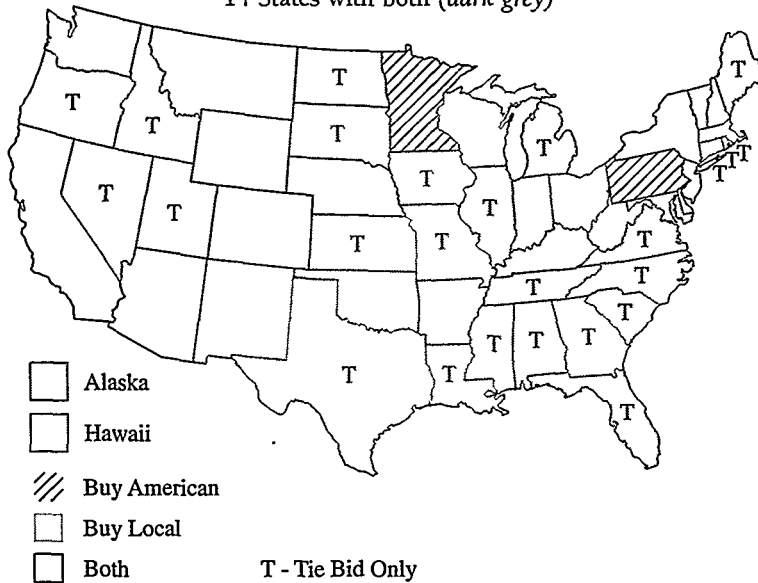
178. See WASH. REV. CODE § 39.04.220(3) (Michie 1996).

179. See WIS. STAT. ANN. § 16.855 (West 1996).

180. See, e.g., EUROPEAN COMMISSION, *supra* note 166, at 37.

Examples of National Treatment Conflicts:
Domestic Procurement Preferences

37 States with "Buy Local" Preferences (*light grey - local only*)
16 States with "Buy America" Preferences (*striped - America only*)
14 States with both (*dark grey*)



(AGP),¹⁸¹ which applies national treatment and other GATT disciplines to state procurement.¹⁸² However, the United States listed several country-specific reservations to avoid an AGP conflict with other procurement programs, including those that promote business development by minorities, women, veterans, and development of distressed areas and general environmental quality.¹⁸³ In addition, individual states listed their own reservations regarding the AGP.¹⁸⁴

- *Investment incentives.* Virtually every state employs large scale investment incentives; the number of state incentives grew 100% between 1983 and 1989.¹⁸⁵ Very few of these programs explicitly discriminate

181. See Agreement on Government Procurement (AGP), Apr. 15, 1994, WTO Agreement, Annex 4, The Results of the Uruguay Round of Multilateral Trade Negotiations: The Legal Texts 438 (GATT Secretariat 1994), 33 I.L.M. 44 (1994) [hereinafter AGP].

182. Most governors committed their states to the AGP without legislative ratification even though the legislatures enacted the procurement policies at issue under the AGP.

183. See AGP, *supra* note 181, Annex 5, ¶ 1, and Annex 2, ¶¶ 2-3.

184. For example, reservations for individual states include Hawaii (software developed in the state and construction); Kansas (construction; automobiles and aircraft); Kentucky (construction); Mississippi (services generally); New York (transit cars, buses and related equipment); Oklahoma (construction); South Dakota (beef); Tennessee (construction and services generally); and Washington (fuel, paper products, boats, ships and vessels). See *id.* United States Appendix to the Agreement on Government Procurement, Annex 2.

185. See WILLIAM SCHWEKE ET AL., BIDDING FOR BUSINESS: ARE CITIES AND STATES SELLING THEMSELVES SHORT? 20 (1994).

- in favor of state residents.¹⁸⁶ The MAI would raise the issue of whether there is a *de facto* violation of National Treatment.¹⁸⁷ The definition of “actionable subsidies” under the WTO Agreement on Subsidies and Countervailing Measures (SCM) would support an investor making a claim under MAI. The SCM prohibits WTO members from causing adverse effects, including injury to the domestic industry of another member,¹⁸⁸ and maintaining tax breaks or subsidies that result in displacement of foreign imports, price undercutting by the subsidized product, or other competitive advantages.¹⁸⁹ The following are examples of programs that could make a difference in the global competitiveness of a firm, particularly when used in conjunction with each other.
- *Tax breaks for raw materials for manufacturing.* Forty-five states¹⁹⁰ provide complete excise tax exemptions for raw materials. As a result of transportation costs, this exception may provide an advantage to established domestic firms. These states include Washington (exemption from sales tax),¹⁹¹ California (exemption from sales and use tax)¹⁹² and Texas (tax exemption for nonprofit development corporations that purchase raw materials).¹⁹³
 - *Industrial development bonds.* Forty-nine states offer subsidized revenue bond financing as an incentive for economic development investments.¹⁹⁴ Arizona,¹⁹⁵ California,¹⁹⁶ and Montana¹⁹⁷ are among the

186. The ones that discriminate include Montana (does not allow a small business with a nonresident alien shareholder to take an investment tax credit. MONT. CODE ANN. § 15-31-123); Oklahoma (requires applicants for agricultural loans to be state residents. OKLA. STAT. ANN. tit. 74 § 5063.23 (West 1996)); and Arizona (limits eligibility for economic development assistance to businesses or other qualified projects clearly in the best interest of the state. ARIZ. REV. STAT. § 41-1505.07 (1998)).

187. An OECD working group recommended absolute MAI limits on development incentives (not just National Treatment) because: (1) they distort private-market investment patterns; (2) they often provide a windfall, i.e., an incentive to do something an investor would have done anyway; and (3) they tend to stimulate competition among governments that is costly to taxpayers without producing a net gain in national or global productivity. OECD DOCUMENTS, *supra* note 58, at 131. The Working Group recommendation was not heeded by the MAI negotiators who felt that “companies should be able to continue to benefit from incentives and that the MAI should not interfere with how governments seek to promote investment” apart from non-discrimination rules, at least until a second round of negotiations. OECD, MAIN FEATURES OF THE MAI ¶ 55 (1996); Anders Ahnlid, *The Multilateral Agreement on Investment: Special Topics* ¶ 4 (Dec. 1996) <http://www.oecd.org/daf/cm/ahnlid.htm>). For a summary of the domestic debate on incentives, see WILLIAM SCHWEKE ET AL., IMPROVING YOUR BUSINESS CLIMATE: A GUIDE TO PUBLIC INVESTMENT IN ECONOMIC DEVELOPMENT (1997); and NATIONAL COUNCIL FOR URBAN ECONOMIC DEVELOPMENT, INCENTIVES: A GUIDE TO AN EFFECTIVE AND EQUITABLE POLICY (1996).

188. See WTO Agreement on Subsidies and Countervailing Measures, Apr. 14, 1994, art. 5(a), WTO Agreement, Annex IA, LEGAL INSTRUMENTS – RESULTS OF THE URUGUAY ROUND, 33 I.L.M. 1125 (1994) [hereinafter SCM].

189. See *id.* art. 6.3.

190. See SCHWEKE ET AL., *supra* note 187, at 18.

191. See WASH. REV. CODE ANN. §§ 82.04.435, 82.08.02565 (West 1996).

192. See CAL. REV. & TAX CODE § 6377(a)(1) (1996).

193. See TEX. CIV. STAT. art. 5190.6, § 2(4), 32 (West 1996).

194. See SCHWEKE ET AL., *supra* note 187, at 19.

195. See ARIZ. REV. STAT. § 41-1505.07 (1995).

many states that designate financing programs for state-based businesses that engage in export development. If the criteria for financing are part of explicit conditions that include export performance, it would count as a prohibited subsidy under the SCM,¹⁹⁸ which would support an investor claim under the MAI.¹⁹⁹

- *Customized job training.* Forty-four states promote global competitiveness of state-based firms through investments in work force training.²⁰⁰ Among the leaders are California,²⁰¹ Alaska,²⁰² and Nebraska.²⁰³ As with designated financing programs, a key National Treatment issue is the extent to which the state agencies explicitly include export promotion as a condition of participating in the program.

One way that state and local officials can affect the conditions of global competition is by combining their incentives into a package for recruitment, retention, or expansion of firms. Incentive packages for recruiting new firms can raise National Treatment issues because of their unique nature. The recruitment process has generated “disappointed bidder” litigation. The MAI would give disappointed foreign bidders a new cause of action and a friendlier forum if a domestic firm wins an incentive package to the exclusion of the foreign firm.

An effect-test discrimination could arise from the efforts of some states to reform how they allocate investment incentives.²⁰⁴ For example, North Carolina screens companies that apply for state incentive programs and limits the awards to only those companies that agree to: (a) make high-impact investments that support job creation, higher than average wages, and productivity-boosting technology; (b) make investments that would not otherwise occur (*e.g.*, in economically afflicted areas); and (c) guarantee to meet performance standards.²⁰⁵ This more disciplined approach may pose a National Treatment conflict because the job creation criteria

196. See CAL. GOV'T CODE § 15392.7 (1996).

197. See MONT. CODE ANN. §§ 90-9-402, 2-15-3015 and tit. 80, ch. 12.

198. See SCM, *supra* note 188, art. 3.1(a).

199. See MAI *Negotiating Text*, *supra* note 7, art. IV(General Treatment)(1.1).

200. See SCHWEKE ET AL., *supra* note 187, at 18.

201. See CAL. UNEMP. INS. CODE § 10200 (West 1996).

202. See ALASKA STAT. § 44.47.758 (Michie 1995).

203. See NEB. REV. STAT. § 81-1203 (1995).

204. States are under growing criticism that their incentive packages do not boost productivity or stimulate investments that would not otherwise occur. The City of Rio Rancho, New Mexico provides an example of an ill-conceived investment package. In 1993, the city awarded Intel Corp. an incentive package based on the company's “ideal incentive matrix.” It included \$118 million in incentives and environmental regulatory relief. The package was so large that the city was unable to afford essential services such as water and schools for the growing population that was attracted by the Intel facility. See David Friedman, *The New Civil War: Politicians Dangle Wasteful subsidies to Lure Companies to relocate or Stay Put. At What Cost?*, INC., May 15, 1996, at 98. See generally SCHWEKE ET AL., *supra* note 185, at 49-54; SCHWEKE ET AL., *supra* note 187; and NATIONAL COUNCIL FOR URBAN ECONOMIC DEVELOPMENT, *supra* note 187.

205. See Corporation for Enterprise Development, *Making Development Incentives More Accountable*, in IMPROVING YOUR BUSINESS CLIMATE 9-10 (1996); OFFICE OF THE GOVERNOR OF NORTH CAROLINA, REPORT BY GOVERNORS BUSINESS INCENTIVES TASK FORCE (1994).

make it easier for a domestic firm or a firm that uses domestic suppliers (as opposed to a foreign firm's existing nonlocal inputs) to win the incentives. The screening criteria also concentrate state resources enough to boost the global competitiveness of companies based in that state.²⁰⁶

A more fundamental National Treatment conflict is raised by incentive programs aimed at business retention. These "stay-at-home programs" are much more likely to exclude foreign investors who are competing with the firms that local officials are trying to retain.²⁰⁷

While state officials want to preserve their ability to promote economic development resources,²⁰⁸ they would prefer to do so in a way that provides net new jobs for their own and neighboring states and minimizes wind-fall benefits for investors at taxpayer expense.²⁰⁹ Rather than deal with such bottom-up issues of inter-governmental competition, MAI negotiators concluded that "companies should be able to continue to benefit from incentives and that the MAI should not interfere with how governments seek to promote investment."²¹⁰

3. Sovereignty Issues

From the high altitude of political debate, where the air is thin, National Treatment under the MAI covers ground that looks similar to the dormant foreign commerce clause under Article I Section 8 of the Constitution.²¹¹ Like National Treatment, the dormant commerce clause can be used to negate the use of state government power that places foreign traders and investors at a commercial disadvantage. It is "dormant" because the Supreme Court invented the doctrine to preempt state law in the absence of congressional action that conflicts with state law.²¹² The dormant commerce clause precludes state action that discriminates against foreign commerce, either explicitly or in effect. This is also the general purpose of

206. Another potential MAI issue is that some state and local governments do not publish their screening criteria. This would violate the transparency obligations under the MAI. See *MAI Negotiating Text*, *supra* note 7, art. III(Transparency)(1).

207. See Walter Hellerstein & Dan T. Coenen, *Commerce Clause Restraints on State Business Development Incentives*, 81 CORNELL L. REV. 789, 853-55 (1996).

208. See WESTERN GOVERNORS' ASSOCIATION, MULTILATERAL AGREEMENT ON INVESTMENT AND IMPLEMENTATION OF TRADE PACTS, Resolution 97-010 (July 24, 1997) [hereinafter WGA RESOLUTION].

209. See, e.g., MD. CODE ANN. art. 83A, § 5-1101 (1996), in which the Maryland General Assembly found that "the widespread adoption of tax subsidies intended to move jobs from one state to another reduces revenues in all participating states without increasing the total number of jobs." *Id.* art. 84, § 4. The General Assembly proposed that the governor negotiate an agreement with neighboring states to repeal "any law in each state that provides a tax subsidy . . . that is intended to create new jobs or entice new jobs to the state." *Id.*

210. MAIN FEATURES OF THE MAI, *supra* note 187, ¶ 55; Ahnliid, *supra* note 187, at 914.

211. The Commerce Clause reads: "Congress shall have Power . . . To regulate commerce with foreign Nations, and among the several States, and with the Indian Tribes . . ." U.S. CONST. art. I, § 8, cl. 3.

212. See LAWRENCE H. TRIBE, CONSTITUTIONAL LAW § 6-2 (2d ed. 1988).

National Treatment.²¹³

Lawrence Tribe interprets congressional authority to regulate foreign commerce under Article I Section 8 as “all but exclusive.”²¹⁴ By negative inference, the federal courts have interpreted this broad power as a mandate for states to withdraw efforts to affect national interests in foreign commerce.²¹⁵ To this end, the Constitution and the MAI share a common purpose of promoting free trade. The fundamental difference is that the Constitution simultaneously embodies a commitment to promote free politics with a system of “dual sovereignty.”²¹⁶

At various times, and as recently as the late 1970s, the Supreme Court has overturned state laws that burden foreign commerce, even in the absence of discrimination or anything that resembled a conflict with federal law. The most recent exercise of what Charles Tiefer calls this “strong preemption” doctrine was the Court’s decision in *Japan Line Ltd. v. County of Los Angeles*.²¹⁷

The *Japan Line* decision extended the life of a doctrine that the United States must speak with “one voice” in international commerce or foreign affairs.²¹⁸ The Court applied one-voice doctrine to invalidate a California property tax on containers in foreign commerce, even though the court upheld the tax under the interstate commerce clause.²¹⁹ *Japan Line’s* claim of multiple taxation triggered the argument for a single voice, which the Solicitor General supported with an *amicus* brief that cited a threat of retaliation from the European Union.²²⁰ In effect, the Supreme Court volunteered to police state laws that rankled foreign nations at the request of the Executive Branch and when Congress had taken no action to support or oppose such a policy.²²¹

In the 1994 decision of *Barclays Bank PLC. v. Franchise Tax Board of*

213. See generally Daniel A. Farber & Robert E. Hudec, *Free Trade and the Regulatory State: A GATT’s-Eye View of the Dormant Commerce Clause*, 47 VAND. L. REV. 1401 (1994).

214. TRIBE, *supra* note 212, § 6-21. Notwithstanding his view of the general preemptive sweep of the commerce clause, Tribe observed that the inference of preemption of state authority without explicit words to that effect presents “no small problem” within the context of specific cases where states have a valid local regulatory purpose. *Id.* at § 6-2, n.6.

215. See *Cooley v. Bd. of Wardens of Philadelphia*, 53 U.S. (12 How.) 299 (1851).

216. “Just as the separation and independence of the coordinate branches of the Federal Government serves to prevent the accumulation of excessive power in any one branch, a healthy balance of power between the States and the Federal Government will reduce the risk of tyranny and abuse from either front.” *Gregory v. Ashcroft*, 501 U.S. 452, 458 (1991). See generally THE FEDERALIST NO. 39 (James Madison) (discussing role of separation of powers between federal and state governments as a safeguard for liberty).

217. 441 U.S. at 434. See Tiefer, *supra* note 13, at 49-59.

218. See *Japan Line*, 441 U.S. at 445. For the application of “one voice” doctrine to foreign affairs power, see *Zschernig v. Miller*, 389 U.S. 429 (1968), which overturned an Oregon law that barred inheritance of property by citizens of communist countries that did not give reciprocal inheritance rights to U.S. citizens.

219. See *id.*

220. *Japan Line*, 441 U.S. at 452, n.17.

221. See Tiefer, *supra* note 13, at 50.

California,²²² however, Justice Ginsburg wrote an opinion for a nearly unanimous court²²³ that neutered the one-voice doctrine without explicitly overturning it. Barclays Bank and the Colgate-Palmolive Company challenged the California “unitary” formula for apportioning world-wide income to establish the base for state income taxation. The companies cited the risk of multiple taxation and the burden of compliance as violations of the dormant foreign commerce clause.²²⁴ As in *Japan Line*, the Executive Branch supported the multinational plaintiff with a brief that cited the threat of retaliation and the need for national uniformity.²²⁵ The United Kingdom and the European Community formally entered the case to express their opposition to the California unitary tax law.²²⁶

The *Barclays* opinion rejected the risk of retaliation as simply not relevant, except to Congress, which the court cited as the appropriate branch for making such a political decision to preempt state authority.²²⁷ The Court dismissed Executive Branch statements on the need for “one voice” in the absence of congressional action as merely “precatory.”²²⁸ Rather than reject the value of a national government that could speak with one voice, the Court sought to clarify constitutional roles as to which branch of government should do the speaking. Under Article I Section 8, the Court reasoned that Congress is the branch that can preempt states when one national voice is required,²²⁹ not the Executive Branch.²³⁰

222. *Barclays Bank*, 512 U.S. 298.

223. While Justice Blackmun expressed reservations in his concurring opinion about giving too much deference to state sovereignty based upon congressional inaction, 512 U.S. at 59 (Blackmun, J., concurring), Justice Scalia expressed a preference for even stronger deference so long as there is no facial discrimination against foreign commerce and no violation of established precedent. See 512 U.S. at 62-63 (Scalia, J., concurring and dissenting). Justice O'Connor wrote for herself and Justice Thomas in support of the Court's reasoning that the “one voice” doctrine did not apply, but she dissented on the analysis of multiple taxation. See 512 U.S. at 65 (O'Connor, J., concurring and dissenting).

224. See *Barclays Bank*, 512 U.S. at 307.

225. See *id.* at 328, nn.29-30.

226. See *id.* at 328, n.30.

227. See *id.* at 351.

228. *Id.* at 356.

229. See *id.* at 338, 351, 355. The allocation of “one voice” power to Congress as a statutory preemption doctrine (not a dormant commerce or foreign affairs doctrine) could be understood as a synthesis of two dissonant opinions. The earliest is *Garcia v. San Antonio Metropolitan Transit Authority*, 469 U.S. 528 (1985), which held that state interests in federalism are protected not by categories of autonomous rule, but by the representation of state interests within the political process of Congress. The latest is *Boerne v. Flores*, 521 U.S. 507 (1997), which recently ruled that Congress must exercise its power to preempt (under the 14th Amendment) with sufficient specificity that it remains accountable for its exercise of preemptive power. Considering that this shift was coupled with a strong presumption against preemption in *Barclays* (Congress can express its intent *not to preempt* by doing nothing), the echoes of *Garcia*-type limits on state power are barely audible.

230. See Schaefer, *supra* note 13, at 634 (“courts may even find toleration [for state action] evinced where Congress has explicitly prohibited private causes of action . . . even though the state action at issue violates the treaty. This would accord with the policy behind such a ban: private causes of action themselves might be an

Throughout the history of dormant commerce clause doctrine, a consistent purpose of judicial scrutiny is to guard against the risk that local legislatures will make decisions that are harmful to traders or investors who are not represented in the political process.²³¹ The Court in *Barclays* found that the “foreign domicile of the taxpayer (or the taxpayer’s parent) is a factor inadequate to warrant retraction” of the Court’s previous holding that unitary taxation does not create an unconstitutional risk of multiple taxation.²³² In terms that anticipate the sovereignty arguments under the MAI, the *Barclays* court observed that “the image of a politically impotent foreign transactor is surely belied by the battalion of foreign governments that has marched to Barclays’ aid, deploring worldwide combined reporting in diplomatic notes, *amicus* briefs, and even retaliatory legislation.”²³³

Under this post-*Barclays* context, MAI negotiators claim that National Treatment is consistent with U.S. constitutional norms. There are two possible arguments that could sustain this claim. The direct argument, which is addressed in this part, is that the MAI only limits state measures that are unconstitutional. The indirect argument, which is addressed in part IV, is that the country-specific exceptions protect constitutional state powers.

Within the scope of this article, it is only possible to skim the surface of a National Treatment/dormant commerce clause comparison. The goal of this comparison, however, is modest. It is simply to illustrate that while National Treatment and the dormant commerce clause share a common theme, they differ fundamentally in the respect they afford to the values of federalism.

a. Explicit Discrimination - *Prima Facie* Violation v. Strict Scrutiny

Under the National Treatment test of “no less favorable treatment,” a law that explicitly discriminates against a foreign investor would constitute a *prima facie* violation of the MAI.²³⁴ The defendants would have to show that the measure qualifies under one of the two general exceptions: protection of essential security interests or preservation of public order.²³⁵ Neither applies to the state laws cited above.²³⁶

Under the dormant commerce clause, there is a presumption that a facially discriminatory statute is unconstitutional.²³⁷ This presumption is

interference with the commerce clause”). See NAFTA Statement of Administrative Action, H.R. Doc. No. 103-159, at 450 (1993); NAFTA, *supra* note 116, at 289.

231. This concern about the abuse of the political process against those who are not represented locally “reflects not a cynical view of the failings of statesmanship at a sub-federal level, but only an understanding that the proper structural role of state lawmakers is to protect and promote the interests of their own constituents.” TRIBE, *supra* note 212, § 6.5.

232. *Barclays Bank*, 512 U.S. at 338.

233. *Id.*

234. See *supra* note 110 (explicit discrimination).

235. See *MAI Negotiating Text*, *supra* note 7, art. VI(Exceptions and Safeguards)(2), (3).

236. See *infra* Appendix II.A. for a discussion of general exceptions.

237. See *City of Philadelphia v. New Jersey*, 437 U.S. 617 (1978); *Oregon Waste Systems, Inc. v. Dep’t of Environmental Quality*, 511 U.S. 93 (1994).

sometimes referred to as a “*per se* rule;” a compelling state interest and demonstration that there are no viable alternatives can overcome the presumption.²³⁸ The more appropriate description in these cases is “strict judicial scrutiny.”

In *Maine v. Taylor*,²³⁹ the Court’s strict scrutiny test upheld a statute that imposed an outright ban on importing baitfish to state waters that border Canada. Maine successfully defended its law by convincing the courts that its import ban was the only way that the state could protect its fisheries from parasites that infected non-native shipments.²⁴⁰ The commerce clause test for explicit discrimination is strict, but it allows the court to defer to legitimate state interests, unlike National Treatment under the MAI.

If there is one category of laws where MAI National Treatment and the dormant commerce clause could be proven analogous, it would be where states explicitly prohibit foreign investors from owning land or acquiring permits to fish, use water, or operate casinos or other businesses. The argument that these laws discriminate on the basis of citizenship or residency without a sufficient redeeming noneconomic purpose is well developed by scholars.²⁴¹

Notwithstanding the potential case against them, at least seventeen states explicitly discriminate against ownership of land by foreign investors, and two of these prohibitions are enshrined in state constitutions.²⁴² Most of these laws avoid a European-style concentration of wealth in the hands of absentee lairds, which would tend to make the state an economic colony but also deprive the state of a civic class of resident landowners.²⁴³ In some states, the popularity of this policy lives on,²⁴⁴ with several legislature enacting such statutes during the family farm crisis of the 1970s.²⁴⁵

The most vulnerable state statutes are those that discriminate on the

238. See *Fort Gatiot Sanitary Landfill, Inc. v. Michigan Dept. of Natural Resources*, 504 U.S. 353 (1992); *New Energy Co. v. Limbach*, 486 U.S. 269 (1988); *Maine v. Taylor*, 447 U.S. 131, 135 (1986).

239. 447 U.S. 131 (1986).

240. See *id.* at 143. See also *TRIBE*, *supra* note 212, § 6-6; *Toomer v. Witsell*, 334 U.S. 385, 398 (1948) (upholding discrimination only if the out-of-state interests “constitute a particular source of the evil at which the statute is aimed.”)

241. See, e.g., Mark Shapiro, *The Dormant Commerce Clause: A Limit on Alien Land Laws*, 20 *BROOKINGS J. INT’L L.* 217 (1993); Charles H. Sullivan, *Alien Land Laws: A Re-Evaluation*, 36 *TEMP. L.Q.* 15 (1962); Fred L. Morrison, *Limitations on Alien Investment in American Real Estate*, 60 *MINN. L. REV.* 621 (1976); William B. Fisch, *State Regulation of Alien Land Ownership*, 43 *MO. L. REV.* 407 (1978).

242. See *supra* notes 120-22.

243. See James A. Fretcher, *Alien Land Ownership in the United States: A Matter of State Control*, 14 *BROOKINGS J. INT’L L.* 147 (1988). Sadly, some of these laws were also adopted during xenophobic episodes of concern about Japanese immigration or Communist control of assets, but most were repealed after the Supreme Court indicated that it would accept a challenge to them on equal protection grounds (after previous decisions to the contrary). See Shapiro, *supra* note 241, at 221 (citing *Takahashi v. Fish and Game Comm’n*, 334 U.S. 410, 425 (1948) and *Oyama v. California*, 332 U.S. 633 (1948)).

244. See *WGA RESOLUTION*, *supra* note 208, ¶ B.2.c.

245. See Shapiro, *supra* note 241, at 221-23.

basis of citizenship alone rather than residency and citizenship.²⁴⁶ However, the residency requirement stands on more rational ground – the unique intra-state character of land. Some commentators and sitting Supreme Court Justices believe character of land is a compelling local concern²⁴⁷ and outside the scope of “interstate or foreign commerce” as understood by the framers of the Constitution.²⁴⁸

The textualists on the Court argue that wholesale preemption of state power is unjustified by a negative inference from the grant of congressional commerce power in Article I Section 8.²⁴⁹ Defining land as “not commerce” is one literal boundary for inhibiting the expansion of federal – and now multinational – power at the expense of states.

The archaic roots of sovereignty are visible in the laws that limit access to fisheries and water rights.²⁵⁰ Yet, it was not until the 1970s that the Supreme Court overruled cases holding to the common law doctrine that states own wild fish, game, and other natural resources.²⁵¹ However, rather than declare the death of all state dominion over birds of the air and fish of the sea, the Court has employed a balancing test²⁵² and recognized a strong state interest in both conserving natural resources, including animals²⁵³ and minerals.²⁵⁴ The Court has not overruled the cases in which the state asserted ownership of tidewater habitat of nonmigratory species.²⁵⁵ In addition, a number of state laws that reserve the right to harvest shellfish and lobsters to their own residents remain on the books.²⁵⁶ As with land ownership laws, the Court has yet to erase the boundary that limits nonresident access to tidewater resources.

The Court has struck down state laws that impose a discriminatory license fee against nonresidents wishing to hunt and fish if the fee has no

246. See *supra* notes 120-26.

247. “Even when federal general law was in its heyday, an exception was carved out for local laws of real property.” *United States v. Little Lake Misere Land Co.*, 412 U.S. 580, 591 (1973); see *Fletcher*, *supra* note 243.

248. See *Sporhase v. Nebraska ex rel. Douglas*, 458 U.S. 941, 963 (1982) (Rehnquist, J., dissenting).

249. See *Camps Newfound/Owatonna, Inc. v. Harrison*, 520 U.S. 564, 610-20 (1997) (Thomas, J., dissenting); see also *Barclays Bank*, 512 U.S. at 331-32 (Scalia, J., concurring in part and dissenting in part).

250. See *supra* notes 140-43.

251. See *Hughes v. Oklahoma*, 441 U.S. 322 (1979) (invalidated an Oklahoma law that prohibited interstate shipping of minnows harvested within the state), which overruled *Geer v. Connecticut*, 161 U.S. 519 (1896) (upheld South Dakota law that prohibited interstate shipping of game birds killed in the state); see also *Douglas v. Seacoast Products, Inc.*, 431 U.S. 265, 284 (1977).

252. See *TRIBE*, *supra* note 212, § 6-10; *Pike v. Church*, 397 U.S. 137, 142 (1970).

253. See *Hughes*, 441 U.S. at 336.

254. See *Sporhase v. Nebraska*, 458 U.S. 941, 957 (1982). Regarding access to underground water, the court held that while a state may not hoard resources for the benefit of its own residents, it may impose reasonable barriers to access for non-protectionist purposes.

255. See *McCready v. Virginia*, 94 U.S. 391 (1877); *Corfield v. Coryell*, 4 Wash. C.C. 371 (1823).

256. See *supra* notes 140-71.

environmental or administrative justification.²⁵⁷ However, these cases display constitutional nuances that are not shared by National Treatment, such as a *de minimis* test in which the courts will tolerate disparate treatment of nonresidents.²⁵⁸ Yet, at least one modern case has excepted a political rationale for high “trophy” fees. In *Montana Outfitters Action Group v. Fish & Game Commission*,²⁵⁹ a federal court upheld a highly discriminatory nonresident fee (a fee ratio of 28:1 in favor of state residents) for elk hunting. The court reasoned that the elk are no longer migratory and the fee was needed to maintain the political motivation of Montana citizens to subsidize a conservation program that primarily benefits out-of-state hunters.²⁶⁰ This logic could have much broader application in the future to “discriminatory” user-fees that support eco-tourism.

In the realm of land ownership and access to fishing or hunting rights, the argument over what is “commerce” has little to do with commerce. Instead, it has much to do with the need to strike a balance between state and federal power. States which adopt discriminatory laws to limit foreign access to resources risk violating the dormant commerce clause. However, the very lack of subtlety in the most discriminatory state laws illustrates the conflict between the allocation of power under the MAI as compared with the Constitution.

The MAI could take the next generation of commerce clause cases out of the Supreme Court (in favor of a friendlier international forum), thus arresting the natural evolution of constitutional law. Such a relocation is a major sovereignty concern for states, especially since the *Barclays* opinion revealed that nine justices would not defer to the Executive Branch concerns about international retaliation to a state law that is not facially discriminatory. One year after *Barclays*, in *United States v. Lopez*, the Court again reset the balance of federal and state powers in the direction of the traditional deference to state powers.²⁶¹ Judicial deference to state authority becomes even more significant when the laws are facially neutral in their treatment of foreign as compared with domestic investors.

257. See *Baldwin v. Montana Fish and Game Comm'n*, 436 U.S. 371 (1978), which was decided under the privileges and immunities clause of Article IV § 2 (for citizens, not corporations), but comports closely to commerce clause analysis. The leading precedent in the P&I line of cases is *Toomer v. Witsell*, 334 U.S. 385 (1948), in which the Court invalidated a shrimp license fee disparity of \$2,500 for non-resident boats to \$25 for resident boats. Regardless of the constitutional basis for the claim, the Supreme Court's analysis of discrimination cases involving access to commercial fishing is very much the same. See *Constitutionality of State Laws Which Discriminate Against Nonresidents or Aliens as to Fishing and Hunting Rights*, 52 L. Ed. 2d 824.

258. See *Baldwin*, 436 U.S. at 371.

259. 417 F. Supp. 1005 (DC Mont. 1976).

260. See *id.*

261. *Lopez* was not a preemption case, but the Court ruled that Congress must meet a burden of proof before it legislates in an area of traditional state regulation. When Congress adopted the Gun-Free School Zones Act, it exceeded congressional authority under the commerce clause since possession of a gun in a local school zone is not economic activity that substantially affects interstate commerce. See *Lopez*, 514 U.S. at 549 (1995).

b. *Facially Neutral Laws – Effects Test v. Balancing Test*

The National Treatment standard of “not less favorable treatment” for foreign investors creates an effects test for laws that are not facially discriminatory.²⁶² The only question in determining a violation is whether the less favorable treatment results in a commercial disadvantage for foreign as compared to domestic firms. This is a question of “simple business economics, applied to undisputed facts,” not a balance of regulatory benefits versus burdens.²⁶³ As noted above, there are no MAI general exceptions that are appropriate defenses for the state laws cited above.²⁶⁴ In this respect, National Treatment is significantly expanded in comparison to GATT, which provides for a variety of general exceptions under Article XX, including public morals, human or animal health, and conservation of exhaustible natural resources, among others.²⁶⁵

In contrast to the MAI, since the 1930s, the U.S. Supreme Court has sought to balance the interests of dual sovereignty by scrutinizing both the purpose and effect of a state law. The Court will uphold a state law if (1) it is rationally related to a legitimate state end, and (2) the regulatory burden imposed on commerce is outweighed by the state interest involved.²⁶⁶ Whether the burden is outweighed turns on the nature of the local interest and whether it can be protected by less restrictive means.²⁶⁷

There are legions of state laws that regulate in a manner that creates a differential burden on foreign and interstate commerce without facial discrimination. The laws cited above involving recycled content, packaging, and local competition are merely examples.²⁶⁸ In their comprehensive comparison of GATT National Treatment and the dormant commerce clause, Professors Farber and Hudec identify two types of GATT disputes involving the National Treatment effects test. The first provides different treatment for two classes. The classification, however, places most of the foreign products, services or firms in the disadvantaged category. The second creates a uniform standard of treatment. It also creates a greater burden of compliance and results in a competitive disadvantage for foreign

262. See *supra* note 112 (effects test).

263. See Farber & Hudec, *supra* note 213, at 1431.

264. See *MAI Negotiating Text*, *supra* note 7, arts. VI(Exceptions and Safeguards)(1) and (2).

265. See *infra* the discussion of general exception in Appendix II.A. The National Treatment under the WTO requires a rigorous two-step process of finding first, the violation, and second, whether the offending measure fits within the rigorous test for Article XX exceptions. The defending nation bears the burden of proof. See Farber & Hudec, *supra* note 213, at 1426.

266. See, e.g., *Southern Pacific Co. v. Arizona*, 325 U.S. 761, 770-71 (1945); *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142 (1970); *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263, 270 (1984); *TRIBE*, *supra* note 212, § 6.5.

267. See *Pike v. Bruce Church, Inc.*, 397 U.S. 137, 142 (1970).

268. See *supra* notes 149-51 and 165. There are 2,700 state and local laws that require safety certifications that create expensive compliance burdens for foreign firms, as do the voluminous state laws on labeling of food, appliances, pharmaceuticals, and alcoholic beverages. See *EU Trade Report - 1997*, *supra* note 24, at 17-23.

firms because of their different geographic or market positions.²⁶⁹

For example, the Maryland gasoline retailer law could be challenged as a discriminatory classification under the MAI because it prohibits vertically integrated oil refiners, none of which were based in Maryland when the law was enacted,²⁷⁰ from owning a retail service station.²⁷¹ This is certainly "less favorable" treatment that would flunk a National Treatment challenge under the MAI.²⁷² However, the Supreme Court upheld this law under the commerce clause balancing test in *Exxon v. Maryland*.²⁷³ The Court recognized the legislative purpose to preserve retail competition and prevent unfair trade practices such as predatory pricing.²⁷⁴

The *Exxon* Court deferred to the facial neutrality of the Maryland law because it applied "evenly" to all vertically integrated firms, whether in-state or out-of-state. The fact that there were no in-state vertically integrated firms did not concern the Court, even though the factual context meant that this law functioned as an anti-takeover policy restricting market access. The Court reasoned that the Commerce Clause "protects the interstate market, not particular inter-state firms, from prohibitive or burdensome regulation."²⁷⁵

Lawrence Tribe suggests that the Court upheld the Maryland law because it did not adversely affect the interstate flow of goods (save for two companies) as it existed at the time.²⁷⁶ By contrast, National Treatment under the MAI is an instrument of protection for market access by individual firms, regardless of any adverse consequences that a large firm's pricing may create for smaller local competitors. The underlying clash of values is illustrated by Tribe's commentary, which explains that "the negative implications of the commerce clause derive principally from a *political* theory of union, not from an *economic* theory of free trade."²⁷⁷ As a conse-

269. See Farber & Hudec, *supra* note 213, at 1422.

270. Only two of 199 stations affected by the law were owned by out-of-state companies. See *Exxon Corp. v. Governor of Maryland*, 437 U.S. 117, 137-38 (1978) (Blackmun, J., dissenting).

271. The law required those that did own stations to divest them. See MD. CODE ANN. art. 56, § 157E (Supp. 1997). Similarly, the Massachusetts franchise law permits a local franchisee to challenge a franchisor's decision to open another franchise on grounds that to do so would encroach upon the local market. See MASS. GEN. LAWS ch 93B, § 4(3)(1) (1995).

272. See Alcoholic and Malt Beverages, *supra* note 33; *Taxes on Petroleum*, *supra* note 110.

273. 437 U.S. 117 (1978). The Court later distinguished the statute in *Exxon* on grounds of facial neutrality from a Florida statute that it overturned on commerce clause grounds. The Florida statute discriminated among financial service companies based on the extent of their contacts with the local economy. See *Lewis v. BT Investment Managers, Inc.*, 447 U.S. 27, 45-49 (1980).

274. See 437 U.S. at 121, 127.

275. *Exxon*, 437 U.S. at 127-28 (Stevens, J.). Justice Blackmun dissented, arguing that the overwhelmingly local composition of the retailer market was a context that created a discriminatory burden on out-of-state oil companies while protecting the in-state retailers. See *id.* at 140-41 (Blackmun, J., dissenting).

276. See TRIBE, *supra* note 212, § 6-6.

277. *Id.* § 6-6.

quence, the Court frequently resolves the balancing of interests in favor of deference to a state.

There are many state laws in Farber's and Hudec's second category of uniform standards that create disparate costs of compliance. For example, in *American Can Company v. Oregon Liquor Control Commission*,²⁷⁸ the Oregon Supreme Court upheld what Justice Scalia calls a "garden variety"²⁷⁹ imposition on interstate commerce. In *American Can*, the court upheld the Oregon "bottle bill," which required beverage producers to use returnable containers, as an appropriate legislative means of addressing environmental needs. In National Treatment terms, such content requirements not only shift a disproportionate cost of compliance to out-of-state producers, they also impose inappropriate "production or process methods" on "like products."²⁸⁰

In *Barclays Bank v. Franchise Tax Board*, the Supreme Court held that the plaintiffs did not meet their burden of proof to establish that their compliance burdens were not only disproportionate, but sufficiently burdensome to violate constitutional standards.²⁸¹ GATT panels have ruled that even a risk of discrimination would violate National Treatment.²⁸² Once a plaintiff establishes a *prima facie* violation of competitive disadvantage in a GATT case, the government has the same burden of defense as if the law were facially discriminatory.²⁸³

Professors Farber and Hudec illustrate the structural difference between GATT National Treatment and the dormant commerce clause. The commerce clause provides for an intuitive balance between regulatory justification and commercial disadvantage. Whereas Article III of GATT separates the question of legal violation from the question of legal justification, a *prima facie* case for violation requires only a showing of commercial disadvantage. Once the violation is established the burden shifts to the defending government to prove that the measure being challenged falls under one of the general exceptions.²⁸⁴ However, as noted before, the GATT general exceptions simply are not available under the MAI. As a result:

. . . because the finding of violation involves only the issue of commercial burden under a monolithic "less favorable treatment" standard, GATT may find it difficult to control disguised protectionist measures at one end of the spectrum without having to find all other regulation with adverse trade

278. 15 Or. App 618, 517 P.2d 691 (Op. Ct. App. 1973). *Accord* *Brotherhood of Locomotive Firemen and Enginemen v. Chicago*, 393 U.S. 129, 142 (1968).

279. *See* *West Lynn Creamery v. Healy*, 512 U.S. 186, 209 (1994) (Scalia, J., dissenting).

280. *See* discussion of "like circumstances," *supra* notes 111-18.

281. 512 U.S. 298, 327-28 (1994). *See* *Hunt v. Washington State Apple Advertising Comm'n*, 432 U.S. 333, 350-51 (1977).

282. *See* *EEC - Payments & Subsidies Paid to Processors & Producers of Oilseeds & Related Animal-Feed Proteins*, Oct. 16, 1990, GATT B.I.S.D. (37th Supp.) at ¶ 141 (1989-90).

283. *See* Farber & Hudec, *supra* note 213, at 1422.

284. *See id.* at 1426.

effects to be in violation²⁸⁵ . . . [The GATT panel decisions on facially neutral measures do not solve] the question of how to confine this analysis so that it will not sweep up all government regulations that involve any differential commercial burden for foreign goods.²⁸⁶

Farber and Hudec, absent the use of a U.S. Supreme Court balancing test, invented a solution based on common sense and a more intuitive interpretation of the competitive impact of such laws. They point to the refined definition of National Treatment within the WTO General Agreement on Trade in Services (GATS) as an “updated restatement” that WTO members adopted.²⁸⁷ In particular, GATS provides that the test of modifying “conditions of competition,” does not apply to “inherent competitive disadvantages which result from the foreign character” of the firms affected by the law.²⁸⁸

Farber and Hudec presume that the “inherent disadvantage” exception to GATS National Treatment will avoid finding violations when the regulation has “routine normalcy (dare we say, credibility?)” that makes it look like it has no protectionist purpose. They interpret “inherent” disadvantages as synonymous with “inevitable,” meaning that GATS National Treatment should apply to a regulation, even if it is enacted in good faith and without protectionist motives, if the legislature could “avoid disadvantaging the foreign supplier.”²⁸⁹ The net effect of the Farber and Hudec interpretation is to reinvent National Treatment with a built-in balancing process akin to Article XX analysis.

While it may be within the interpretative power of a WTO or MAI dispute panel, the Farber and Hudec intuitive test of balancing regulatory purpose with commercial effect is more aspirational than predictive. Since the time of Farber and Hudec’s article, subsequent GATT Article XX decisions have evidenced a “monolithic” focus on the supremacy of trade values with little or no deference to domestic legislative purposes.²⁹⁰ Without the structural counter-balance of GATT’s Article XX exceptions, it is reasonable to expect that MAI dispute panels would be even less likely than WTO panels to show deference to conflicting regulatory purposes.

Unless and until the Farber and Hudec interpretation transforms international dispute panels’ approaches, the comparison of MAI National Treatment and the dormant commerce clause boils down to the following for laws that are not facially discriminatory: The MAI provides a monolithic test of commercial effect. The dormant commerce clause provides a test that balances commercial effect with legislative purpose. The MAI does not provide such a test.

285. *Id.*

286. *Id.* at 1427.

287. *Id.* at 1428.

288. GATS, *supra* note 114, art. XVII.

289. *Id.*

290. *See infra* cases cited at notes 579-80.

c. Alcoholic Beverages – State Regulation Under the 21st Amendment

The 21st Amendment would prove irrelevant to a challenge of state law that regulates alcoholic beverage dealers, producers, or products under the MAI.²⁹¹ Under the dormant commerce clause, however, the 21st Amendment places a finger on the balancing scale as a constitutionally protected state interest.²⁹² Section 2 of the amendment reads: “The transportation or importation into any State, Territory, or possession of the United States for delivery or use therein of intoxicating liquors, in violation of the laws thereof, is hereby prohibited.”

The Supreme Court has adjusted the commerce clause balance for interstate or foreign commerce in alcohol by deferring to state laws that would otherwise violate the dormant commerce clause.²⁹³ However, the state law must regulate “the perceived evils of an unrestricted traffic in liquor.”²⁹⁴ The 21st Amendment does not protect a state alcohol law that amounts to “mere economic protectionism.”²⁹⁵ In addition, a nonprotectionist state law that conflicts with federal regulation of interstate or foreign commerce, such as antitrust enforcement, is merely a factor in a court’s analysis.²⁹⁶

Two cases suggest that the 21st Amendment probably expands state sovereignty to impose regulatory burdens that would not survive a National Treatment challenge under the MAI. This would fail because the increased costs of compliance disadvantage the competitive position of foreign firms. In *State Board of Equalization v. Young’s Market Company*,²⁹⁷ the Supreme Court upheld a license fee on the business of importing liquor from another state, which is otherwise a violation of the dormant commerce clause. In *North Dakota v. United States*, the Court also upheld a state law that imposed burdensome reporting and labeling requirements on the federal government regarding liquor at military installation sales

291. See *Alcoholic and Malt Beverages*, *supra* note 33, ¶ 5.47.

292. See *TRIBE*, *supra* note 212, § 6-24 (the 21st Amendment is a “constitutional adjustment” of the balance of federal/state powers); *NOWAK & ROTUNDA*, *CONSTITUTIONAL LAW* § 8-8 (1991) (the 21st Amendment gives states “wide latitude” to regulate without federal interference).

293. The 21st Amendment has placed liquor in a category different from that of other articles of commerce. Though the precise amount of power it has left in Congress to regulate liquor under the Commerce Clause has not been marked out by decisions, this much is settled: local, not national, regulation of the liquor traffic is now the general Constitutional policy.

Carter v. Virginia, 321 U.S. 131, 138 (1944) (Black, J., concurring).

294. *Bacchus Imports, Ltd. v. Dias*, 468 U.S. 263, 276 (1984).

295. *Id.*

296. See *United States v. Frankfort Distilleries*, 324 U.S. 293 (1945) (upholding federal prosecution of price fixing in the liquor distribution business); *California Retail Liquor Dealers Ass’n v. Midcal Aluminum, Inc.*, 445 U.S. 97 (1980).

297. 299 U.S. 59 (1936). More recently, however, the Court invalidated a state tax on foreign liquor imports, holding that the 21st Amendment does not constrain limits on state power under the export/import clause, which is an explicit limit on state power as compared with the implicit limits of the dormant commerce clause, and which also has implications for foreign policy. See *Department of Revenue v. James B. Beam Distilling Company*, 377 U.S. 341, 346 (1964).

within the state.²⁹⁸

These cases upheld regulatory burdens and effective discrimination, which are similar to the laws that the United States was unable to defend in the Canadian challenge against state laws in the *Beer II* decision.²⁹⁹ These included relatively higher licensing fees³⁰⁰ and requirements that foreign producers use wholesale distributors³⁰¹ and common carriers.³⁰²

d. Subsidies – Exception to the Dormant Commerce Clause

Compared to the turbulent rapids that mark the course of state regulatory power, the rivers of subsidy that flow from state and local government are much calmer waters. Relatively few of the hundreds of subsidy laws and programs are facially discriminatory.³⁰³ Although the Supreme Court has “never squarely confronted the constitutionality of subsidies,”³⁰⁴ the Court recently acknowledged in *West Lynn Creamery v. Healy* that “direct subsidization of domestic industry does not ordinarily run afoul of the negative commerce clause.”³⁰⁵ Even Supreme Court decisions rejecting regulations as discriminatory have recognized that direct subsidies are a valid exception to the preemptive scope of the dormant commerce clause.³⁰⁶

Where subsidies do run afoul of the dormant commerce clause, it is because they are tax subsidies that are “functionally indistinguishable” from discriminatory taxes that function like tariffs.³⁰⁷ The dissenters in *West Lynn Creamery*,³⁰⁸ complained not about the holding, but the implications of Justice Stevens’ “functional” rationale, which maintains that the dormant commerce clause forbids state laws that “artificially encourage in-state production” or “neutralize the advantage possessed by lower cost out-of-state producers.”³⁰⁹ This rationale would support a “commercial disadvantage” claim that a state law violates National Treatment.

While the dissenters sought to use their rationale to attack any state

298. 495 U.S. 423 (1990).

299. See *Alcoholic and Malt Beverages*, *supra* note 33, at 206.

300. The states included Alaska and Vermont. See *id.* ¶ 6.1(m).

301. The states included Alaska, California, Connecticut, Florida, Hawaii, Idaho, Illinois, Indiana, Iowa, Kansas, Louisiana, Maine, Maryland, Massachusetts, Minnesota, Montana, New Hampshire, Ohio, Oregon, Pennsylvania, Rhode Island, Tennessee, Texas, Utah, Virginia, Washington, West Virginia, and Wisconsin. See *id.* ¶ 6.1(j).

302. The states included Arizona, California, Maine, Mississippi, and South Carolina. See *id.* ¶ 6.1(l).

303. See, e.g., *supra* notes 191-203.

304. *West Lynn Creamery v. Healy*, 512 U.S. 186, 199 (1994).

305. *Id.* (quoting *New Energy Co. of Indiana v. Limbach*, 486 U.S. 269, 278 (1988), and citing *Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794, 815 (1976) (Stevens, J., concurring)).

306. See *C & A Carbone v. Town of Clarkstown*, 511 U.S. 383, 395 (1994) (after rejecting a local law that required delivery of all solid waste to a newly constructed processing center, the Court said that the town could simply finance the facility out of general taxes or municipal bonds); *South-Central Timber Development v. Wunnicke*, 467 U.S. 82, 99, 103 (1984). (plurality opinion and Rehnquist, J., dissenting).

307. See *West Lynn Creamery v. Healy*, 512 U.S. 186 (1994); *Bacchus Imports v. Dias*, 468 U.S. 263 (1984).

308. 512 U.S. 186 (1994).

309. *Id.* at 193 and 205 (quoting *Baldwin v. GAF Seelig*, 294 U.S. 511, 527 (1935)).

subsidy,³¹⁰ the majority holding dealt specifically with taxes that coupled an in-state producer subsidy with a simultaneously adopted tax on all producers, from which the subsidy is drawn as a functional "tax rebate."³¹¹ The rebate character of the subsidy distinguishes it from all direct subsidies that stand alone on funds from general revenue.³¹² This decision shows how the Court uses a formal distinction between types of subsidies to stop short of a doctrine that would encroach any further on state power.³¹³

The Court's own rationale and commentators suggest that the commerce clause deference to direct subsidies will continue, even in the era of free trade. In addition to the federalism rationale advanced by the dissenters, the majority was satisfied that a simple subsidy "merely assists local business," whereas a tax rebate shifts the burden discriminately to out-of-state competitors.³¹⁴ Thus, the courts can rely on taxation with representation as a discipline on subsidies paid from general taxpayer funds.³¹⁵ Taxpayers are often willing to pay for subsidies that support nonprotectionist "positive externalities," such as job creation, business retention, and environmental protection.³¹⁶ Even in non-subsidy cases, the Supreme Court has accepted the regulatory legitimacy of protecting local jobs as opposed to protecting the market share of local business.³¹⁷

As noted in Part III.A.2 above, some subsidy targets (e.g., "stay-at-home" packages) could be challenged as inherently more protectionist than others (e.g., new business recruitment).³¹⁸ Likewise, more subtle screening of subsidies, designed to eliminate investor windfalls, restrain inter-governmental competition, and maximize net new jobs, will disadvantage foreign firms.³¹⁹ There is little indication, however, that the Supreme Court would find such targeting or screening criteria to constitute a "func-

310. See 512 U.S. at 213 (Rehnquist, J., joined by Blackmun, J.).

311. 512 U.S. at 199.

312. See *id.* at 197.

313. See Walter Hellerstein & Dan T. Coenen, *Commerce Clause Restraints on State Business Development Incentives*, 81 CORNELL L. REV. 789, 836-46 (1996); Note, *Functional Analysis, Subsidies, and the Dormant Commerce Clause*, 110 HARV. L. REV. 1537, 1541-42 (1997) [hereinafter Note, *Functional Analysis*].

314. 512 U.S. at 197.

315. See Hellerstein & Coenen, *supra* note 313, at 847.

316. See Note, *Functional Analysis*, *supra* note 313, at 1547-48.

317. See *White v. Massachusetts Council of Construction Employers*, 460 U.S. 204 (1983) (local construction contracts with public funds); *Brotherhood of Locomotive Firemen v. Chicago, RI & PR Company*, 393 U.S. 129 (1968) (minimum-size train crews); TRIBE, *supra* note 212, § 6-13. When nation A imposes a protective tariff (or tax subsidy that functions as a tariff) on goods from nation B, it is very difficult, if not impossible, for nation B to take countermeasures like retaliatory tariffs (because the original product does not benefit) or counter-subsidies (because goods are exported to multiple countries). In the case of a simple subsidy, the counter-measure of a counter-subsidy is more feasible because the reciprocally subsidized products compete wherever they are sold in the same market. See Note, *Functional Analysis*, *supra* note 313, at 1545, n.57.

318. See Hellerstein & Coenen, *supra* note 313, at 850.

319. See *supra* note 205-09.

tional" violation of the dormant commerce clause.³²⁰

The ultimate basis of a National Treatment challenge to state subsidy programs is their economic effect on the conditions of competition. The relevant effect is not limited to their efficacy in influencing business location decisions.³²¹ Rather, the relevant effect is on competitiveness of firms that receive the subsidies in comparison to those that do not. These effects will vary drastically based on the industry and the unique situation of subsidy receivers and competitors. Especially when used in multi-million dollar packages, the most innovative state programs could establish a *prima facie* case that a subsidy package uniquely places a foreign investor at a competitive disadvantage.

The value of state innovation in this sector is not merely that it promotes local economic competitiveness.³²² The most progressive state experiments today are the ones that actually impose disciplines on that competition. Foreign investors who can make a case that the screening criteria or subsidy strategies work to their commercial disadvantage can challenge these disciplines.

e. Market Participation – Exception to the Dormant Commerce Clause

Just as U.S. courts show considerable deference to subsidies, even though they commercially disadvantage foreign firms, the courts are not likely to invoke the dormant commerce clause to invalidate state procurement and other market activities. No matter how discriminatory it may be, market activities are not "regulation" of international or interstate trade, which is the national interest that courts are empowered to safeguard from excessive burdens of subnational regulation.³²³ While state regulation of foreign commerce will attract closer scrutiny by the courts, the exception for mar-

320. Even in a tax exemption context, "the [Supreme] Court has pointedly refused to distinguish between incentives afforded new and existing business operations," even though the latter are obviously more likely to exclude out-of-state firms. Hellerstein & Coenen, *supra* note 313, at 854 (citing *Westinghouse Electric Corp. v. Tully*, 466 U.S. 388, 406 (1984) (declining to draw any distinction between a discriminatory tax that "diverts new business into the State" and one that "merely prevents current business from being diverted elsewhere")). See also *Philadelphia v. New Jersey*, 437 U.S. 617, 623-624 (1978) (distinguishing between protectionism and "incidental burdens on interstate commerce").

321. A study of 74 foreign investment projects by 30 companies showed that incentives did influence the location decisions of foreign investors in two-thirds of the cases studied. See STEPHEN E. GUISENGER ET AL., INVESTMENT INCENTIVES AND PERFORMANCE REQUIREMENTS: PATTERNS OF INTERNATIONAL TRADE, PRODUCTION AND INVESTMENT 47-49 (1985). Studies of U.S. domestic business, however, conclude that subsidies have at best a marginal effect on the choice of location. See, e.g., Walter Hellerstein, *Selected Issues in State Business Taxation*, 39 VAND. L. REV. 1033, 1036 (1986); Richard Pomp, *The Role of State Tax Incentives in Attracting and Retaining Business: A View from New York*, 29 TAX NOTES 521, 525 (1985); SCHWEKE ET AL., *supra* note 185, at 35. Stephen Guisinger observes that if competing investment incentives offset each other, the absence of incentives could be a costly change in policy. "If one country were to eliminate its incentives while others maintain theirs, the country's share of foreign investment projects might decline substantially." GUISENGER ET AL., *supra*, at 38-39.

322. See Hellerstein & Coenen, *supra* note 313, at 851.

323. See *Reeves v. Stake*, 447 U.S. 429, 441 (1980).

ket participation applies equally to laws that affect domestic and international commerce.³²⁴

In general terms, the MAI would significantly expand the application of National Treatment to market activities of state and local government in comparison to existing international agreements. Under GATT, National Treatment generally carves out government procurement altogether; the MAI would not.³²⁵ GATT retains a number of general exceptions that recognize legitimate government purposes related to market activities of state government, such as conservation of exhaustible natural resources;³²⁶ the MAI would not.³²⁷ Both NAFTA Chapter 11³²⁸ and the General Agreement on Trade In Services (GATS) have a general exception for government procurement; the MAI would not.³²⁹ The WTO Agreement on Government Procurement (AGP) does provide for National Treatment,³³⁰ but it does not cover local government³³¹ or state procurement below a minimum level,³³² and it applies only to those states that choose to join the agreement.³³³ The MAI, on the other hand, applies to all subnational governments and lacks a minimum threshold.³³⁴ Finally, the MAI's investor-to-state remedies provide the most significant change in the reach of National Treatment in comparison with existing agreements.

Just as the Supreme Court has developed a functional rationale for its deference to state subsidies, it has developed several rationales for its deference to state market participation. For example, states are entitled to promote the economic welfare of their own citizens when managing publicly owned resources.³³⁵ In addition, when acting as market participants, states are entitled to exercise the same control as any other market actor over how and with whom they do business.³³⁶ Lawrence Tribe has observed that these public and private rationales are inconsistent alterna-

324. See *South-Central Timber Dev. v. Wunnicke*, 467 U.S. 82, 100 (1984) (plurality opinion); NOWAK & ROTUNDA, *supra* note 292, § 8.9.

325. See GATT, *supra* note 111, art. III.8; MAI *Negotiating Text*, *supra* note 7, arts. II(Scope and Application)(1) and VI(Exceptions and Safeguards)(2).

326. See GATT, *supra* note 111, art. XX.

327. See *id.* art. III.8; MAI *Negotiating Text*, *supra* note 7, arts. II(Scope and Application)(1) and VI(Exceptions and Safeguards)(2). The MAI general exceptions are protection of "essential security interests," maintenance of "international peace and security," and maintenance of "public order." *Id.* art. VI(2). These may be relevant to military procurement, which is not a significant state-level activity.

328. See NAFTA, *supra* note 116, art. 1108.7.

329. See GATT, *supra* note 111, art. III.8; MAI *Negotiating Text*, *supra* note 7, arts. II(Scope and Application)(1) and VI(Exceptions and Safeguards)(2).

330. See AGP, *supra* note 181, art. III.1(a).

331. See *id.* Annex 2 - United States.

332. The AGP minimum threshold for subnational government is 35,000 SDRs (approximately \$500,000 US) for goods and services and 5 million SDRs (approximately \$7 million US) for construction. See *id.* Annex 2 - United States.

333. At present, 37 states have accepted the AGP through correspondence from the governor. See *id.* Annex 2 - United States.

334. See MAI *Negotiating Text*, *supra* note 7, arts. II(Scope and Application)(1) and VI(Exceptions and Safeguards)(2).

335. See *id.*; *McReady v. Virginia*, 94 U.S. (4 Otto) 391 (1877).

336. See *Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794 (1976).

tive rationales for the market participant exception.³³⁷ However, both rationales are consistent with the distinction between regulating the private market versus managing public resources, where states act as “guardian and trustee” of the public interest.³³⁸ Neither rationale is consistent with National Treatment under the MAI, which tests a law only in terms of whether it places foreign investors at a commercial disadvantage.³³⁹

When states limit use or sale of state land to their own citizens,³⁴⁰ they act within the economic welfare rationale of the market participation doctrine. The Supreme Court has upheld state limits on distributions of “government largesse” to state residents,³⁴¹ who should be free to reap what they have sown with their own investment of tax dollars.³⁴² When states limit nonresident access to natural resources that the state does not literally own (e.g., access to an underground aquifer), the Court has overturned the limit as a regulatory burden on commerce.³⁴³ Likewise, when a state imposes regulatory limits on the “downstream” use of state-owned resources after they are harvested (e.g., milling of timber), the Court has overturned the limit as a regulatory burden.³⁴⁴ The Court has upheld, however, residency limits on the sale or use of state-owned land or resources as within the scope of market participation.³⁴⁵ Such discrimination on the face of these laws would establish a *prima facie* violation of National Treatment.³⁴⁶

The domestic purchasing preferences of most state governments³⁴⁷ do not have any regulatory complications, and are therefore within the scope of the private market rationale. While the purchasing preferences for small and minority businesses are facially neutral, foreign governments have criticized their implicit bias that excludes foreign firms from approximately twenty percent of procurement in California and Texas to as much as sev-

337. See *TRIBE*, *supra* note 212, § 6-11.

338. See *Reeves*, 447 U.S. at 438 (quoting *Heim v. McCall*, 239 U.S. 175, 191 (1915)).

339. It is difficult, if not impossible, to see how the general exceptions to the MAI would apply to state activities as market participants. The MAI general exceptions are protection of “essential security interests,” maintenance of “international peace and security,” and maintenance of “public order.” *MAI Negotiating Text*, *supra* note 7, art. VI(Exceptions and Safeguards)(2).

340. See *supra* notes 120-30 and accompanying text (limits on sale or use of public land).

341. *Reeves*, 447 U.S. at 441.

342. See *Hellerstein & Coenen*, *supra* note 313, at 845.

343. See *Sporhase v. Nebraska ex rel. Douglas*, 458 U.S. 941 (1982).

344. See *South-Central Timber Dev. v. Wunnicke*, 467 U.S. 82 (1984).

345. Although the Court invalidated Alaska’s requirement that timber companies process logs in the state before exporting them, the Court acknowledged a number of alternative ways for the state to promote economic welfare. These included restricting sales to state residents, operating state-owned sawmills, and providing direct subsidies to in-state processors. See *id.* at 95. In *McReady v. Virginia*, the Court recognized the state’s right to sell its own land to its own citizens or to manage the land “to be used as a common by its people for the purposes of agriculture.” 94 U.S. (4 Otto) 391, 395-96 (1877).

346. See *supra* note 110 and accompanying text (explicit discrimination).

347. See *supra* notes 167-69 and accompanying text (buy-America or buy-local procurement preferences).

enty percent in Kentucky.³⁴⁸

Environmental purchasing preferences for recycled content have had a dramatic impact on the cost of market access for foreign investors.³⁴⁹ The national treatment issue is whether they continue to require significant processing costs that are disproportionately higher for foreign firms because of their geographical or market positions.³⁵⁰ The answer is likely to be yes if increasing numbers of states expand their environmental preferences beyond paper into other materials (e.g., wood, plastic, glass, and ceramics). A potential state defense is that recycled materials are not "like products" or that the foreign firms that use virgin materials are not in "like circumstances," with their recyclable competitors. However, this defense has failed in the context of GATT litigation when products that compete with each other are treated differently based on how they are made rather than how they perform as products.³⁵¹

State and local market participation is a highly sensitive issue under the MAI because the market is so large. Individual foreign firms would have a strong economic incentive under the MAI to file National Treatment complaints against state laws that limit market access. The commerce clause justification is that the market participation exception allows states to act like firms in the private market. A discriminatory effect is not relevant, so long as the courts view the states' market participation as serving a nonregulatory purpose. Yet even state regulation of foreign commerce receives a sliding-scale degree of deference when courts balance purpose and effect under the dormant commerce clause.

Farber and Hudec read GATS as a "restatement" that relaxes the effects test ("conditions of competition") when the adverse conditions are "inherent competitive disadvantages which result from the foreign character" of a firm.³⁵² But the way to defend a law under this inherent-disadvantage test, they argue, is to establish the law's routine normalcy, so that the regulation does not look protectionist, even though it may have an adverse affect on commerce.³⁵³ This is where the analogy to a balancing test stops because a search for routine normalcy begs the question. How can a state be a laboratory if it cannot experiment with solutions that are beyond the routine? There is no escape from the fact that the most liberal interpretation of an effects test cannot turn it into a balancing purpose test as well.

National Treatment under the MAI is an effects test only. By contrast, the purpose-and-effect balancing of the dormant commerce clause is designed to reconcile competing values of national versus local allocation of power and economic versus noneconomic objectives of government. The movement that the balancing test produces is not a weakness or cover

348. See EU TRADE REPORT — 1997, *supra* note 24, at 27; see also Alcoholic and Malt Beverages, *supra* note 33 (like products).

349. See *supra* note 158 and accompanying text (Canadian paper mills).

350. See Hellerstein & Coenen, *supra* note 313, at 1422.

351. See *supra* notes 116-18 and accompanying text (like products).

352. See Farber & Hudec, *supra* note 213, at 1429.

353. See *id.*

for protectionism. The movement in the balancing test is like the pendulum of a clock. The gravitational pull between legislative purpose and commercial effect is an energy source. By subtracting legislative purpose out of the balance, the MAI would stop the clock, and with it, the dynamic of state laboratories when their experiments affect foreign commerce.

4. Significance of Proposed MAI Revisions

The Chairman's Proposal to change the National Treatment text would make permanent the phrase that requires member nations to provide "treatment no less favourable than the treatment it accords in like circumstances to its own investors and their investments . . ." ³⁵⁴ This language is followed by an interpretative note in the text that recognizes that governments may have legitimate policy reasons to treat foreign investors differently in relation to domestic investors or investors from third countries. ³⁵⁵ If a law pursues a policy objective that is legitimate under the MAI, the Chairman's Proposal makes it possible to justify "different treatment" if the measure is otherwise not discriminatory. ³⁵⁶

The example in the Chairman's Proposal is limited to "securing compliance with domestic laws that are not inconsistent with national treatment . . ." ³⁵⁷ In other words, if a law violates National Treatment in the first place, then a panel would not even consider whether there are "like circumstances." A "different effect" on foreign investors could not rise to the level of *de facto* discrimination. As noted above, *de facto* discrimination means an effect on the competition of domestic as compared with foreign competitors. By negative inference, "in like circumstances" could justify a different effect that has no bearing on competition.

One could argue that the inclusion of the phrase, "in like circumstances," makes it more likely that a recycled-content statute would pass under national treatment since there is no explicit discrimination. How-

354. MAI Negotiating Text, *supra* note 7, Annex 2(2)(1).

355. The full text of the interpretive note reads:

National Treatment and most favoured nation treatment are relative standards requiring a comparison between treatment of a foreign investor and investments and treatment of domestic or third country investors and investments. Governments may have legitimate policy reasons to accord differential treatment to different types of investments. Similarly, governments may have legitimate policy reasons to accord differential treatment as between domestic and foreign investors and their investments in certain circumstances, for example, where needed to secure compliance with domestic laws that are not inconsistent with national treatment and most favoured nation treatment. The fact that a measure applied by a government has a different effect on an investment or investor of another Party would not in itself render the measure inconsistent with national treatment and most favoured nation treatment. The objective of "in like circumstances" is to permit the consideration of all relevant circumstances, including those relating to a foreign investor and its investments, in deciding to which domestic or third country investors and investments they should appropriately be compared.

Id. Annex 2(2)(3) n.8.

356. *Id.* Annex 2, 2(13).

357. *Id.* Annex 2(3)-(17), 2(15) n.3.

ever, the arguments against these laws include that they either place foreign producers at a competitive disadvantage, or they distort investment decisions at the expense of foreign producers. In addition, the laws discriminate based on how a product is made, not how it is used. In short, the insertion of "in like circumstances," with its interpretative note, is unlikely to offset the authority of international law.

B. Most-Favored-Nation (MFN) Treatment

1. MAI Provisions

The MAI would protect investors from discrimination based upon their activities in third countries. This activity usually arises in the context of sanctions or withdrawal of public purchasing on human rights grounds. Canada and the EU propose further MAI language that would make sanctions on investors or secondary boycotts an explicit violation of the MAI.³⁵⁸ Such a bright line, however, is not necessary. The MAI provisions for MFN³⁵⁹ are implicit and likely to result in the same degree of investor protection, and ultimately the same degree of controversy, as a ban on boycotts or sanctions.

There are two elements that expand MFN Treatment under the MAI in comparison to GATT, NAFTA, and WTO agreements. The first is the MAI's expansive definition of "investment"³⁶⁰ and "investor."³⁶¹ An investor from a MAI-member nation need only have a minority interest in an invest-

358. While over half of the OECD nations likely support this language, the United States opposes it because of its explicit conflict with the Helms-Burton sanctions on investors that have investments in Cuba. See 22 U.S.C. §§ 6021-91. The proposal reads:

No Contracting Party may take measures that

(i) either impose or may be used to impose liability on investors or investments of investors of another Contracting Party;

(ii) or prohibit, or impose sanctions for, dealing with investors or investments of investors of another Contracting Party;

because of investments an investor of another Contracting Party makes, owns or controls, directly or indirectly, in a third country in accordance with [international law and] regulations of such third country.

MAI *Negotiating Text*, *supra* note 7, Annex I (Draft Article on Secondary Investment Boycotts) (emphasis omitted) (brackets in original).

359. Each Contracting Party shall accord to investors of another Contracting Party and to their investments, treatment no less favourable than the treatment it accords [in like circumstances] to investors of any other Contracting Party or of a non-Contracting Party, and to the investments of investors of any other Contracting Party or of a non-Contracting Party, with respect to the establishment, acquisition, expansion, operation, management, maintenance, use, enjoyment, and sale or other disposition of investments.

MAI *Negotiating Text*, *supra* note 7, art. III(National Treatment and Most Favoured Nation Treatment)(2) (brackets in original).

360. The MAI defines "investment" as "[e]very kind of asset owned or controlled, directly or indirectly, by an investor" including, among other assets, an enterprise, ownership shares or stocks, contract rights, and property rights such as leases. *Id.* art. II(Definitions)(2).

361. The MAI defines "investor" as a "natural person having the nationality of, or who is permanently residing in, a Contracting Party" and "a legal person or any other entity constituted or organised under the applicable law of a Contracting Party, . . . whether private or government owned or controlled, and includes a corporation, trust, partner-

ment located in a non-member nation to challenge a policy that discriminates against the third-nation investment.³⁶² The second element is that MFN under the MAI is not limited to treatment of investments in the territory of a Contracting Party.³⁶³ MAI negotiators explained that their intent is to protect the "international activities of established foreign investors."³⁶⁴ The lack of territorial limits for MFN stands in contrast to the "absolute" investor protections, such as General Treatment and limits on performance requirements. The latter are limited to investments in the territory of a Contracting Party.³⁶⁵

In this regard, the standing of investors to seek a remedy for treatment of non-MAI countries is more liberal under the MAI than under NAFTA.³⁶⁶ Thus, the MAI definitions, coupled with MFN treatment, create a global umbrella for protection of investments, as long as the complaining investor is a national or resident of a non-MAI nation.

2. *The Potential for Conflict*

Human and labor rights advocates argue that the MAI would prohibit Contracting Parties and subnational governments from using their sovereign purchasing power to enforce human and labor rights.³⁶⁷ The leverage for

ship, sole proprietorship, joint venture, association or organisation." *Id.* art. II(Definitions)(1).

362. The MFN provisions would prohibit discrimination based on differential treatment of one MAI-member nation when compared with other MAI-member nations. However, differential treatment based on human rights abuses by OECD nations is not the focus of current policy debates. Rather, the current policy debates focus on human rights violations by non-OECD nations. This third-party dynamic raises two causes for concern about how the MAI might affect economic measures that discriminate against human rights violators. First, MFN treatment might constrain enforcement measures against non-OECD/non-MAI member rogue states. Second, if the MAI comes into force, the umbrella of MFN protection would make a strong incentive for rogue states to join the MAI. Military regimes in Myanmar and Nigeria, for example, show great enthusiasm for most goals of the MAI. See Ken Silverstein, *So You Want to Trade with a Dictator?*, MOTHER JONES, May/June 1998, at 40.

363. See MAI Commentary, *supra* note 101, art. III(National Treatment and Most Favoured Nation Treatment)(2). Compare MAI Negotiating Text, *supra* note 7, art. III(National Treatment and Most Favoured Nation Treatment)(2), with *id.* art. III(Performance Requirements)(1), and *id.* art. IV(1).

364. The broader context of MAI negotiators' explanation was that if the MAI were to limit MFN to a Contracting Party's treatment of investments "in its territory," the Contracting Parties would "not have obligations with regard to investors of another Contracting Party in a third country." MAI Commentary, *supra* note 101, art. III(National Treatment and Most Favoured Nation Treatment)(2). Instead, the MAI negotiators intended "not to unduly limit the scope of the agreement, for example by excluding the international activities of established foreign investors and their investments." *Id.*

365. Compare MAI Negotiating Text, *supra* note 7, art. III(National Treatment and Most Favoured Nation Treatment)(2), with *id.* art. III(Performance Requirements)(1), and *id.* art. IV(1).

366. See NAFTA, *supra* note 116, art. 1117 (requiring investors to own or control an investment in a non-MAI nation before they can claim a remedy under NAFTA on behalf of that investment in a non-MAI nation).

367. See JIM EGAN & JAMES ISBISTER, INQUIRY INTO THE MULTILATERAL AGREEMENT ON INVESTMENT 5 (1998); HUMAN RIGHTS PROGRAM OF HARVARD LAW SCHOOL, THE MULTILATERAL AGREEMENT ON INVESTMENT: ITS IMPACT ON INTERNATIONAL HUMAN RIGHTS PROTECTION

enforcement, they argue, is to deny violators access to markets, or at the very least, to avoid doing business with investors that violate human rights, do business with repressive regimes, or contribute to economic activity upon which repressive regimes depend for tax revenues, foreign currency, and political legitimacy.³⁶⁸ A U.N. subcommission on human rights called on OECD nations to review the draft MAI to ensure that its provisions are consistent with their human rights obligations.³⁶⁹

Within the past thirty years, a majority of U.S. states and many cities set human rights standards for companies with which they do business. The best known example is the South Africa selective purchasing boycott, in which nineteen states and sixty-two local governments participated.³⁷⁰ In 1998, twenty-three state and local governments used purchasing prefer-

AND THE WORK OF INTERNATIONAL HUMAN RIGHTS NGOs 4 (1997). The Harvard report also reviews the potential impact of the MAI on economic measures that fall outside the scope of this Article. These include U.S. investment bans, visa limits, limits on investment incentives, and conditions on foreign aid or debt relief. These measures also include sovereignty interests of prospective MAI members, such as the South African constitutional commitment to domestic ownership as a component of land reform. See *id.* at 19.

368. Burton Levin, a former U.S. Ambassador to Burma, stated that “[f]oreign investment in most countries acts as a catalyst to promote change, but the Burmese regime is so single-minded that whatever they might obtain from foreign sources they pour straight into the army while the rest of the country is collapsing.” See Craig Forcese, *Municipal Buying Power and Human Rights in Burma: The Case for Canadian Municipal ‘Selective Purchasing’ Policies* (1998) (unpublished paper on file with author) (quoting CANADIAN FRIENDS OF BURMA (CFOB), *DIRTY CLOTHES—DIRTY SYSTEM* 51 (1996)).

369. Commission on Human Rights, Subcommission on Prevention of Discrimination and Protection of Minorities, 50th Sess., Agenda Item 4(a), *The International Economic Order and the Promotion of Human Rights* ¶ 5 (Aug. 21, 1998). A delegate to the subcommission supported this resolution by arguing that:

This freedom for investors could have tragic consequences as the MAI could counter and negate the positive measures that states have taken or may propose to take to end discrimination faced by vulnerable people and communities in relation to the human rights to food, health, housing, land and work. Necessary measures such as food subsidies, control of land speculation, agrarian reform, and the implementation of health and environmental standards are all under threat of being viewed as ‘illegal’ under the MAI.

Mr. Miloon Kothari, Statement at the 50th Session of the United Nations Commission on Human Rights, Sub-Commission on Prevention of Discrimination and Protection of Minorities 3 (Aug. 12, 1998) (transcript on file with author).

370. See Kevin Lewis, *Dealing with South Africa: The Constitutionality of State and Local Divestment Legislation*, 61 TUL. L. REV. 469, 471 (1987); *South Africa: The Eagle Waits to Peck*, *ECONOMIST*, Sept. 20, 1986, at 34. There is considerable variety among the South Africa laws, which applies to banks with loans in South Africa, companies selling strategic military or police products, firms not receiving a minimum “Sullivan Principles” rating, and firms doing business in South Africa. The “doing business in” statutes are the model for the Massachusetts Burma Law. These states included California, Massachusetts, Montana, New Mexico, New Jersey, and Wisconsin. See *id.* at 473. For additional scholarship on South Africa laws, see also Michael H. Shuman, *Dateline Main Street: Courts v. Local Foreign Policies*, 86 FOREIGN POL’Y 158 (1992); Anne R. Bowden, Note, *North Carolina’s South African Divestment Statute*, 67 N.C. L. REV. 949 (1989); Peter J. Spiro, Note, *State and Local Anti-South Africa Action as an Intrusion Upon the Federal Power in Foreign Affairs*, 72 VA. L. REV. 813, 815 (1986); Grace Jublinsky, Note, *State and Municipal Governments React Against South African Apartheid: An Assessment of the Constitutionality of the Divestment Campaign*, 54 U. CIN. L. REV. 543 (1985).

ences to avoid business with companies that operate in Burma³⁷¹ and Cuba,³⁷² extract oil from Nigeria,³⁷³ operate in Northern Ireland without following the MacBride code of corporate responsibility,³⁷⁴ or withhold financial assets (in Swiss banks) from the families of Holocaust victims.³⁷⁵ At least eight other states and four cities considered similar legislation in 1998.³⁷⁶

These policies will inspire future investor-to-state disputes under the MAI. Most recently, the Swiss government threatened a WTO complaint in response to the announcement that California, New York State and City, and Pennsylvania would lead a U.S. boycott of services by Swiss banks in America if Switzerland and the private banks do not negotiate a settlement with Holocaust survivors and descendants.³⁷⁷ However, a few weeks after the states' policy was announced, the Swiss banks came to a compromise settlement with the class of Holocaust survivors and heirs.³⁷⁸

On another front, the European Union and Japan filed a September 1998 WTO complaint against the Massachusetts Burma law, which the

371. The 22 jurisdictions include the Commonwealth of Massachusetts; the county of Alameda, CA; and the cities of Ann Arbor, MI; Berkeley, CA; Boulder, CO; Brookline, MA; Cambridge, MA; Carrboro, NC; Chapel Hill, NC; Madison, WI; New York, NY; Newton, MA; Oakland, CA; Palo Alto, CA; Portland, OR; Quincy, MA; San Francisco, CA; Santa Cruz, CA; Santa Monica, CA; Somerville, MA; Takoma Park, MD; West Hollywood, CA. FRANKLIN RESEARCH & DEVELOPMENT CORPORATION, BURMA SELECTIVE PURCHASING LAWS (1998); INVESTOR RESPONSIBILITY RESEARCH CENTER, STATE & LOCAL GOVERNMENTS WITH COUNTRY-SPECIFIC SELECTIVE PURCHASING LAWS app. F chart (1998) [hereinafter IRRIC REPORT]. For a specific example, see MASS. GEN. LAWS ch. 7, § 22(G-M) (1966).

372. The jurisdiction is Dade County, FL. See USA Engage, *States and Municipalities with Prepared or Enacted Sanctions Laws* (visited Dec. 29, 1998) <<http://www.usaengage.org/resources/map3.html>>; USA Engage, *State and Local Sanctions Watch List* (visited Jan. 11, 1999) <<http://www.usaengage.org/news/status.html>>.

373. The jurisdictions include Berkeley, CA; Amherst, MA; Alameda Co., CA; and Oakland, CA. See IRRIC REPORT, *supra* note 371, app. F chart.

374. The 14 jurisdictions include the states of New Jersey and New York. The 12 cities include Albany, Boston, Chicago, Cleveland, Lakewood, New York City, Philadelphia, Rensselaer City, Rochester, San Francisco, Scranton, and Yonkers. See *id.*

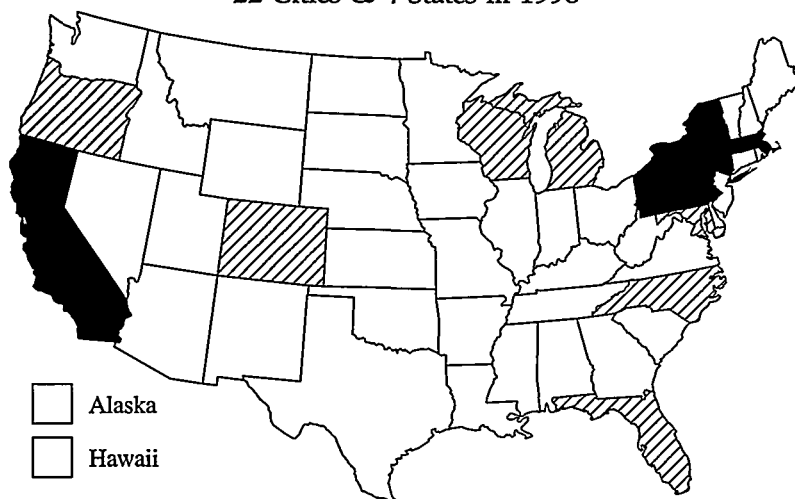
375. The leading jurisdictions included the City of New York and the states of California, New York, and Pennsylvania. See Henry Weinstein & John Goldman, *Nazi-Era Claims Spark Sanctions on Swiss Banks*, L.A. TIMES, July 2, 1998, at A1; *New York governor signs bill to punish firms who don't resolve Holocaust-era insurance claims*, JERUSALEM POST, July 10, 1998, at 5.

376. The states included Connecticut (Burma), California (Burma), Maryland (Nigeria), Massachusetts (Indonesia), North Carolina (Burma), Rhode Island (Indonesia), Texas (Burma), and Vermont (Burma). The cities included Davis (Burma), Los Angeles (Burma), Minneapolis (Burma), New York (Burma), and Seattle (Burma). See USA Engage, *USA ENGAGE, Ferr Trade, Unilateral and Economic Trade Sanctions* (visited Sept. 25, 1998) <<http://www.usaengage.org>>.

377. See John Goshko, *Sanctions on Swiss Banks to Proceed*, WASH. POST, July 2, 1998, at A-3; John Zarcorostas, *Bern withdraws threat over Holocaust claims*, J. COM., July 8, 1998, at 3A; David Sanger, *How a Swiss Bank Gold Deal Eluded a U.S. Mediator*, N.Y. TIMES, July 12, 1998, at 1-6. The issue still lingers regarding insurance claims of Holocaust survivors, where insurance is a traditional domain of state regulation. Weinstein & Goldman, *supra* note 375, at A1; *New York governor signs bill to punish firms who don't resolve Holocaust-era insurance claims*, *supra* note 375, at 5.

378. See John Goshko, *Swiss Banks' Pact Ends NY Threat of Sanctions*, WASH. POST, Aug. 14, 1998, at A14.

Example of Potential MFN Conflict:
Human Rights Standards for Procurement
22 Cities & 4 States in 1998



Solid = State and City; *Stripe* = City.

U.S. government has pledged to defend.³⁷⁹ In the meantime, a coalition of multinational companies has challenged the same law in U.S. federal court on constitutional grounds.³⁸⁰ The EU has filed an *amicus* brief in support of the plaintiffs.³⁸¹ In fact, the EU is represented by the same law firm that represents USA*Engage, the corporate coalition challenging the state law. Lest the EU present itself as a unified Europe in this conflict, the European Parliament responded to the EU's own WTO complaint by passing a resolu-

379. See Michael S. Lelyveld, *US vows to defend action by state*, J. COM., Sept. 11, 1998, at 3A; *EU to Request WTO Panel Ruling On Massachusetts Law*, INSIDE U.S. TRADE, Sept. 11, 1998, at 1. The EU Demarche complains of three violations of the AGP: (1) art. VIII(b), which prohibits conditions on a tendering company that are not essential to ensure the firm's capability to fulfill a contract; (2) art. X(3), which prohibits qualification criteria based on political rather than economic considerations; and (3) art. XIII(4), which prohibits making contract awards based on political rather than economic considerations. See European Commission Demarche to the U.S. Department of State, reprinted in INSIDE U.S. TRADE, Jan. 31, 1997, at 10. The European Union did not cite violation of the AGP provisions on MFN treatment, which provide for "treatment no less favorable than . . . that accorded to products, services and suppliers of any other Party." AGP, *supra* note 181, art. II.1(b). In comparison, the MAI provisions for MFN treatment would offer a stronger complaint than the AGP provisions because the MAI provides for treatment no less favorable than that accorded to "investors of any other Contracting Party or of a non-Contracting party, and to the investments of investors of any other Contracting Party or of a non-Contracting party . . ." MAI Negotiating Text, *supra* note 7, art. III(National Treatment and Most Favoured Nation Treatment)(2) (emphasis added).

380. See *National Foreign Trade Council (NFTC) v. Baker*, 26 F. Supp. 2d 287 (D. Mass. 1998). See *infra* notes 387-404 and accompanying text.

381. See *Amicus Curiae Brief for Plaintiff, National Foreign Trade Council (NFTC) v. Baker*, 26 F. Supp. 2d 287 (D. Mass. 1998). See also Nancy Dunne, *EU in Burma Law Protest*, FIN. TIMES, July 13, 1998, at 3.

tion that criticized the European Commission for requesting a WTO panel and deplored the escalation of human rights violations in Burma.³⁸²

3. Sovereignty Issues

The state policies that incite such legal battles are not foreign expeditions. For example, California Treasurer Matt Fong represents 20,000 California Holocaust survivors or their children.³⁸³ In the footsteps of the European refugees of the 1940s, thousands of expatriate Nigerians and Burmese became residents and citizens of the United States to avoid prison, torture, or ethnic cleansing.³⁸⁴ U.S. state legislators responded to their constituents' liberty interests, just as the state officials leading the boycott against Swiss banks acted to protect their constituents' financial rights.³⁸⁵

Multinational corporations, who support both the MAI³⁸⁶ and the litigation against Massachusetts,³⁸⁷ complain that state initiatives are burdensome incursions into two exclusive zones of federal power: conduct of foreign policy³⁸⁸ and regulation of foreign commerce,³⁸⁹ both of which

382. Relevant excerpts from the resolution include:

The European Parliament . . .

3. Believes that, in the interest of a foreign policy founded upon the principles of human rights and democracy, the scope of the WTO to take these principles into account should be enlarged rather than restricted and calls upon the European Union to use its weight as the biggest trading power of the world to this end;

4. Criticizes in this context the Commission decision to insist on a conflict resolution panel within the WTO over the law of the US State of Massachusetts, which set a pricing penalty on purchases of goods by state authorities from companies that do business in Burma.

EUROPEAN PARLIAMENT, RESOLUTION ON HUMAN RIGHTS VIOLATIONS IN BURMA I (Sept. 17, 1998).

383. See Goshko, *supra* note 377, at A3; Weinstein & Goldman, *supra* note 375, at A1.

384. See U.S. DEP'T OF ST., 1997 HUMAN RIGHTS REPORT - NIGERIA AND BURMA (Feb. 1998); U.N. SPECIAL RAPPORTEUR, MYANMAR (1997).

385. See, e.g., Mark Matthews, *Challenging Nigeria and Big Oil; Hopkins Student Fights Homeland's Rulers*, BALT. SUN, Jan. 4, 1998, at 1A; Teresa Malcolm, *Oil Blight Lingers for Ogoni*, NAT'L CATHOLIC REP., Mar. 27, 1998, at 4.

386. Multinational corporations complain as members of the U.S. Council for International Business.

387. Multinational corporations complain as members of the National Foreign Trade Council (NFTC) and USA*Engage.

388. See, e.g., Memorandum of Points and Authorities in Support of Plaintiff's Motion for Consolidation and Expedited Consideration of the Merits, at 6-12, 17-19, NFTC v. Baker, 26 F. Supp. 2d 287 (D. Mass. 1998) [hereinafter NFTC Memorandum]. For the "one voice" theory of foreign relations power, plaintiffs rely primarily on *Zschernig v. Miller*, 389 U.S. 429 (1968).

389. See NFTC Memorandum, *supra* note 388, at 27-28. For the "one voice" theory of foreign commerce power, plaintiffs rely primarily on *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434 (1979). For a range of scholarship on the Burma law controversy, see Daniel M. Price and John P. Hannah, *The Constitutionality of United States State and Local Sanctions*, HARV. INT'L L.J. 443 (1998); Jennifer Loeb-Cederwall, Note, *Restrictions on Trade with Burma: Bold Moves or Foolish Acts?*, 32 NEW ENG. L. REV. 929 (1998); Anne Q. Conaughton, *Factoring U.S. Export Controls and Sanctions Into International Trade Decisions*, 27 STETSON L. REV. 1211 (1998); Michael Wallace Gordon, *The Conflict of United States Sanctions Laws with Obligations Under the North American Free Trade Agreement*, 27 STETSON L. REV. 1259 (1998); David R. Moran, *No Panacea: Analyzing Sanctions*

require the United States to speak with "one voice." They argue that human rights standards for government purchasing are not valid local legislative purposes, and even if they are, their discriminatory nature is impossible to justify under a strict-scrutiny balancing test.³⁹⁰ Considering the nature of the state's legal arguments,³⁹¹ the arguments by the National Foreign Trade Council (NFTC) are a rough translation of MFN Treatment under the MAI into the language of constitutional doctrine. The following points illustrate how MFN Treatment and constitutional law may differ. This, of course, depends on whether the courts accept all of the plaintiff's assertions.

- *Speaking with "one voice."* More than 30 years after the Supreme Court used the "one voice" doctrine upon which the NFTC relies (for both foreign affairs and commerce clause), a nearly unanimous Court repudiated the doctrine in *Barclays*.³⁹² Arguably, MFN Treatment under the MAI would resolve any ambiguity over which federal "voice" the courts should enforce (*ie.*, the Executive rather than Congress) and whether the federal government's voice preempts all state voices (even harmonious voices).
- *Meaning of discrimination.* In the constitutional litigation, Massachusetts argues that its standard treats all companies similarly regardless of their status as foreign or domestic. The dormant commerce clause is not violated because it has a valid purpose for avoiding companies that do business with Burma, and it does not encroach upon a federal commercial interest such as protectionism.³⁹³ In contrast, the MFN standard of "treatment no less favorable" than that given to an investment from any other country precludes even the question of discrimination among third-party nations unless the general exceptions make that discrimination possible.
- *Balancing test.* The NFTC asserts that there is nothing to balance because the federal interest is exclusive. Massachusetts points to state regulatory statutes that were challenged as intrusions into federal foreign affairs power. The Supreme Court weighed these similar statutes and found one acceptable and the other exceedingly intrusive into the

Before Imposition, 27 STETSON L. REV. 1403 (1998); Alejandra Carvajal, Note, *State and Local "Free Burma" Laws: The Case for Sub-National Trade Sanctions*, 29 LAW & POL'Y INT'L BUS. 257 (1998); David R. Schmahmann & James Finch, *The Unconstitutionality of State and Local Enactments in the United States Restricting Business Ties with Burma (Myanmar)*, 30 VAND. J. TRANSNAT'L L. 175 (1997).

390. NFTC Memorandum, *supra* note 388, at 23, 34.

391. See Defendant's Memorandum in Support of their Motion for Summary Judgment, *NFTC v. Baker*, 26 F. Supp. 2d 287 (D. Mass. 1998) [hereinafter Massachusetts Memorandum].

392. See discussion of *Barclays*, *supra* Part II.A.3 and notes 222-32, 281-83 and accompanying text.

393. See Massachusetts Memorandum, *supra* note 391, at 38-40. As noted above in the discussion of National Treatment, *supra* Part II.A., the dormant commerce clause protects the market, not individual firms. See *Exxon v. Maryland*, 436 U.S. 117, 127-28 (1978). See also Lewis, *supra* note 370, at 492-502.

conduct of foreign affairs.³⁹⁴ As noted under National Treatment, the MAI uses a monolithic test of commercial disadvantage that is akin to the exclusive federal interest argument. The only permissible justifications that the MAI would "balance" under its general exceptions are "essential security interests," United Nations obligations for maintenance of international peace and security,³⁹⁵ and maintenance of "public order," which applies when a "serious threat is posed to one of the fundamental interests of society."³⁹⁶

- *Market participation.* The absence of relevant MAI general exceptions is parallel to the NFTC position that the market participation exception does not apply to exclusive federal powers in the execution of foreign affairs and regulation of foreign commerce.³⁹⁷ Even if the exception does apply, the NFTC argues that the exception is limited to protection of local economic interests, not factors unrelated to the immediate business between the state and the corporation.³⁹⁸ While recognizing the Supreme Court's caution that it has had "no occasion to explore the limits imposed on state proprietary actions by the foreign commerce clause,"³⁹⁹ Massachusetts cites both federal and state courts that have applied the exception to foreign commerce. This includes human rights criteria outside the scope of contract goods or services.⁴⁰⁰ These cases reason that when states act as market participants, they exercise the same rights as private corporations undertaking the same activity.⁴⁰¹ In 1986, the United States Justice Department endorsed the market participant exception as applied to South Africa boycott legislation,⁴⁰² as did Professor Tribe in 1988.⁴⁰³ In short, Massachusetts' argument

394. See Massachusetts Memorandum, *supra* note 391, at 47-49.

395. MAI *Negotiating Text*, *supra* note 7, art. VI(2).

396. *Id.* art. IV(3), (2)(2.5) n.2.

397. See NFTC Memorandum, *supra* note 388, at 31-32.

398. See *id.* at 27.

399. Massachusetts Memorandum, *supra* note 391, at 31 (quoting *Reeves v. Stake*, 447 U.S. 429, 438 n.9 (1980)).

400. See *id.* at 30 (citing *Trojan Techs. v. Commonwealth of Pennsylvania*, 916 F.2d 903, 909-13 (3d Cir. 1990); *Board of Trustees v. Mayor of Baltimore*, 562 A.2d 720, 752 (Md. 1989); *K.S.B. Technical Sales Corp. v. New Jersey District Water Supply Comm'n*, 381 A.2d 774, 784-89 (N.J. 1977)).

401. Matthew Porterfield argues that as market participants, state governments enjoy First Amendment protection for both political speech and policy decisions on how the state should spend and invest its funds. See Matthew C. Porterfield, *The First Amendment as an Instrument of Federalism*, 35 STAN. J. INT'L L. (forthcoming 1998) (Part IV.B - Selective Investment and Purchasing Laws as Protected Activity Under the First Amendment).

402. In response to the South Africa boycott upon which the Massachusetts Burma law is modeled verbatim, the U.S. Justice Department, under Attorney General Edwin Meese, concluded that "[t]he role of the state as 'guardian and trustee for its people' in spending or investing their funds is as strong when the state's market participation affects foreign as when it affects interstate commerce." *Constitutionality of South African Divestment Statutes Enacted by State and Local Governments*, 10 Op. Off. Legal Counsel 49, 54-55 (Apr. 9, 1986).

403. See TRIBE, *supra* note 212, § 6-22, which opined:

[U]nder the Supreme Court's market participant exception to the Commerce Clause, a state would be free to pass laws forbidding investment of the state's

enjoys wide support.

The constitutional litigation in Massachusetts helps prove the first sovereignty impact of the MAI version of MFN treatment. This includes authorization of an extraterritorial forum, rather than the Supreme Court, to decide whether a state government should be able to act as “a guardian and trustee of its people”⁴⁰⁴ when conducting its own business as a market participant.

The second sovereignty impact is that the MAI would deny to states any of the sovereignty doctrines that remain standing after the Burma law litigation has reached its final destination. These include the *Barclays* interpretation of the “one voice” doctrine, the *Exxon* interpretation of market discrimination, the balancing test for competing federal and state interests, and the market participation exception.

The third category involves the status of state governments under international law. Those state sovereignty arguments that remain standing after *NFIC v. Baker*, regardless of the fate of this particular statute, are vulnerable with respect to the MAI’s influence on the balance of state power in at least three categories: (1) the scope of legitimate market participation under international agreements; (2) the availability of general exceptions under international agreements (which would “balance” against strict application of MFN Treatment); and (3) the capacity of the U.S. government to serve as a diplomatic buffer.

The MAI would reduce the scope of permissible market participation compared to existing international agreements. Similar to the MAI version of MFN Treatment, both the NAFTA investor protections⁴⁰⁵ and the GATS⁴⁰⁶ have MFN provisions that reach treatment of activity in non-MAI countries. However, neither NAFTA⁴⁰⁷ nor GATS⁴⁰⁸ apply MFN treatment to government procurement. In effect, NAFTA and GATS have an exception for market participation, but the MAI does not.

The WTO Agreement on Government Procurement covers thirty-seven

pension funds in companies that do business with South Africa, or rules requiring that purchases of goods and services by and for the state government be made only from companies that have divested themselves of South African commercial involvement.

404. *Atkin v. Kansas*, 191 U.S. 207, 222-23 (1903).

405. Apart from the exceptions that include government procurement, MFN under NAFTA Chapter 11 is equivalent to the MAI: “Each Party shall accord to investors of another Party treatment no less favorable than 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.” NAFTA, *supra* note 116, art. 1103.1. NAFTA’s next section requires “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 . . .” *Id.* art. 1103.2.

406. “[E]ach member shall accord immediately and unconditionally to services and service suppliers of any other Member treatment no less favorable than that it accords to like services and service suppliers of any other country.” GATS, *supra* note 114, art. II.1.

407. *See* NAFTA, *supra* note 116, art. 1108.7.

408. *See* GATS, *supra* note 114, arts. XIII.1 & XIV(e).

U.S. states⁴⁰⁹ but no cities. Thus, even if the United States were to lose a WTO complaint based on the AGP, it would have no legal bearing on cities. In contrast, the MAI covers local, state, and national governments.⁴¹⁰ Finally, the WTO agreement only applies to purchases that exceed \$500,000 for goods and services and \$7 million for construction.⁴¹¹ This threshold opens the door to selective purchasing in a state like Massachusetts, where a large majority of state contracts fall below the threshold.⁴¹² In effect, the AGP includes two exceptions for market participation that the MAI does not: one for jurisdictions that do not accept the AGP and a minimum threshold for all jurisdictions.

The MAI represents a radical change in the availability of general exceptions to MFN Treatment under existing international agreements. The AGP provides general exceptions that include "public morals, order and safety,"⁴¹³ the scope of which is yet to be addressed in any GATT or WTO dispute. Steve Charnovitz argues persuasively that human rights standards for business partners would fall within the scope of public morals based on the history of GATT Art. XX(a), several European treaties, and multiple human rights conventions.⁴¹⁴

Although recent WTO and GATT decisions have opposed the extraterritorial aims of U.S. trade regulations,⁴¹⁵ government procurement represents a wholly different context. In theory, this context gives the WTO room to consider whether discrimination to protect "public morals and order" is an appropriate form of market participation for government procurement.⁴¹⁶ The lack of general exceptions in the MAI would close the

409. See AGP, *supra* note 181, U.S. Annex II. There is considerable controversy on whether Massachusetts ever consented to join the AGP; the letter responding to the U.S. Trade Representative's request certainly did not say so. See Letter from William Weld, Governor of Massachusetts, to Mickey Kantor, U.S. Trade Representative (Dec. 3, 1993) (on file with author). The other states that joined the AGP did so by letter, with no legislative authority to waive or suspend statutes that are not consistent with the AGP.

410. See OECD DOCUMENTS, *supra* note 58, at 123.

411. The minimum threshold is 355,000 SDRs (approximately US \$500,000) for supplies and services and 5 million SDRs (approximately US \$7 million). See AGP, *supra* note 181, U.S. Annex II.

412. Interview with Harold R. Fisher, General Counsel, Operational Services Division, Executive Office of Administration and Finance of the Commonwealth of Massachusetts (Mar. 2, 1998) (notes on file with author).

413. AGP, *supra* note 181, art. XXIII.1.

414. See Steve Charnovitz, *The Moral Exception in Trade Policy*, 38 VA. J. INT'L. L. 689, 710, 713, 728 (1998).

415. See *Shrimp Report*, *supra* note 104, ¶ 187; Charnovitz, *supra* note 414, at 46-48, 71-77. See also Howard F. Chang, *An Economic Analysis of Trade Measures to Protect the Environment*, 83 GEO. L.J. 2131, 2194 (1995) (discussing the territorial principle).

416. See Charnovitz, *supra* note 414, at 729. See also Christopher McCrudden, *International Economic Law and Human Rights: A Framework for Discussion of the Legality of "Selective Purchasing" Laws under the WTO Government Procurement Agreement*, 2 J. INT'L. ECON. L. (forthcoming 1999). Additional scholarship on the public morals exceptions includes Christoph T. Feddersen, *Focussing on Substantive Law in International Economic Relations: The Public Morals of GATT's Article XX(a) and "Conventional" Rules of Interpretation*, 7 MINN. J. GLOBAL TRADE 75 (1988).

door to that room.⁴¹⁷

Finally, the MAI would change the balance of state power in terms of the role of the U.S. federal government. In WTO disputes that have involved U.S. states, the parties have used diplomatic channels for an extended period during which state and local policy created significant leverage on the principal actors.⁴¹⁸ In this process, the objective is not to "win," but to reach "an equitable resolution on all of the issues."⁴¹⁹

A crucial element of sovereignty protection, surfacing in the debate prior to the adoption of the Uruguay Round, involves this capacity of the federal government to serve as a buffer on behalf of U.S. states.⁴²⁰ Under the MAI, the private companies that could bring complaints for monetary damages would have much less interest in seeking a diplomatic resolution that meets public policy objectives. The first NAFTA case brought by the Ethyl Corporation against Canada is a case in point.⁴²¹ The Ethyl Corporation had a capital investment to protect, which justified a further investment in legal fees based on the legal merits of the case. The U.S. government declined the opportunity to bring a state-to-state case on Ethyl's behalf. The government would have gained no immediate return and would have risked considerable political capital by making the first NAFTA investment case a state-to-state challenge against Canadian environmental law.

417. Like the general exception of GATS, *supra* note 114, art. XIV(a), n.5, the MAI defines its general exception for public order very narrowly to consist of only a "genuine and serious threat" to "one of the fundamental interests of society." *MAI Negotiating Text*, *supra* note 7, art. VI(General Exceptions)(3). Unlike the MAI, however, GATS has a carve-out for government procurement. GATS, *supra* note 114, art. XIV(e). Christopher McCrudden explains how the textually unrestricted meaning of "ordre public" or "public policy" in the Treaty of Rome has been interpreted in a comparably narrow way by the European Court of Justice. See McCrudden, *supra* note 416, at 39. Nonetheless, the AGP's general exception for "public morality and order" is not restricted by a textual amendment as seen in the GATS or MAI exceptions. Thus, the WTO has an explicit basis for recognizing a broader scope of sovereignty in public procurement, which comports with U.S. constitutional law on market participation by states. If adopted, the MAI language gives dispute panels an easy way to ratchet up "public morals and order" to a burden of proof that U.S. states could not meet unless their internal security was threatened.

418. Undersecretary of State Stuart Eizenstat criticized the city and state treasurers' initiative as a "counterproductive" intrusion into the Swiss bank negotiations. California State Treasurer Matt Fong responded that "our aggressiveness brought the banks to the table." Weinstein & Goldman, *supra* note 375, at A1. After the state initiative brought the banks to a settlement, the pragmatic Undersecretary of State hailed the outcome as a "historic agreement," which "carried the moral weight of the growing international consensus . . ." *Id.* He acknowledged the direct interest of U.S. citizens as evidenced by state-level legislation, and he commended state insurance commissioners for organizing their response to the controversy as advocates for their constituents. See Stuart Eizenstat, *Justice After the Holocaust*, WASH. POST, Sept. 23, 1998, at A5.

419. John Zarocostas, *Bern Withdraws Threat over Holocaust Claims*, J. COM., July 8, 1998, at 3A.

420. The U.S. Senate debated several times on the Uruguay Round. See 140 CONG. REC. S8847, S8853, S8855, S8862-64 (July 13, 1994). See also Letter from Michael Kantor, U.S. Ambassador, to Michael E. Carpenter, Attorney General of Maine, Attachment ¶ 2 (July 1994), reprinted in *Special Report*, INSIDE U.S. TRADE, July 22, 1994, at S-3.

421. See SFORZA & VALLIANATOS, *supra* note 79, at 1.

In sum, MFN provisions under the MAI could have three significant effects on the power of U.S. states: (1) a substantial reduction in the scope of legitimate market participation; (2) a virtual elimination of general exceptions that are available under existing agreements; and (3) a short-circuit on the role the federal government plays as a buffer and diplomatic problem-solver on behalf of U.S. states.

The political effects of this altered balance of power could prove significant. For example, cities and states would no longer act as catalysts within the U.S. federal system on issues of human rights, as they did in the campaign against apartheid in South Africa. Nor would they continue to experiment with consumer choice standards for doing business in a global economy as they have with application of Sullivan or MacBride principles. Nor would they offer hope to advocates for human rights and democracy through a process of bottom-up policymaking when national governments have other priorities.

4. Significance of Proposed MAI Revisions

The Chairman's proposals on labor and the environment include a preamble and a slightly altered text for MFN Treatment. The relevant preamble paragraph states that the MAI Contracting Parties would renew

their commitment to the Copenhagen Declaration of the World Summit on Social Development and the observance of internationally recognised core labour standards, i.e., freedom of association, the right to organise and bargain collectively, prohibition of forced labour, the elimination of exploitative forms of child labour, and non-discrimination in employment, and [the Contracting Parties note] that the International Labour Organisation is the competent body to set and deal with core labour standards world-wide.⁴²²

The change in the MFN text would make permanent the bracketed phrase that requires Contracting Parties to provide "treatment no less favourable [than] the treatment it accords in *like circumstances* to its own investors and their investments"⁴²³ This change in language would likely permit only those differences that do not affect competition, not the kind of explicit discrimination based on human rights standards. The preamble suggests the need for general exceptions in the MAI concerning core labor standards, but since the preamble is not part of the MAI text, it contains only interpretive value.

The example in the text is limited in application to general domestic standards of foreign investors. It is too limited to address the fundamental question of whether MFN treatments permit a government to discriminate based on behavior in a third country. Policymakers and courts will likely read the Chairman's language as limiting the application of the preamble to only *de facto* enforcement measures. In this context, the preamble is something of a tautology; it states that Contracting Parties may adapt their domestic policies to comply with International Labor Organization (ILO)

422. MAI Negotiating Text, *supra* note 7, Annex 2(1) (Preamble).

423. *Id.*

agreements, which is already the case. It does not authorize member nations to enforce ILO agreements by choosing not to do business with investors or nations that violate ILO agreements. With respect to MFN treatment, the Chairman's proposal represents a pragmatic technical correction, not a response to sovereignty concerns.

C. Absolute Investor Protections

The MAI provides a number of "absolute" investor protections, so called because they apply even when there is equal relative treatment (National Treatment or Most Favoured Nation Treatment) when foreign investors are compared to domestic investors. Apart from the MAI articles on financial services and taxation, there are at least twelve absolute MAI provisions.⁴²⁴ The scope of this article permits only a summary of three absolutes that could pose the greatest limits on state lawmaking authority: the limits on performance requirements, provisions on compensation for expropriation, and general treatment.

1. Limits on Performance Requirements

The MAI prohibits twelve specific types of performance requirements or mandates that governments might impose on an investment in its territory.⁴²⁵ The first five prohibited requirements parallel those of the WTO

424. The absolute provisions include, *id.* arts. III(Transparency, Temporary Entry, Nationality Requirements, Employment Requirements, Performance Requirements and Monopolies/State Enterprises), and IV(General Treatment, Expropriation, Protection from Strife, Transfers, Information Transfer and Data Processing, and Subrogation).

425. See *id.* art. III(Performance Requirements)(1). The full text is:

A Contracting Party shall not, in connection with the establishment, acquisition, expansion, management, operation, maintenance, use, enjoyment, sale or other disposition of an investment in its territory of an investor of a Contracting Party or of a non-Contracting Party, impose, enforce or maintain any of the following requirements, or enforce any commitment or undertaking:

- (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;
- (d) to relate in any way the volume or value of imports to the volume or value of exports or to the amount of foreign exchange inflows associated with such investment;
- (e) to restrict sales of goods or services in its territory that such investment produces or provides by relating such sales to the volume or value of its exports or foreign exchange earnings;
- (f) to transfer technology, a production process or other proprietary knowledge to a natural or legal person in its territory, except when the requirement
 - is imposed or the commitment or undertaking is enforced by a court, administrative tribunal or competition authority to remedy an alleged violation of competition laws, or
 - concerns the transfer of intellectual property and is undertaken in a manner not inconsistent with the TRIPS agreement [referring to the WTO Agreement on Trade Related Aspects of Intellectual Property Rights];
- (g) to locate its headquarters for a specific region or the world market in the territory of that Contracting Party;

Agreement on Trade-Related Investment Measures (TRIMS).⁴²⁶ The MAI prohibits any requirement to export goods or services, achieve a given level of domestic content, purchase domestic goods or services, or restrict domestic sales to the volume of exports.⁴²⁷ The other seven prohibitions do not apply if a MAI country links the requirement to an "advantage" such as a subsidy or tax benefit.⁴²⁸ Without such a link, the MAI prohibits any requirements to transfer technology or proprietary knowledge, locate a regional headquarters, conduct research and development, hire local personnel, establish a joint venture, or achieve a minimum level of local equity participation.⁴²⁹

The MAI provisions on performance requirements expand considerably upon the limits that are already imposed under NAFTA chapter 11.

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- (h) to supply one or more of the goods that it produces or the services that it provides to a specific region or the world market exclusively from the territory of that Contracting Party;
 - (i) to achieve a given level or value of research and development in its territory;
 - (j) to hire a given level of nationals;
 - (k) to establish a joint venture with domestic participation; or
 - (l) to achieve a minimum level of domestic equity participation other than nominal qualifying shares for directors or incorporators of corporations.

Id.

426. See Agreement on Trade-Related Investment Measures, GATT Doc. MTN/FA II-A1A-7, Annex (Illustrative List) (Dec. 15, 1993) [hereinafter TRIMS].

427. See MAI Negotiating Text, *supra* note 7, art. III(Performance Requirements)(1)(a)-(e).

428. The exact language is:

A Contracting party is not precluded by paragraph 1 from conditioning the receipt or continued receipt of an advantage, in connection with an investment in its territory of a Contracting Party or of a non-Contracting Party, on compliance with any of the requirements, commitments or undertakings set forth in paragraphs 1(f) through 1(l).

Id. art. III(Performance Requirements)(2).

429. See *id.* art. III(Performance Requirements)(1)(f)-(l). Apart from the subsidy link, there are two proposals for exceptions that could limit the negative impact of these MAI provisions on state sovereignty. The first is a proposal to create an exception to the prohibitions on requirements for using domestic content or purchasing domestic goods or services. The exception would cover requirements designed to conserve resources and perhaps those that protect human or animal life or health.

A majority of delegations do not see a need for these exceptions. If added, some would support an interpretative note similar to the following:

Provided that such measures are not applied in an arbitrary or unjustifiable manner, or do not constitute a disguised restriction on investment, nothing in paragraphs 1(b) and 1(c) shall be construed to prevent any Contracting Party from adopting or maintaining measures necessary to secure compliance with environmental laws and regulations [that are not otherwise inconsistent with the provisions of this Agreement and] that are necessary for the conservation of living or non-living resources, [or that are necessary to protect human, animal or plant life or health.]

Id. art. III(Performance Requirements)(4) n.30 (brackets in original). Paragraph 1(b) prohibits domestic content requirements, and paragraph 1(c) prohibits preferences for domestic goods or services.

Another proposal is to create an exception for government procurement from the prohibitions on requirements for using domestic content, purchasing domestic goods and services, transferring technology, or supplying goods or services to a specific region. See *id.* art. III(Performance Requirements)(5)(b).

First, the MAI would extend the provisions to cover existing local law, which NAFTA does not.⁴³⁰ Second, NAFTA provides two significant exceptions, which the MAI does not.

The first NAFTA exception allows governments to promote economic development by linking subsidies with trade-related performance requirements.⁴³¹ The MAI does not allow any of these requirements, even when a subsidy is attached.⁴³² Both NAFTA and the MAI prohibit state and local economic development powers to the extent that they link program benefits with export performance. The MAI, however, would extend the prohibition to local government programs and expand the prohibition to cover domestic content and purchasing preferences.⁴³³ Under the dormant commerce clause, these state programs are secure from constitutional challenge because of the exceptions for market participation⁴³⁴ and subsidies.⁴³⁵

Another area where the MAI could constrain domestic lawmaking is community lending policy. The federal government and many states require a bank owner to demonstrate that it meets community credit needs under a federal or state Community Reinvestment Act (CRA). New York,⁴³⁶ Washington,⁴³⁷ Connecticut,⁴³⁸ Massachusetts,⁴³⁹ West Virginia,⁴⁴⁰ Ohio,⁴⁴¹ and Iowa⁴⁴² are among the states that enforce CRA requirements most rigorously when a bank owner applies to purchase, expand, or move a banking business. A bank owner can demonstrate its community lending performance through making specific kinds of loans, undertaking joint ventures or contracts with nonprofit developers or public agencies, or hiring and training community residents.⁴⁴³ These performance measures would violate several MAI limits on performance require-

430. See NAFTA, *supra* note 116, art. 1108.1-2.

431. The NAFTA exception provides:

Nothing in paragraph 3 [which is parallel to MAI prohibitions (b) through (e)] shall be construed to prevent a Party from conditioning the receipt or continued receipt of an advantage, in connection with an investment in its territory of an investor of a Party or of a non-Party, on compliance with a requirement to locate production, provide a service, train or employ workers, construct or expand facilities, or carry out research and development in its territory.

Id. art. 1106.4.

432. See MAI *Negotiating Text*, *supra* note 7, art. III(Performance Requirements)(2).

433. See *supra* notes 167-69 (examples of state domestic purchasing preferences).

434. See discussion *supra* Part II.A.3.e (Market Participation) and notes 323-39.

435. See discussion *supra* Part II.A.3.d (Subsidies) and notes 303-22.

436. See N.Y. BANKING LAW § 28-b (McKinney 1985 & Supp. 1987).

437. See WASH. REV. CODE ANN. §§ 30.04.010, 30.04.212 (West Supp. 1986).

438. See CONN. GEN. STAT. § 36a-32 (1996) (state-supervised banks); CONN. GEN. STAT. § 36a-412 (1996) (interstate acquisition).

439. See MASS. GEN. LAWS ANN. ch. 167, § 14 (West 1984).

440. See W. VA. CODE § 31A-8B-1 (1982 & Supp. 1987).

441. See OHIO REV. CODE ANN. § 1111 (Banks-Baldwin 1978 & Supp. 1987).

442. See IOWA CODE ANN. § 524.1090 (West 1996).

443. Most state bank supervisors follow the lead of federal bank examiners in the area of CRA performance standards. See generally 12 C.F.R. 25.21-25 and 25.21.29 (1998); 12 U.S.C. §§ 2901-07 (1997); Craig E. Marcus, Note, *Beyond the Boundaries of the Community Reinvestment Act and the Fair Lending Laws: Developing a Market-Based Framework for Generating Low- and Moderate-Income Lending*, 96 COLUM. L. REV. 710 (1996).

ments since no subsidies are involved. In addition, the MAI article on financial services limits regulation to prudential measures, which includes "safety and soundness" regulations, but not community lending requirements.⁴⁴⁴

2. Expropriation

The MAI provides that Contracting Parties

shall not expropriate or nationalise directly or indirectly an investment in its territory . . . or take any measure or measures having equivalent effect . . . except: a) for a purpose which is in the public interest, b) on a nondiscriminatory basis, c) in accordance with due process of law, and d) accompanied by payment of prompt, adequate and effective compensation . . .⁴⁴⁵ Compensation shall be equivalent to the fair market value of the expropriated investment . . .⁴⁴⁶

Apart from the MAI commentary, which explains that "measures having equivalent effect" include "creeping" expropriation, there is no definition of expropriation.⁴⁴⁷

The MAI legislative history includes a Working Group report explaining that measures having an "equivalent effect" to expropriation include "confiscations, seizure, interventions, temporary takings, modalities on the use and disposal of the investment, interference, government administration, even if it does not affect the title or ownership of the investment, and forced sales. . . . A broad definition would be a safeguard against new forms of expropriations in the future."⁴⁴⁸

With somewhat poetic timing, news of the MAI's expropriation provisions reached the U.S. environmental advocates shortly after they thought they had turned back a series of congressional "property rights" initiatives.⁴⁴⁹ Environmentalists had persuaded President Clinton to threaten a veto,⁴⁵⁰ because the bills would have relaxed the threshold for defining a

444. MAI Negotiating Text, *supra* note 7, art. VII(Prudential Measures)(1).

445. *Id.* art. IV(2)(2.1).

446. *Id.* art. IV(2)(2.3).

447. MAI Commentary, *supra* note 101, art. IV(2)(5).

448. Working Group A, *Existing Legislation*, in OECD DOCUMENTS, *supra* note 58, at 118.

449. See Private Property Protection Act of 1995, H.R. 925, 104th Cong. (1995); the Omnibus Property Rights Act of 1995, S. 605, 104th Cong. (1995). See also S. REP. NO. 104-239 at 12 (1996); the Omnibus Property Rights Act of 1996, S. 1954, 104th Cong. (1996); the Private Property Rights Implementation Act of 1997, H.R. 1534, 105th Cong. (1997). For environmental perspectives on the legislative history, see Glenn P. Sugameli, *Takings Bills Threaten Private Property, People and the Environment*, 8 FORDHAM ENVTL. L.J. 521, 525-50 (1997); John D. Echeverria, *The Politics of Property Rights*, 50 OKLA. L. REV. 351 (1997).

450. President Clinton wrote the Senate Judiciary Committee stating that "S. 605 does not protect legitimate private property rights. The bill instead creates a system of rewards for the least responsible and potentially most dangerous uses of property. It would effectively block implementation and enforcement of existing laws protecting public health, safety, and the environment." Letter from William Clinton, President of the United States, to Orrin Hatch, Chairman of the Senate Judiciary Committee (Dec. 13, 1995), *quoted in* S. REP. NO. 104-239, at 55 (1996).

“taking” as a partial percentage diminution of value of *any part* of an investor’s property.⁴⁵¹

Environmental advocates read the MAI as a parallel strategy for gaining a friendlier forum for investors, a more relaxed threshold for finding a compensable taking, and a fiscal incentive for environmental deregulation.⁴⁵² Twenty organizations wrote President Clinton to suggest the contradiction between his proposed veto of the property rights bills and his support for the MAI and its expropriation provision.⁴⁵³ Their concern is a reflection of the timing of the MAI proposal, its indeterminate coverage of indirect and direct expropriation or measures “having equivalent effect,” and the interpretive latitude of dispute panels that are unfettered by U.S. constitutional law.⁴⁵⁴

The Fifth Amendment to the U.S. Constitution requires the government to compensate investors when the government “takes” their property.⁴⁵⁵ Until the twentieth century, the Supreme Court applied the takings clause only to direct appropriation of property or the “practical ouster of [the owner’s] possession.”⁴⁵⁶ In 1922, the Court recognized that government regulation could effect a taking if it goes too far,⁴⁵⁷ but generally, courts find that a government regulation results in a taking only when

451. For example, S. 605 would have required compensation for any regulatory action that reduced by 33% or more of the value of any affected portion of real, personal, or intangible property. The Omnibus Property Rights Act of 1995, S. 605, 104th Cong. § 204(a) (1995). S. 1954 expanded the scope of takings to include a *temporary* loss of the value of any part of affected property. See The Omnibus Property Rights Act of 1996, S. 1954, 104th Cong. § 204(a)(2)(c) (1996).

452. See Sugameli, *supra* note 449, at 567-70.

453. See Letter from the American Oceans Campaign, Center for Marine Conservation, Defenders of Wildlife, Earthjustice Legal Defense Fund, Environmental Defense Fund, Friends of the Earth, Iszck Walton League, League of Conservation Voters, National Audubon Society, National Environmental Trust, National Parks and Conservation Association, National Trust for Historic Preservation, National Wildlife Federation, Natural Resources Defense Council, Physicians for Social Responsibility, Rails to Trails Conservancy, Scenic America, Sierra Club, United States Public Interest Research Group, and the Wilderness Society to the President of the United States (Feb. 10, 1998) (on file with author) [hereinafter NGO Letter]. The reply to this letter sought to assure you that we will oppose any international agreements that are inconsistent with or that undermine our domestic takings law. To that end, we made good progress on this issue over the past spring. We were also pleased that the *Ministerial Statement* reflects a consensus that normal regulatory action, even when it affects the value of investments, should not be considered an expropriation or “taking” requiring compensation.

Letter from Susan Esserman, General Counsel, Executive Office of the President, to Mark Van Putten, President and Chief Executive Officer of National Wildlife Federation (undated, received 1 Oct. 1998) (copy on file with author) (emphasis added). The response also acknowledged that “difficult issues remain.” *Id.*

454. NGO Letter, *supra* note 453. See also *MAI Negotiating Text*, *supra* note 7, art. IV(2)(2.1)-(2.2).

455. U.S. CONST. amend. V. (“No person shall . . . be deprived of life, liberty, or property, without due process of law; nor shall private property be taken for public use without just compensation.”). The Fifth Amendment applies to states under the Fourteenth Amendment.

456. *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003, 1014 (1992).

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

it eliminates all or substantially all of a property's value.⁴⁵⁸ Consistent with this rule, the Supreme Court recently affirmed that "our cases have long established that mere diminution in the value of property, however serious, is insufficient to demonstrate a taking."⁴⁵⁹

The open-ended meaning of direct or indirect expropriation, "measures having equivalent effect" and "creeping expropriation" would create considerable latitude for MAI dispute panels to ignore or alter at least one or more of the analytic tests that U.S. courts have developed over the years to determine when a complete taking or elimination of economic value occurs. These tests include:

- *Elimination of economic value* - Courts presume that a regulation is not a taking of real estate unless the regulation has a severe economic impact and interferes with investment-backed expectations.⁴⁶⁰ Courts will not find a taking if the investor could have reasonably foreseen a change in policy.⁴⁶¹ In cases involving non-real estate (such as equipment, contracts or patents), courts usually presume that government action is foreseeable and that even the complete loss of value of business property is not a taking.⁴⁶² A federal court has explicitly ruled this way in a case involving termination of foreign investor claims in an arbitration forum.⁴⁶³
- *Voluntary participation* - Courts presume that heavy regulation of a subsidized industry (such as health care) is not a taking as long as providers are voluntarily participating in the regulated field.⁴⁶⁴ Courts refrain from inquiring into the profitability of government regulations unless the government regulates the entire industry as a public utility.⁴⁶⁵

458. See *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003, 1019 n.8 (1992) ("It is true that in at least some cases the landowner with 95% loss will get nothing, while the landowner with total loss will recover in full."); *Euclid v. Ambler Realty Co.*, 272 U.S. 365, 384 (1926) (holding that 75% diminution in value is not a taking). See also *Zealy v. City of Waukesha*, 548 N.W.2d 528, 531 (Wis. 1996) ("[t]he rule emerging from opinions of our state courts and the United States Supreme Court is that a regulation must deny the land owner all or substantially all practical uses of a property in order to be considered a taking for which compensation is required.").

459. *Concrete Pipe and Prods. of Cal. v. Construction Laborers Pension Trust for S. Cal.*, 508 U.S. 602, 645 (1993).

460. See *Pennsylvania Coal. Co.*, 260 U.S. at 413.

461. See *Concrete Pipe*, 508 U.S. at 645.

462. See *Lucas*, 505 U.S. at 1028.

463. See *Abraham-Youri v. United States*, 139 F.3d 1462 (Fed. Cir. 1997) (holding that the expectations of foreign investors should include the changing diplomatic climate between nations, which affects or extinguishes property rights just as the common law of nuisance affects the uses and value of land).

464. See *Whitney v. Heckler*, 780 F.2d 963 (11th Cir. 1986), (doctors claimed that a freeze on Medicare fees amounted to a taking because it denied a reasonable profit; held not a taking because doctors were not required to treat Medicare patients, even though Medicare patients comprised a substantial percentage of the doctors' practice).

465. See *Minnesota Ass'n of Health Care Facilities Inc. v. Minnesota Dep't of Pub. Welfare*, 742 F.2d 442 (8th Cir. 1984) (mandating Medicare rates that do not permit a reasonable return on investment are not a taking because participation in the industry is voluntary).

- *Law enforcement* - Courts presume that complete forfeiture of property as a sanction for violating criminal law or civil regulations is not a taking.⁴⁶⁶ The MAI apparently does not apply to seizures of property as a penalty for violation of criminal law.⁴⁶⁷ Since civil penalties are not mentioned, the inference is that the MAI expropriation provisions *would* apply in the case of civil law enforcement. U.S. courts have rejected takings claims brought against civil law mandates after the government imposed a fine or tax for failure to comply with the mandate.⁴⁶⁸
- *Military and public health* - The MAI does not provide a general exception from expropriation in cases of military action to protect essential security interests.⁴⁶⁹ Nor does it provide an explicit exception for destruction of property when necessary to control a threat to public health.⁴⁷⁰ The MAI general exception for preservation of public order could conceivably apply to public health emergencies as a “serious threat . . . posed to one of the fundamental interests of society.”⁴⁷¹ If so, the government would have to prove that the destruction of property was “necessary,”⁴⁷² which GATT and WTO dispute panels have construed to mean least-restrictive.⁴⁷³

Most state and local governments mandate that land developers mitigate some or all costs of the environmental, aesthetic, or infrastructure impact they have on the local community. A typical example is a local zoning mandate that developers build streets, sewers and other utilities, and dedicate land for schools and parks.⁴⁷⁴ Many jurisdictions go beyond the norm. For example, most western states require reclamation of surface-mined areas with requirements that exceed or differ from minimum federal standards.⁴⁷⁵ Washington,⁴⁷⁶ California,⁴⁷⁷ and the Chesapeake Bay states⁴⁷⁸ lead the majority of states that protect estuaries, tidal wetlands,

466. Examples include forfeiting a car or a boat used in drug trafficking or goods that were fraudulently advertised.

467. This provision is provided in the MAI commentary, not the MAI negotiating text. It reads: “The Drafting Group understands that the violation of criminal laws could result in the loss of an investment (or part thereof) which would not be deemed expropriation, provided those laws and their application are non-discriminatory and otherwise consistent with the standards of this agreement.” *MAI Commentary*, *supra* note 101, art. IV(2)(2).

468. *See, e.g., Concrete Pipe and Prods. of Cal. v. Construction Laborers Pension Trust for S. Cal.*, 508 U.S. 602 (1993) (mandating ERISA fees for withdrawal from pension plan is not equivalent to government occupation of property).

469. *See MAI Negotiating Text*, *supra* note 7, art. VI(General Exceptions)(1).

470. *Id.* art. VI.

471. *Id.* art. VI(General Exceptions)(3) n.2.

472. *Id.* art. VI(General Exceptions)(3).

473. *See* GATT Panel Report on Thailand - Restrictions on Importation of and Internal Taxes on Cigarettes, Nov. 7, 1990, GATT B.I.S.D. (37th Supp.) at 200 (1990).

474. *See MAI Negotiating Text*, *supra* note 7, art. VI(General Exception)(3) n.2.

475. *See* Surface Mining Control and Reclamation Act, 30 U.S.C. §§ 1230-65 (1966).

476. *See generally* WASH. REV. CODE § 35.63 (1998) (Planning Commissions).

477. *See* California Coastal Act, CAL. PUB. RES. CODE §§ 30240, 30241, 20350 (West 1996).

478. *See* CHESAPEAKE BAY FOUNDATION, WETLANDS PERMITTING PROGRAMS IN THE CHESAPEAKE BAY AREA app. C (Oct. 1994); MD. CODE ANN., ENVIR. § 5-901 (1996).

and coastal areas by regulating the alteration of topography, mineral extraction, timber harvest, conversion of agricultural land, and location of construction. These laws can impose substantial design, mitigation, or infrastructure burdens on developers, or alternatively, reduce the value of land.

The environmentalists fear that under MAI expropriation, investors will be able to argue that a portion of their property has been effectively or temporarily taken by government action or regulation, an argument that investors cannot make under takings law.⁴⁷⁹ There are many areas besides land use where investors have litigated takings claims that U.S. courts have rejected. These too could receive different treatment under the MAI. A sampling of failed taking claims, which could receive different treatment under the MAI, includes:

- Reduction of mining operations.⁴⁸⁰
- Alteration of wetlands.⁴⁸¹
- Employment benefits.⁴⁸²
- Employer mandates under civil rights laws.⁴⁸³
- Health care reimbursement.⁴⁸⁴
- Housing fees and regulations.⁴⁸⁵

479. See NGO letter, *supra* note 453. Professor Carl Rose argues that “[o]nce land can be apportioned into ‘relevant’ portions, any diminution can be manipulated to become a 100% diminution . . . [v]irtually any regulation with *any* adverse impact on an owner’s parcel could become an occasion for compensation, without regard to the owner’s expectations and whether they were reasonable.” S. REP. NO. 104-239, at 258 (1996) (minority views).

480. See *Department of Natural Resources v. Indiana Coal Council, Inc.*, 542 N.E.2d 1000 (Ind. 1989) (holding that historic designation of land to protect artifacts was not a taking even though it curtailed access to a portion of coal reserves); *M & J Coal Co. v. United States*, 30 Fed. Cl. 360 (1994) (reducing coal mining operation to avoid damage to homes and highway is not a taking).

481. See, e.g., *Good v. United States*, 39 Fed. Cl. 81 (1997) (denying dredging permit which significantly impaired commercial value of property because owner should have known that wetlands were subject to strict regulation; therefore, investor expectations were not reasonable). The environmental risk of investing in wetlands development takes on a double meaning in the booming market for floating casino resorts. See Joby Warrick, *Lott Backs Casinos Planned for Undeveloped Coastal Bays*, WASH. POST, Oct. 18, 1998, at A8.

482. See, e.g., *Concrete Pipe and Prods. of Cal. v. Construction Laborers Pension Trust for S. Cal.*, 508 U.S. 602 (1993) (mandating that ERISA fees do not amount to government occupation of property interests).

483. See, e.g., *Pinnock v. International House of Pancakes Franchisee*, 844 F. Supp. 574 (S.D. Cal. 1993) (finding that ADA mandates for wheelchair access, which required expenditures and loss of space, are not a taking); *Heart of Atlanta Motel v. United States*, 379 U.S. 241 (1964) (requiring renting rooms to people of color, which results in lost profits, is not a taking).

484. See, e.g., *Minn. Ass’n of Health Care v. Minn. Dep’t of Pub. Welfare*, 742 F.2d 442 (8th Cir. 1984) (mandating Medicare rates that do not permit a reasonable return on investment are not a taking because industry participation is voluntary).

485. See, e.g., *Commercial Builders of N. Cal. v. City of Sacramento*, 941 F.2d 872 (9th Cir. 1991) (holding that fee on commercial development to pay for low-income housing has a sufficient nexus to be a rational burden and therefore is not a taking).

- Drinking on premises or in public.⁴⁸⁶
- Entertainment licenses.⁴⁸⁷

The Chairman's proposal to change the MAI text on expropriation reads as follows: "A Contracting Party shall not expropriate or nationalise an investment in its territory of an investor of another Contracting Party or take any measure tantamount to expropriation or nationalization except: . . ." ⁴⁸⁸ It drops the reference to expropriating "directly or indirectly," and the reference to "any measure tantamount to expropriation" replaces the reference to "measures having equivalent effect."⁴⁸⁹ These changes are explained by insertion of an interpretative note, which reads in pertinent part:

Articles – on General Treatment, and – on Expropriation and Compensation, are intended to incorporate into the MAI existing international legal norms. The reference in Article IV.2.1 to expropriation or nationalisation and "measures tantamount to expropriation or nationalisation" reflects the fact that international law requires compensation for an expropriatory taking without regard to the label applied to it, even if title to the property is not taken. It does not establish a new requirement that Parties pay compensation for losses which an investor or investment may incur through regulation, revenue raising and other normal activity in the public interest undertaken by governments. Nor would such normal and non-discriminatory government activity contravene the standards in Article – 1 (General Treatment).⁴⁹⁰

The Chairman's proposal is significant to the extent that it assures that the MAI is not creating new rights in international law that do not already exist under the doctrine of compensation for expropriation. The concern, however, is not only that the MAI could create new international norms, but that it would substitute the *existing* international norms by which foreign investors can seek to overcome the *existing* constitutional norms of takings law.

The points of comparison are fundamental. First, any MAI dispute panel reviewing an expropriation claim would be freed from the well-developed precedents of U.S. constitutional law. Second, the analytic framework within international expropriation law is not finely tuned.⁴⁹¹ The

486. See *Get Away Club, Inc. v. Coleman*, 969 F.2d 644 (8th Cir. 1992) (reducing drinking on premises furthers public goal of protecting against drunk drivers); *Glasheen v. City of Austin*, 840 F. Supp. 62 (W.D. Tex. 1993) (restricting consumption of alcohol "in or on" public streets and sidewalks is not a taking because the law was properly related to its goal).

487. See *Midnight Sessions, Ltd. v. City of Philadelphia*, 945 F.2d 667 (3d Cir. 1991) (denying license for night club supports a valid public interest).

488. *MAI Negotiating Text*, *supra* note 7, Annex 2(5)(2).

489. *Id.* art. IV(2)(2.1).

490. *Id.*

491. See generally PAUL COMEAUX & STEPHEN N. KINSELLA, *PROTECTING FOREIGN INVESTMENT UNDER INTERNATIONAL LAW* (1997); C.G. Christie, *What Constitutes a Taking of Property under International Law*, 38 BRIT. Y.B. INT'L L. 307 (1964); Vance R. Koven, *Expropriation and the Jurisprudence of OPIC*, 22 HARV. INT'L L.J. 269 (1981); Patrick M. Norton, *A Law of the Future or a Law of the Past? Modern Tribunals and the International Law of Expropriation*, 85 AM. J. INT'L L. 474 (1991).

U.S. cases involve garden-variety regulations that are close to a "taking." The international cases, by comparison, tend to be more exotic. Many of them involve noncomparable situations of civil unrest.⁴⁹² The concept of "public purpose" is not well defined,⁴⁹³ and the breadth of cultural and governmental differences greatly complicate the comparison of cases. Some international tribunals have awarded damages for "deprivation of use," which could open the door to a flexible standard when a government action is "tantamount" to expropriation. As noted below, General Treatment protects investors from "impairment" of use. The ultimate problem is the essential indeterminacy of these terms. A slight change in the definition could produce different results than U.S. takings law.

3. General Treatment

The MAI would protect investors with "General Treatment" under international law with two provisions that dramatically expand the scope of the agreement. The first requires Contracting Parties to give investors "fair and equitable treatment and full and constant protection and security. In no case shall a Contracting Party accord treatment less favorable than that required by international law."⁴⁹⁴ This language is similar to general treatment under NAFTA,⁴⁹⁵ the model that the United States currently uses for negotiating bilateral investment treaties (BITs).⁴⁹⁶

Without this language, MAI panels could interpret MAI terms "in accordance with the applicable rules of international law."⁴⁹⁷ With this language, the MAI goes further to give investors a dispute forum where they can claim that a nation has failed to comply with an international trade agreement⁴⁹⁸ to buttress a claim under the MAI that a measure adversely

492. See generally ADEOYE A. AKINSAYE, *THE EXPROPRIATION OF MULTINATIONAL PROPERTY IN THE THIRD WORLD* (1980).

493. See, e.g., *Amoco Int'l Fin. Corp. v. Iran*, 15 Iran-U.S. C.T.R. 189 (1987).

494. *MAI Negotiating Text*, *supra* note 7, art. IV(1). The commentary explains that the reference to international law is "worded in the most simple manner," which makes it broadly inclusive. *MAI Commentary*, *supra* note 101, art. IV(1)(3).

495. The comparable NAFTA provision reads: "Each Party shall accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security." NAFTA, *supra* note 116, art. 1105.1.

496. See TREATY AFFAIRS OFFICE, U.S. DEP'T OF STATE, UNITED STATES: 1994 MODEL BILATERAL INVESTMENT TREATY (1994) [hereinafter U.S. MODEL BIT]; Treaty on the Reciprocal Encouragement and Protection of Investment, Oct. 22, 1992, U.S.-Czech Rep.-Slovk., art. II, S. TREATY DOC. No. 31 (1992) [hereinafter U.S.-Czech and Slovak Investment Treaty]; Treaty on the Reciprocal Encouragement and Protection of Investment, Nov. 14, 1991, U.S.-Arg., art. II, S. TREATY DOC. No. 2 (1993) [hereinafter U.S.-Argentina Investment Treaty].

497. *MAI Negotiating Text*, *supra* note 7, art. V(D)(14)(a).

498. The standard of no less favorable treatment than "that required by international law" appears to create an investor cause of action independent of other MAI investor protections. Those protections are so broad, however, that the most likely scenario is that an investor would use the non-MAI international law standard in conjunction with an explicit MAI provision. As noted above in Part I.E.1, this is the area of law where trade and investment agreements have overlapping jurisdiction. This overlap was anticipated by the OECD working group on investment protection, which acknowledged that

affects an investment or investment opportunity.⁴⁹⁹

All MAI nations participate in several WTO agreements that could amplify investor protection beyond the terms of the MAI. For example, the WTO Agreement on Technical Barriers to Trade (TBT) requires that "technical regulations shall not be more trade-restrictive than necessary to fulfill a legitimate objective."⁵⁰⁰ In similar fashion, the Agreement on Sanitary and Phytosanitary Standards (SPS) requires that a measure "is applied only to the extent necessary to protect human, animal or plant life or health . . ."⁵⁰¹ As noted in Part II.A.1, GATT, WTO, and other dispute panels have interpreted a "necessary" measure to mean one that is least-trade restrictive.⁵⁰² This test is considerably more stringent than the standard applied by modern U.S. courts, which require only that a law have a rational relationship to a legitimate government purpose.⁵⁰³

There are many other standards of international law that could be used to amplify investor protection under the MAI. These include the requirements for national uniformity and performance characteristics in standard-setting under the TBT,⁵⁰⁴ the requirement for risk assessment under the SPS,⁵⁰⁵ the standards for prohibited and actionable subsidies under the WTO Agreement on Subsidies and Countervailing Measures,⁵⁰⁶ and the standards for technical specifications and qualified suppliers under the WTO Agreement on Government Procurement,⁵⁰⁷ to name just a few.

the overlap between trade and investment "may have the consequence that the MAI dispute settlement mechanism would be available with regard to such rights irrespective of whether these other treaties provide for arbitration or not." Working Group C, *Investment Protection*, in OECD DOCUMENTS, *supra* note 58, at 134.

499. The crucial difference between a trade agreement dispute and an investor dispute under the MAI is that the MAI requires that

an alleged breach of the MAI must be causally linked to loss or damage to the investor or investment . . . but the damage, while imminent, would not need to have been incurred before the dispute is ripe for arbitration. Further [,] a lost opportunity to profit from a planned investment would be a type of loss sufficient to give an investor standing to bring an establishment dispute under this article

MAI Commentary, *supra* note 101, art. V(Investor-to-State Procedures)(D)(1)(a)(1).

500. Agreement on Technical Barriers to Trade, GATT Doc. MTN/FA II-A1A-6, art. 2.2 (Dec. 15, 1993) [hereinafter TBT].

501. Agreement on the Application of Sanitary and Phytosanitary Measures, GATT Doc. MTN/FA II-A1A-4, art. 2.2 (Dec. 15, 1993) [hereinafter SPS].

502. See, e.g., Panel Report on Thailand, *supra* note 473, at 23. See also Panel Report on Lobsters from Canada, USA-89-1807-01, 1990 WL 299945 (U.S. Can. F.T.A. Binat. Panel) (May 25, 1990).

503. See *Nebbia v. New York*, 291 U.S. 502 (1934) (regarding price controls on milk); *West Coast Hotel v. Parrish*, 300 U.S. 379 (1937) (concerning minimum wage for women); see also *Beatie v. City of New York*, 123 F.3d 707 (2d Cir. 1997) (regarding anti-smoking ordinance).

504. See TBT, *supra* note 500, art. 4.1, Annex 3, ¶¶ H (uniformity), I (performance characteristics).

505. See SPS, *supra* note 501, art. 5.1-3.

506. See SCM, *supra* note 188, arts. 3, 5 and 6.

507. See AGP, *supra* note 181, art. VIII.

While the MAI's incorporation of international law standards is a somewhat subtle expansion of investor protection, the General Treatment provision on impairment of use is not. It provides that "[a] Contracting Party shall not impair by . . . [unreasonable and discriminatory] measures the operation, management, maintenance, use, enjoyment or disposal of investments in its territory . . ." ⁵⁰⁸ This language has been used in bilateral investment treaties ⁵⁰⁹ but was not used in NAFTA. ⁵¹⁰

MAI negotiators have yet to decide whether the unreasonable and discriminatory tests of "impairment" would work independently of each other or conjunctively. A conjunctive test would require that government must not impair an investment in a way that is both unreasonable *and* discriminatory. An independent test would require that government must not impair use of an investment in a way that is either unreasonable *or* discriminatory. Since the MAI would otherwise protect foreign investors from discrimination under National Treatment and MFN Treatment, the independent test for impairment would yield a more stringent test that is absolute; meaning, it limits government power even in the absence of any discrimination. ⁵¹¹

Prior to the New Deal, U.S. courts provided strikingly similar protection to investors from "impairment" of "use" or "enjoyment" by legislation. ⁵¹² The substantive due process doctrine ⁵¹³ allowed the courts to second-guess the legislative purpose behind the law as well as to determine whether the means validly effectuated that purpose. ⁵¹⁴ The Supreme Court has since abandoned this approach in favor of greater judicial defer-

508. MAI *Negotiating Text*, *supra* note 7, art. IV(General Treatment)(1)(1.2).

509. U.S. MODEL BIT, *supra* note 496, art. II; U.S.-Czech and Slovak Investment Treaty, *supra* note 496, art. II; U.S.-Argentina Investment Treaty, *supra* note 496, art. II.

510. See NAFTA, *supra* note 116, art. 1105.

511. See MAI *Commentary*, *supra* note 101, art. IV(General Treatment)(1)(4)-(7).

512. See, e.g., *Coppage v. Kansas*, 236 U.S. 1, 14 (1915) (discussing restrictions on contract opportunities creating a "substantial impairment of liberty"); *Standard Oil Co. of La. v. Hall*, 24 F.2d 455, 457 (M.D. Tenn. 1927) (citing *Fairmont Creamery Co. v. Minnesota*, 274 U.S. 1 (1927)) (a statute that "impaired" the obligation of contracts could be strictly scrutinized); *Allgeyer v. Louisiana*, 165 U.S. 578 (1897) (regarding a liberty interest to "use" and "enjoy" personal investment).

513. The decision is most widely associated with the substantive due process doctrine in *Lochner v. New York*, 198 U.S. 45 (1905), where the Court applied a two-pronged test: whether the legislative means were "necessary and appropriate" to achieving the legislative ends, and whether the legislative ends were "proper, reasonable and fair." *Id.* at 62.

514. The Supreme Court struck down a range of legislation under the substantive due process doctrine. See *id.* (regarding a 10-hour work day and 60-hour work week for bakers); *Adair v. U.S.*, 208 U.S. 161 (1908) (protecting workers from being fired because of membership in a union); *Coppage v. Kansas*, 236 U.S. 1 (1915) (banning "yellow-dog contracts," which conditioned employment upon not being a member of a union); *Muller v. Oregon*, 208 U.S. 412 (1908) (limiting working hours for women); (*Allgeyer v. Louisiana*, 165 U.S. 578 (1897) (requiring insurance policies be issued by companies registered to do business in the state); *Railroad Retirement Bd. v. Alton R. Co.*, 295 U.S. 330 (1935) (retroactive credit of employee tenure for computing pension benefits).

ence to legislatures.⁵¹⁵ Given the similarity between the MAI's "impairment" provision and the now diminished "substantive due process" doctrine, the MAI could reverse sixty years of constitutional law.

In addition, because the MAI gives investors a remedy for damages, the impairment provision could create a basis for applying a lower burden of proof when challenging regulatory takings as compared to a case of expropriation under international law.⁵¹⁶

A lower burden of proof under the impairment-of-use standard is the most obvious impact General Treatment could have on sovereignty. The outcome of the failed takings litigation cited above (reduction of mining operations, limits on alteration of wetlands, etc.) could produce a different result under an impairment doctrine of the MAI.⁵¹⁷ The MAI impairment doctrine could similarly strike down many other non-taking, non-discriminatory situations that courts had previously upheld. In these cases, the courts currently uphold the statutes if they can find a rational relationship between the legislative measure and a legitimate public purpose.⁵¹⁸ Examples include:

- Affordable housing mandates for office developers.⁵¹⁹
- Regulation of restaurants and other public facilities.⁵²⁰

515. The seminal case in abandoning substantive due process was *Nebbia v. New York*, 291 U.S. 502 (1934) (upheld price controls on milk), which, after a gap of several years, was followed consistently, beginning with *West Coast Hotel v. Parrish*, 300 U.S. 379 (1937) (upheld minimum wage for women). See also *Usery v. Turner Elkhorn Mining Co.* 428 U.S. 1, 15 (1976).

516. There are at least three possible ways that investors could invoke General Treatment. One way includes invoking constitutional doctrines such as substantive due process if the more specific allegations such as expropriation or National Treatment fail. See *Graham v. Connor*, 409 U.S. 386 (1989). Alternatively, investors could advance General Treatment as a cause of first resort since it could reach measures that are beyond the reach of discrimination arguments and the impermissible categories of performance requirements. Like U.S. courts, MAI dispute panels may prefer the judicial economy of deciding cases on the more concrete and specific basis of investor protection. See *id.* A third function of General Treatment consists of strengthening a pro-investor interpretation of the other, more specific principles of investor protection. For example, General Treatment could support a liberal approach to invoking the TBT as a standard for reasonable or necessary use of regulatory power, and "impairment" could liberalize the effects test under National Treatment.

517. See *supra* Part II.C.2 and notes 480-87.

518. The Supreme Court presumes state laws that affect or modify contracts do not violate the contracts clause of the Constitution unless the impact is substantial. Even if the impact is substantial, the law will survive a challenge if it promotes a legitimate purpose and is reasonably tailored to achieve that purpose. See *Allied Structural Steel Co. v. Spannaus*, 438 U.S. 234, 244 (1978). The contracts clause reads: "No State shall . . . pass any . . . Law impairing the Obligation of Contracts . . ." U.S. CONST. art. I, § 10, cl. 1.

519. See *Commercial Builders of N. Cal. v. City of Sacramento*, 941 F.2d 872 (9th Cir. 1991) (challenging impact fees on commercial development with a takings argument that applied a test following the lines of substantive due process doctrine).

520. See *Beatie v. City of New York*, 123 F.3d 707 (2d Cir. 1997) (holding that anti-smoking ordinance was rationally related to the government's interest in protecting public health as a matter of law).

- Housing code enforcement.⁵²¹
- Mandates to pay insurance benefits.⁵²²
- Mandates to pay employee benefits.⁵²³

The MAI's impairment provision is also likely to provide stricter scrutiny than U.S. courts give to nondiscriminatory laws that impose burdens on foreign commerce. For example, oil tanker companies recently failed in an attempt to argue that a Washington state law created an impermissible burden under the foreign commerce clause.⁵²⁴ The Washington law goes into great detail in regulating the operation, management, and use of oil tankers and crews,⁵²⁵ which is essentially the test of MAI General Treatment when combined with the causal link required under investor-to-state dispute resolution.⁵²⁶ By adopting the first law that seeks to prevent rather than react to oil spill disasters, the state was acting as a laboratory for the thirty-four states with coastlines to protect. However, given the stricter standards under the MAI's impairment doctrine, the result under General Treatment could prove different from a result under U.S. constitutional law.

In terms of legislative process, General Treatment would impose higher standards on legislatures for developing a factual record, identifying multiple alternatives, and then justifying the alternative chosen. In addition to the thirteen specific rules for treatment of investors, General Treatment (1) imports a least-trade-restrictive standard from several potential sources of international law, and (2) provides an impairment rationale for second-guessing the reasonableness of legislative objectives. General Treatment would shift presumptions about the validity of legislative compromises. By shifting legislative choices to one end of the spectrum, the MAI could accomplish a political power shift in the legislative process that U.S. courts have resisted ever since the Great Depression.

The Chairman's proposal to change the MAI text on General Treatment acknowledges the severity of the MAI's impairment provision by deleting the entire paragraph from the MAI.⁵²⁷ Of all the Chairman's pro-

521. See *Armendariz v. Penman*, 75 F.3d 1311 (9th Cir. 1996) (discussing over-enforcement of housing code to relocate criminals).

522. See *Honeywell, Inc. v. Minnesota Life and Health Ins. Guar. Ass'n*, 86 F.3d 766 (8th Cir. 1996) (involving retroactive limitation on payments to state residents).

523. See *Chateaugay Corp. v. Shalala*, 53 F.3d 478 (2d Cir. 1995) (mandating contributions to health and benefit plan for retired coal miners).

524. Although the Plaintiffs were successful on appeal in part of their claim, the Court of Appeals affirmed the lower court ruling that the burdens created by the law do not violate the foreign commerce clause. See *International Ass'n of Indep. Tanker Owners (Intertanko) v. Lowry*, 947 F. Supp. 1484 (W.D. Wash. 1996), *rev'd in part*, 148 F.3d 1053 (9th Cir. 1998).

525. See WASH. REV. CODE § 88.46.010 (1996).

526. See *MAI Commentary*, *supra* note 101, art. V(Investor-to-State Procedures)(D)(1)(a)(1).

527. See *MAI Negotiating Text*, *supra* note 7, Annex 2(5)(1). There is no explanation for why the second paragraph of General Treatment is deleted; it is simply not there. If the absence of the impairment provision from the Chairman's proposal is not intended to communicate its deletion, then the proposal would do nothing to alleviate the severity of an impairment standard within General Treatment. Considering the legal significance of an impairment standard, the absence of any commentary whatsoever in the

posals, this is the one that would clearly fix a problem with the text.

The Chairman's proposal also includes an interpretative note that "normal and non-discriminatory government activity" would not contravene the general standard of treatment that is no less favorable than that required by international law.⁵²⁸ Like the other proposals, except the deletion of impairment, this footnote only begs the question. First, what is "normal" in the eyes of a dispute panel? The laws of greatest concern under the MAI are progressive laws; laws that are innovative and hence not "normal." Progressive laws are not always brand new. They may stand at the furthest extent of legal evolution when compared to the predominant practice of other countries. Second, the discussion in Part II.A.3 shows at length how the MAI standards of discrimination differ greatly from analogous standards in U.S. constitutional law. For these reasons, the Chairman's proposed footnote is better understood as a restatement of, rather than as a change in, the MAI text.

D. Scope of Potential Impact

The preceding section-by-section analysis of the MAI fails to convey the full scope of the MAI's potential impact on state lawmaking powers. As noted in Part I, direct preemption is neither the only nor the most immediate threat. A change in the role of the federal government as buffer for U.S. states and a significant shift of political power within the legislative process represents the most immediate threat to state lawmakers. Threats of monetary damages in investor-to-state disputes and retaliation by foreign nations in the diplomatic arena of trade negotiations and dispute settlement would propel the political shift.

The scope of the MAI's potential impact is a defining theme for both global economic liberalization and domestic federalism. From an international perspective, the complexity and commercial burdens created by the federal system are already contentious issues. The MAI would increase exponentially the opportunities to challenge these burdens with expanded investor protections and investor-to-state challenges of state law outside of the federal courts. The MAI monetary remedies would also create fiscal pressure on Congress and state legislatures to preempt or change state law, most likely with the backing of the federal Executive Branch.

The state-level targets for limiting government power are well known. From the perspective of domestic federalism, the scope of the MAI rivals the central values of diversity and experimentation at the state and local level. The threat to federalism posed by the MAI is graphically demonstrated by mapping the states with laws that stand just inside the boundary of constitutional state power under the dormant commerce clause.⁵²⁹ The scope of the MAI can also be graphed as a matrix of state and local government powers and measures that could be challenged under various MAI

Chairman's proposal reveals an apparently high degree of political sensitivity within the OECD.

528. *See id.* art. IV(1)(1.1).

529. *See, e.g.*, charts *infra* Part III.A.2.

investor protections. The following chart is limited to the state law examples and MAI provisions previously cited in this article.

Scope of Potential MAI Impact on State & Local Law

State & Local Powers / Measures	MAI Investor Protections				
	National Treatment	General Treatment	Comp. for Exprop.	Limits on Perf. Req.	MFN Treatment
Balancing Test: Economic Regulation					
Land ownership limits	19 states				
Fishing fleet restrictions	8 states				
Casino/gambling licenses	8 states				
Local competition policy	6 states				
Commun. reinvest. policy	16 states				
Balancing Test: Land Use & Environmental Regulation					
Gen. zoning limits/mandates	most states				
Wetlands/coastal zone limits					
Recycled content mandates	13 states				
Packaging requirements	12 states				
Market Participation: Selective Purchasing and Use of State Land					
Domestic preferences	43 states				
Minority preferences					
Human rights preferences	within 19 states				
Environmental preferences	29 states				
Limits on use of state land	9 states				
Subsidies: Economic Development					
Export finance programs					
Targeted job training	44 states				
Business recruitment/retention criteria					

The thirty-seven marked cells in this chart are only theoretical targets. As the *Beer II* case illustrates,⁵³⁰ the real potential for conflict between the MAI and state powers depends on the specifics of the statutes and their effect on foreign commerce. The chart illustrates the difficulty of using country-specific exceptions to assure state and local governments that the MAI poses no threat to sovereignty.

III. The Viability of Country-Specific Exceptions

U.S. negotiators support MAI provisions that diminish sovereign regulatory and market participation powers of state and local governments. At the same time, they "are not going to reach agreements [in the MAI] that take away [their] sovereign power in any regard."⁵³¹ Their strategy for balancing this seemingly contradictory provision is to create a legal equation: [MAI limits on state sovereignty] minus [U.S. exceptions from those MAI

530. Canada's National Treatment complaint targeted approximately 210 state and local statutes; it prevailed on about 60. See NATIONAL CONFERENCE OF STATE LEGISLATURES, *GATT Decision on Beer/Wine Threatens State Sovereignty*, in INFORMATION ALERT (1993); Alcoholic and Malt Beverages, *supra* note 33, ¶¶ 2.10-2.32 (targets in complaint), 6.1 (findings of the panel).

531. MCGINTY, *supra* note 10, at 8.

limits] equals [no change in sovereign power of state and local government]. In other words, two negatives make a positive.

Drafting exceptions to exceptions (double negatives) is a common technique for avoiding direct conflict, but the resulting ambiguity can generate distrust, disbelief, and ultimately litigation.⁵³² This article, however, accepts the double-negative strategy at face value. Legally, the double-negative strategy might work, but only to the degree that the exceptions correlate with the MAI limits that they are supposed to neutralize. The following analysis shows that the correlation does not yet exist and that the legal scope of sovereignty protection falls short of the federal government's assertions.

There are two complementary approaches to striking a balance with double negatives. One is to change the multilateral structure of the MAI itself – for example, by expanding the general exceptions or limiting the right of investors to sue governments for damages. MAI negotiators have avoided this approach⁵³³ in favor of unilateral options, i.e. through country-specific exceptions. In the last stage of negotiations, all OECD countries will propose and negotiate lists of laws to which the MAI will not apply *in that country alone*.⁵³⁴ The United States initially proposed 275 draft exceptions,⁵³⁵ which explains the complexity involved in the MAI

532. An exchange between Ambassador Jeffrey Lang and national talk-show host Derrick McGinty conveys the sense of the debate:

Lang: [W]e need to recognize that [MAI negotiations are] going to be a two-way street. Now, in no case, no matter what we come up with, are we going to limit our sovereign ability of our states or our federal government to impose necessary regulatory restrictions? In some cases – and this is the next phase in the negotiation, in fact, we are going to ask that whole sectors be completely exempt from the rules of the MAI. And that is going to be true for other countries.

... But even in those sectors that are subject to investor-to-state dispute settlement, we are not going to obligate ourselves except in international law. Under domestic law, we are going to retain our freedom to do things that are –

McGinty: ... now wait a minute, Mr. Ambassador ... it seems to me if you have that, every country can say that, and that means the treaty is no good. I mean ... either you obey it or you don't. ...

Lang: Well, that's true. ... And we hope that what we can get is an agreement that we will be able to live with ... We're not going to agree to something that doesn't let us do the necessary kind of domestic regulation we need to do.

Id. at 9.

533. The MAI article on taxation is an exception that partially carves out taxation from MAI coverage other than expropriation. See *MAI Negotiating Text*, *supra* note 7, art. VIII.

534. See *id.* art. IX. Since the practice of listing country-specific “reservations” has a reciprocal effect under treaty law, MAI drafters chose to use the term “exceptions” to avoid any reciprocal effect. However, the norm of listing exceptions rather than reservations does not preclude listing a measure that has a reciprocity requirement. *Id.* art. IX(A) n.1.

535. See *Foreign Investment: Environmental Discussions Top Agenda of OECD Investment Treaty Negotiations*, *Int'l Trade Rep. (BNA)* 1918 (Nov. 5, 1997) [hereinafter *BNA, Treaty Negotiations*].

negotiations.

This last stage represents the “greatest disharmony among MAI negotiators,”⁵³⁶ when trade-offs on major sovereignty concerns are necessary before the MAI’s completion. The EU nations continue to press for deletion of U.S. state-specific exceptions, while the United States continues to press for deletion of the EU investment preferences⁵³⁷ and protection of subsidies for cultural industries.⁵³⁸ The country-specific exceptions serve two purposes: first, as priorities for sovereignty protection, and second, as bargaining chips to attain greater market access.⁵³⁹

The United States seeks two kinds of exceptions. The first consists of a blanket exception for all existing, nonconforming state and local measures. The second acts as a “carve out” for broad categories of laws that would continue into the future.⁵⁴⁰

A. Grandfathering of Existing Nonconforming Laws

1. Limits on Grandfathering

The most significant limit of the “grandfathering” strategy is that it only covers existing law. The MAI would constrain future lawmaking on the topics with standstill requirements,⁵⁴¹ forbidding additional non-conforming measures and limiting amendments to those that do “not decrease the conformity of the measure.”⁵⁴² In other words, other states may not replicate a listed measure, and states may not substantially reform existing laws except to increase compliance with the MAI.

536. *Id.* at 1919.

537. *See id.*

538. *See* European Information Service, *European Parliament Weighs into Stalled Investment Pact* § 2299 (Mar. 14, 1998).

539. The United States acknowledges its strategy for binding states in exchange for market access:

Many OECD countries want to bind state and local jurisdictions to the same obligations as those undertaken at the federal level. If we succeed in negotiating a strong and balanced agreement that provides the U.S. with access to substantial new markets, we are prepared to bind the states and their subdivisions, subject to Congressional approval.

U.S. DEP’T OF STATE, THE MULTILATERAL AGREEMENT ON INVESTMENT (MAI) 3 (1997).

540. “Our approach has been, as it was in the case of NAFTA, to grandfather all existing non-conforming measures at the state and local level, first of all.” *Multilateral Agreement on Investment: Win, Lose or Draw for the U.S.?*, *supra* note 9 (statement of Alan Larson, Assistant Secretary of State for Economic and Business Affairs, U.S. Department of State).

541. *MAI Negotiating Text*, *supra* note 7, art. IX(Country Specification)(A) n.3; *MAI Commentary*, *supra* note 101, art. IX(Standstill and the Listing of Country Specific Reservations)(1), which states:

Standstill would result from the prohibition of new or more restrictive exceptions to this minimum standard of treatment. From this perspective, a violation of standstill would be a violation of the underlying MAI obligations (e.g. of National Treatment and MFN), and the dispute settlement provisions would apply to such breaches of the MAI obligations.

542. *MAI Commentary*, *supra* note 101, art. IX(Standstill and the Listing of Country Specific Reservations)(3)(c), (d).

Another limit of the grandfathering proposal is that it does not include tribal law except for corporations organized under the Alaska Native Claims Act.⁵⁴³ One version of the proposal covered "all existing nonconforming measures of all states, localities, the District of Columbia and Puerto Rico."⁵⁴⁴ Tribal law is not included even though the United States Trade Representative defines tribal governments as "subfederal jurisdictions" for purposes of compliance with international agreements.⁵⁴⁵

There are 500 federally recognized reservations and Indian communities.⁵⁴⁶ Tribal governments consider themselves sovereign nations within a nation. Their lands and affairs are often managed in trust by the federal government under laws that defer to tribal sovereignty and treaty rights.⁵⁴⁷ In the context of the MAI, tribal sovereignty interests are even greater than those of cities and states because of discrimination in favor of tribal residents, particularly in laws governing the role of private investors in economic development,⁵⁴⁸ economic regulation,⁵⁴⁹ environmental protection,⁵⁵⁰ resource conservation and land use.⁵⁵¹ Tribal governments

543. See Partial Draft of Country-Specific Exceptions Proposed by the United States, item 10 (Apr. 22, 1998) (on file at the reading room of the U.S. Trade Representative, Washington, DC).

544. *Id.* item 22.

545. *Id.* item 10.

546. *See id.*

547. *See, e.g.*, 25 U.S.C. § 450 (1996) (Indian self-determination); 25 U.S.C. § 3101 (1996) (Indian forest lands); and 25 U.S.C. §§ 2, 9, 2101-08 (1996) (Indian mineral resources). "Among the attributes of tribal sovereignty [are] the power to manage and control water and land resources, associated natural resources and environmental protection. . . . Federal recognition of these powers, whether arising from statute, executive order, or treaty, is the supreme law of this land" U.S. DEP'T OF THE INTERIOR, TRIBAL SELF DETERMINATION (1994).

548. For example, as a condition for granting service or construction contracts, mineral leases, or extraction permits, the Navajo Nation imposes explicit performance requirements on private companies to create new jobs, hire and train Navajo residents, and pay prevailing wages. *See* 3 NAVAJO TRIBAL CODE tit. 16, § 601 (1978) (dealing with land use); 4 NAVAJO TRIBAL CODE tit. 18, § 1006 (1978) (dealing with extraction permits); 4 NAVAJO TRIBAL CODE tit. 18, § 1506 (1978) (dealing with oil and gas leases). *See also* 25 U.S.C. § 450e(b) (1996) (stating a federal procurement preference for Indian organizations and Indian-owned enterprises to perform contracts or grants that benefit Indian people).

549. For example, regarding intellectual property rights, the Indian Treaty Rights Committee claims that multinational corporations have secured patents or trademarks over indigenous symbols and traditional Indian seed crop genetics and horticultural processes. By failing to involve tribal governments in negotiations and by acquiescing in agreements that enable non-Indian investors to enforce these property rights, the Committee alleges that the federal government is not meeting its trust responsibilities. *See* INDIAN TREATY RIGHTS COMMITTEE, GATT AND NAFTA AND INDIANS 2 (1994).

550. Over 300 reservations are threatened by severe environmental hazards that tribal governments are responding to with reversals of traditionally lax conservation policies, both federal practices and their own. The changes that Indian tribes either implement or advocate involve limits on clear cutting and mining permits, mining and forest reclamation, dam sites and fish ladder construction, and other practices. These policies could have adverse effects on foreign businesses compared to native Indian enterprise or the MAI might consider them performance requirements or regulatory takings. *See* Winona LaDuke, *Like Tributaries to a River, The Growing Strength of Native Environmentalism*, 81 SIERRA 41 (1996) (citing a study by the World Watch Institute).

are the second-largest land owners in the United States and own one-third of all western low-sulfur coal and vast mineral and timber reserves.⁵⁵²

The United States has not publicly disclosed exactly what it will include in its list of grandfathered state and local laws. According to OECD officials, the United States listed approximately five measures per state, which follows the precedent of state-level reservations listed for NAFTA.⁵⁵³ After the NAFTA process, however, some state attorneys general complained that the federal government failed to include many state measures that the states identified as nonconforming with state law.⁵⁵⁴ Ultimately, the U.S. federal government informed state officials that NAFTA reserved all pre-existing nonconforming state laws.⁵⁵⁵ A general reservation of all existing nonconforming measures, however, "was not contemplated by the wording of NAFTA and was incorporated only through an exchange of letters among the three NAFTA parties. It is unclear whether parties to the MAI would be prepared to accept general reservations of subnational measures."⁵⁵⁶

2. Technical Specifications

Although U.S. negotiators proposed to grandfather all existing state and local law, the MAI has more specific listing requirements than NAFTA. The MAI would require each nation to classify exceptions to the respective articles that they violate (*e.g.*, National Treatment, MFN Treatment, etc.), and then for each measure listed, add six other technical descriptions⁵⁵⁷ "in the

551. Navajo law states that use of Navajo land by non-Navajo individuals or organizations should be kept to a minimum. See 3 NAVAJO TRIBAL CODE tit. 16, § 601 (1978).

552. LaDuke, *supra* note 550, at 41.

553. See BNA, *Treaty Negotiations*, *supra* note 535, at 1919. It is significant that the NAFTA reservations were listed in the two years after the NAFTA text had been formally adopted, whereas the MAI country-specific exceptions are part of the negotiations process. See NAFTA, *supra* note 116, art. 1108.2.

554. "Unfortunately, we do not understand why your office proposes to delete most of our reservations." Letter from Theodore R. Kulongoski, Attorney General of Oregon, to Michael Kantor, United States Trade Representative 1 (Dec. 15, 1995) (on file with author).

555. See Letter from Phyllis Shearer Jones, NAFTA Coordinator for State Matters and Assistant U.S. Trade Representative for Intergovernmental Affairs and Public Liaison, Office of the United States Trade Representative, to Enrique Martinez-Vidal, Department of Legislative Reference, State of Maryland (May 1, 1996) (on file with author).

556. Testimony of Ian Waddell, Minister of the Legislative Assembly, and Noel Schacter, Director of the International Branch of the Ministry of Employment and Investment, Government of British Columbia, *Regarding the Proposed Multilateral Agreement on Investment*, House of Commons Standing Comm. on Foreign Affairs and Int'l Trade 10 (Nov. 26, 1997) [hereinafter British Columbia, *Testimony Regarding the MAI*].

557. Each exception sets out the following elements:

- (a) Sector refers to the general sector in which the exception is taken;
- (b) Sub-Sector refers to the specific sector in which the exception is taken;
- (c) Obligation specifies the MAI provision referred to in paragraph 1 for which an exception is taken;
- (d) Level of Government indicates the level of government maintaining the measure for which an exception is taken;

most precise terms possible.”⁵⁵⁸ This level of precision is designed to limit the scope of exceptions by creating a matrix of factors for narrow interpretation.

**Matrix for Grandfathering (or Challenging)
Country-Specific Exceptions to the MAI**

Technical Specification of Measures	MAI Obligations from Which the Country Takes an Exception					
	A	B	C	D	E	F
1. <i>Measure #1</i>						
2. <i>Measure #2</i>						
3. <i>Measure #3</i>						
<i>Etc.</i>						

An investor could challenge a nonconforming measure on either side of the matrix:

- *Obligations*: First, the MAI text may not allow countries to take exceptions from all MAI obligations.⁵⁵⁹ For example, the MAI general exception for “essential security interests” does not apply to expropriation,⁵⁶⁰ and the United States does not apply its country-specific exceptions to expropriation.⁵⁶¹ The draft MAI article on country-specific exceptions lists only National Treatment and MFN Treatment; it leaves the others for later determination in the negotiating process.⁵⁶² MAI exceptions

(e) *Legal source or authority of the measure identifies the specific legal source of the exception, whether in the form of a law, regulation, rule, decision, or any other form;*

(f) *Succinct Description of the Measure sets out [the] non-conforming aspects of the existing measures for which the exception is taken, together with any commitment to eliminate or reduce the non-conformity of the measure; [and*

(g) *Motivation or purpose describes the rationale for a given measure].*

MAI Negotiating Text, *supra* note 7, art. IX(Lodging of Country Specific Exceptions)(2) (brackets in original).

558. MAI Commentary, *supra* note 101, art. IX(Standstill and the Listing of Country Specific Reservations)(3)(b).

559. “While some [OECD delegations] favoured an open list, others argued for a limited closed list of disciplines comprising National Treatment, MFN and new disciplines (special topics).” *Id.* art. IX(Lodging of Country Specific Exceptions)(3).

560. MAI Negotiating Text, *supra* note 7, art. VI(General Exceptions)(1).

561. See Partial Draft of Country-Specific Exceptions Proposed by the United States, *supra* note 543, at 19-21.

562. It is agreed that the disciplines listed in the chapeau text of parts A and B of the draft Article should remain incomplete for the time being pending political

may number as few as two or as many as fourteen. Furthermore, if the MAI text does not preclude country-specific exceptions from applying to a certain MAI article, the countries themselves may limit their exceptions as a result of trade-offs in the negotiations. For example, EU countries might agree to take an exception for their Regional Economic Integration Organization from most MAI articles, but not from privatization, monopolies, employment, or performance requirements. In exchange, the United States might agree to take an exception from National Treatment for government procurement, but not from MFN Treatment.

- *Technical specification.* A measure is only excepted to the extent that it is defined as an exception.⁵⁶³ For example, an investor could challenge a government procurement measure by claiming: (1) the sector in which the investor operates, such as banking, was not stated in the specifications, (2) the authorities cited covered, for example, central purchasing agencies, but not airport authorities where the investor operates, or (3) the motivations listed covered local labor and economic development objectives, but not the human rights record of the company in a third country that is not party to the MAI.

Some advocates argue that the acrimonious history of disputes between the United States and Canada over softwood lumber subsidies is grounds for concern that investors would challenge country-specific exceptions using all available arguments.⁵⁶⁴

In addition to promoting a narrow interpretation of country-specific exceptions, the technical detail required by the MAI fosters the transparency necessary for achieving a long-term “ratcheting effect” or an eventual phase-out of country-specific exceptions.⁵⁶⁵ “Ratcheting” is also described as a “rollback” process, achieved through: (1) commitments by MAI countries in their technical specifications for country-specific excep-

decisions by the Negotiating Group. The text could also be reviewed after negotiators have decided how measures by sub-national entities and regional economic integration organisations should be treated across the MAI.

MAI *Negotiating Text*, *supra* note 7, art. IX(A) n.4.

563. *See id.* art. IX(2)(a)-(f).

In the interpretation of an exception, elements (a) to (f) shall be considered. In the event of a discrepancy between the non-conformity of the measure as set out in the legal source or authority identified and the non-conformity as set out in the other elements in their totality, the exception shall be deemed to apply to the non-conformity of the measure as set out in the legal source or authority.

Id. art. IX(3). In other words, if the citation of legal authority in the MAI is narrower than non-conforming laws in state or local codes, then it is the narrower MAI citation that controls.

564. *See* LORI WALLACH, *THE NGO POCKET TRADE LAWYER FOR THE MULTILATERAL AGREEMENT ON INVESTMENT 5* (1998).

565. In order to clarify the automatic ratchet effect of List A [grandfathered] measures, the Chairman proposed the addition of the following phrase at the end of paragraph (e)[which requires specification of the “legal source or authority . . . of the exception whether in the form of a law regulation, rule, decision or any other form;”]: “as of the date of entry into force of the Agreement, or as continued, renewed or amended after that date.”

tions (e.g., “liberalisation commitments,” phase-out schedules or sunset clauses); or (2) “obligations” that this or subsequent rounds might impose on MAI countries to adjust their exceptions.⁵⁶⁶ MAI negotiators may accomplish the latter by drafting the introductory clause to limit the scope of country-specific exceptions.⁵⁶⁷

B. Exceptions for Future Nonconforming Measures

If the United States proposes a grandfathering list that averages only five measures per state, it is not clear how U.S. negotiators can credibly advertise sovereignty protection for “all nonconforming measures,” and still meet the MAI standard for technical specificity necessary for effectively taking an exception. The only conceivable way is to “carve out” exceptions for future lawmaking within fairly broad categories of federal, state and local law, which include:

- *Minority affairs*: “[M]easures according rights or preferences to socially or economically disadvantaged minorities, including corporations organized under the laws of the state of Alaska in accord with the Alaska Native Claims Act.”⁵⁶⁸
- *Social services*: Social services includes public law enforcement, corrections, income security or insurance, social security, social welfare, public education, public training, and health care.⁵⁶⁹ The Canadian government made a similar country-specific reservation to NAFTA for health services, but provincial officials “remain deeply concerned that the integrity of Canada’s existing health care system and social services will not be adequately protected by means of reservations.”⁵⁷⁰ The U.S. government has a different view about the meaning of the reservation, which could lead to a narrow interpretation of Canada’s health reservation by a NAFTA dispute panel.⁵⁷¹
- *Subsidies*: “[A]ny measures relating to subsidies and grants including government-supported loans, guarantees and insurance.”⁵⁷² The draft MAI includes a “compromise” section that would create a built-in agenda for negotiating the standstill and rollback of country-specific exceptions for subsidies.⁵⁷³

MAI *Negotiating Text*, *supra* note 7, art. IX(2)(e) n.15; *id.* art. IX(2)(a)-(f).

566. See MAI *Commentary*, *supra* note 101, art. IX(Rollback)(1)-(4).

567. See MAI *Negotiating Text*, *supra* note 7, art. IX(A).

568. Partial Draft of Country-Specific Exceptions Proposed by the United States, *supra* note 543, item 10.

569. See *id.* item 13.

570. British Columbia, *Testimony Regarding the MAI*, *supra* note 556, at 11.

571. See NAFTA, *supra* note 116, Annex II-C-9; see also British Columbia, *Testimony Regarding the MAI*, *supra* note 556, at 11.

572. Partial Draft of Country-Specific Exceptions Proposed by the United States, *supra* note 543, item 23.

573. This section, which has not reached consensus, states that “[even if applied on a non-discriminatory basis, investment incentives may have distorting effects on the flow of capital and investment decisions.]” MAI *Negotiating Text*, *supra* note 7, art. III(Investment Incentives), (2.2). The agenda for negotiations would address “[the issue of positive discrimination, [transparency], standstill and rollback.]” *Id.* art. II(3).

These categories do not cover the general exceptions in GATT Article XX (such as laws that protect public morals, human and animal health, and conservation of exhaustible natural resources), the General Agreement for Trade in Services (GATS), NAFTA Chapter 11, or the WTO Agreement on Government Procurement. They are generic categories of government activity rather than types of legitimate purposes for nonconforming measures.

"Carve-outs" for future lawmaking are opposed by some OECD delegations as undermining the MAI disciplines to which they are applied.⁵⁷⁴ Consequently, the MAI text is bracketed to show that there is not agreement on whether the categorical exceptions function as "carve-outs" or grandfather existing measures within the listed categories.⁵⁷⁵ This is obviously a major tension in the negotiation process because the United States has committed itself domestically to retain the carve-outs.⁵⁷⁶

Thus, the carve-out categories may be treated more like existing nonconforming laws on the grandfathered list. This would mean that: (1) they could be more narrowly negotiated within a matrix of obligations and technical specifications; and (2) the listing process could create the agenda for future application of standstill and rollback requirements.

The strategy of turning the current round of country-specific exceptions into the agenda for future MAI negotiations is mentioned in draft MAI provisions for developing countries. Developing countries would be allowed to lodge exception lists that are "longer than ones lodged by developed countries. Their [exceptions] are, however, subject to the roll-back process, as will be introduced for existing contracting parties."⁵⁷⁷ This strategy reflects the bias against carve-out exceptions to the MAI expressed by the OECD in 1995.⁵⁷⁸

C. Interpretation by Dispute Panels

A final limitation of country-specific exceptions is that MAI dispute panels could interpret an exception to restrict measures that it purports to cover. Dispute panels narrowly interpreted general exceptions under GATT Arti-

574. See *id.* art. IX(B) n.9.

575. The text of this provision reads: "[B. Articles X; Y, [Article Z, . . . , and Article . . .] do not apply to any measure that a Contracting Party [adopts] or [maintains] with respect to sectors, subsectors or activities, as set out in its Schedule to Annex B of the Agreement.]" *Id.* art. IX(B) (brackets in original).

576. See McGINTY, *supra* note 10, at 9.

577. OECD, SPECIAL AND DIFFERENTIAL TREATMENT FOR DEVELOPING COUNTRIES II, Specific Points n.7 DAF/MAI/RD(97)56 (1997).

578. "The MAI would aim to raise the level of existing liberalization based on a "top-down" approach under which the only exceptions permitted are those listed when adhering to the agreement and which are subject to progressive liberalization." Committee on International Investment and Multinational Enterprises (CIME) and the Committee on Capital Movements and Invisible Transactions (CMIT), *A Multilateral Agreement on Investment*, OECD DOCUMENTS, *supra* note 58, at 11. See also Working Group A, *Existing Liberalization*, OECD DOCUMENTS, *supra* note 58, at 119, which defines the future liberalization process as a "ratchet" mechanism [with] future rounds of negotiation."

cle XX so that the exception did not apply to the challenged measure. These decisions are relevant to the viability of country-specific exceptions under the MAI to the extent that the decisions are based upon principles of international law that would apply to any multilateral agreement.

Before the WTO was created, two GATT panels ruled against U.S. measures that limited tuna imports on grounds that the tuna-catching methods unnecessarily killed dolphins. The *Tuna I* panel read into Article XX a non-textual limit on U.S. jurisdiction to impose its dolphin conservation standards in a way that affected fishing practices outside of U.S. territorial jurisdiction.⁵⁷⁹ The *Tuna II* panel used a more flexible approach, but still found limits on the legal jurisdiction of the United States, which extends beyond territorial waters only to U.S. nationals and U.S.-chartered vessels.⁵⁸⁰ In short, both panels found jurisdictional limits on U.S. sovereignty that were not based on the text of Article XX. If jurisdictional limits preclude the United States from limiting access to its own market under a GATT general exception, then jurisdictional limits could preclude the use of a country-specific exception.

Subsequently, the WTO Appellate Body analyzed the general exceptions of GATT Article XX in the broad context of rights and obligations that are created by the agreement as a whole.⁵⁸¹ Before listing the general exceptions, Article XX articulates two tests designed to prevent the abuse of general exceptions. The first test guards against measures that would constitute "arbitrary or unjustifiable discrimination," and the second test guards against creating "a disguised restriction on international trade."⁵⁸² In its *Gasoline* opinion, the Appellate Body stated:

[t]he chapeau is animated by the principle that while the exceptions of Article XX may be invoked as a matter of legal right, they should not be applied so as to frustrate or defeat the legal obligations of the holder of the right under the substantive rules of the General Agreement.⁵⁸³

In the context of the MAI, the question becomes whether the legal right to exercise a country-specific exception should be limited by or balanced against the substantive obligations of the MAI in the absence of the language in the Article XX chapeau that guards against abuse of the exceptions.

579. See GATT Panel Report on United States - Restrictions on Imports of Tuna, Sept. 3, 1991, GATT B.I.S.D. (39th Supp.) at 155 (1991) (circulated but not adopted) [hereinafter *Tuna I*].

580. See GATT Panel Report on United States - Restrictions on Imports of Tuna, June 16, 1994, DS29/R 33 I.L.M. 839 [hereinafter *Tuna II*]. See also GATT Panel Report of Thailand, *supra* note 473; GATT Panel Report on Canada - Measures Affecting Export of Unprocessed Herring and Salmon, GATT B.I.S.D. (35th Supp.) at 98 (adopted Mar. 22, 1988); GATT Panel Report on United States - Restrictions on Imports of Imports of Tuna and Tuna Products of Canada, GATT B.I.S.D. (29th Supp.) at 91 (adopted Feb. 22, 1982).

581. See WTO Appellate Body Report on United States - Standards for Reformulated and Conventional Gasoline, Apr. 24, 1996, 1996 WL 227476 (W.T.O.), WT/DS2/R [hereinafter *Gasoline*].

582. GATT, *supra* note 111, art. XX.

583. *Gasoline*, *supra* note 581, at 15 (emphasis added).

Is it conceivable that by omitting both the Article XX exceptions and chapeau language, the MAI would afford greater sovereignty protection than the GATT, simply through the device of country-specific exceptions? One answer to this question would be "yes," based upon the assurances that U.S. negotiators have given state government officials. Another answer, however, appears to be "no," based upon the most recent Appellate Body decision in the *Shrimp/Turtle* case before the WTO.⁵⁸⁴

In the *Shrimp/Turtle* case, the Appellate Body explained what it meant in the *Gasoline* decision when it said that the Article XX chapeau "is animated by" the principle that the right to invoke exceptions should not frustrate obligations to comply with the agreement.⁵⁸⁵ The chapeau of Article XX is:

. . . but one expression of the principle of good faith. This principle, at once a general principle of law and a general principle of international law, controls the exercise of rights by states. One application of this general principle, the application widely known as the doctrine of *abus de droit*, prohibits the abusive exercise of a state's rights and enjoins that whenever the assertion of a right "impinges on the field covered by [a] treaty obligation, it must be exercised bona fide, that is to say, reasonably."⁵⁸⁶

In *Shrimp/Turtle*, the Appellate Body concludes that the application of international law principles to the Article XX chapeau results in a delicate task of

marking out a line of equilibrium between the right of a Member to invoke an exception under Article XX and the rights of the other Members under varying substantive provisions . . . so that neither of the competing rights will cancel out the other and thereby distort and nullify or impair the balance of rights and obligations . . .⁵⁸⁷

In short, the Appellate Body recognizes a balancing test derived from gen-

584. See WTO Appellate Body Report on United States - Import Prohibition of Certain Shrimp and Shrimp Products, Oct. 12, 1998, 1998 WL 720123 (W.T.O.), WT/DS58/AB/R [hereinafter *Shrimp/Turtle*]. The *Shrimp/Turtle* case involved a complaint by India, Pakistan, Thailand, and Malaysia against a federal law that bans shrimp imports from any country that the United States has not certified as meeting U.S. goals for protecting sea turtles that are drowned in the process of harvesting shrimp. See 16 U.S.C. § 1537, amending the Endangered Species Act of 1973; 16 U.S.C. § 1531; Department of Commerce, Justice, and State, the Judiciary, and Related Agencies Appropriations Act, Pub. L. 101-162, § 609 (1989); Revised Notice of Guidelines for Determining Comparability of Foreign Programs for the Protection of Turtles in Shrimp Trawl Fishing Operations, 61 Fed. Reg. 17,342 (1996).

585. See *Shrimp/Turtle*, *supra* note 584, ¶¶ 151, 156-60.

586. *Id.* ¶ 158, quoting BOM CHENG, GENERAL PRINCIPLES OF LAW AS APPLIED BY INTERNATIONAL COURTS AND TRIBUNALS (1953), which elaborates that,

[a] reasonable exercise of the right [to invoke an exception to an agreement] is regarded as compatible with the obligation. But the exercise of the right in such a manner as to prejudice the interests of the other contracting party arising out of the treaty is unreasonable and is considered as inconsistent with the bona fide execution of the treaty obligation, and a breach of the treaty.

Id.

587. *Shrimp/Turtle*, *supra* note 584, ¶ 159.

eral principles of international law and the framework of the agreement.⁵⁸⁸ The test is based on principles of international law, not merely the language of the Article XX chapeau. The chapeau is itself a reflection of the underlying principles, which would also apply to interpretation of country-specific exceptions under the MAI.

The Appellate Body further found that even though the purpose of the U.S. shrimp conservation program fit within the scope of Article XX(g), it was applied in a manner that resulted in "arbitrary or unjustifiable discrimination" between countries where the same conditions prevail.⁵⁸⁹ In so doing, the Appellate Body stressed that "the most conspicuous flaw in this measure's application relates to its intended and actual coercive effect on the specific policy decisions made by foreign governments . . ."⁵⁹⁰ It then cited the failure of the United States to engage shrimp exporting nations in "serious, across-the-board negotiations with the objective of concluding bilateral or multilateral agreements . . . before enforcing the import prohibition . . ."⁵⁹¹

The Appellate Body concluded that the lower dispute panel erred because it focused on the design of the U.S. measure as it was written, rather than as it was applied,⁵⁹² and because the panel went beyond the purpose of the Article XX chapeau, which is to prevent abuse of the specific general exceptions.⁵⁹³ The erroneous result was the lower panel's overly broad test of whether a measure would "undermine the WTO multilateral trading system."⁵⁹⁴ By comparison, the Appellate Body's standard is

588. This balancing test weighs treaty rights and obligations, unlike the U.S. constitutional balancing test under the dormant commerce clause, which balances legitimate local needs against the burden that the method chosen places on interstate or international commerce. See *supra* Part II.A.3.b.

589. See *Shrimp/Turtle*, *supra* note 584, ¶¶ 161-86.

590. *Id.* ¶ 161. The Appellate Body held that the standard under the U.S. measure required other countries to adopt comparable regulatory programs, essentially identical programs of using turtle excluder devices (TEDs) rather than comparable programs. See *id.* ¶ 163. The Appellate Body in *Shrimp/Turtle* did not address the *Tuna I* panel's approach to limiting "coercive" measures through a territorial limit on U.S. jurisdiction. The lower dispute panel in *Shrimp/Turtle* took pains to distance itself from the *Tuna I* jurisdictional analysis: "[w]e are not basing our finding on an extra-jurisdictional application of U.S. law. Many domestic governmental measure can have an effect outside the jurisdiction of the government which takes them." GATT Panel Report, United States - Import Prohibition of Shrimp and Certain Shrimp Products, WT/DS58/R (May 15, 1998 *not adopted*) ¶ 3.157, at 76 (Legal Arguments), ¶ 3.207, at 97 (Legal Arguments) [hereinafter *Shrimp/Turtle Panel*].

591. *Shrimp/Turtle Panel*, *supra* note 590, ¶ 166.

592. See *id.* ¶ 115.

593. See *id.* ¶ 116. In the words of the Appellate Body,

[t]hus, the Panel arrived at the very broad formulation that measures which 'undermine the WTO multilateral trading system' must be regarded as 'not within the scope of measures permitted under the chapeau of Article XX.' Maintaining, rather than undermining, the multilateral trading system is necessarily a fundamental and pervasive premise underlying the WTO Agreement; but it is not a right or an obligation, nor is it an interpretative rule which can be employed in the appraisal of a given measure under the chapeau of Article XX.

Id.

594. *Id.* ¶ 116.

whether a measure as applied “reduces the treaty obligation to a merely facultative one and dissolves its juridical character, and, in so doing, negates altogether the treaty rights of other members.”⁵⁹⁵ By focusing on specific exceptions under Article XX, the Appellate Body was able to write a much more conservative option, yet still reach the same result. Yet notwithstanding its criticism of the panel’s reasoning, the Appellate Body and the lower panel both share the premise that GATT’s general exceptions are limited by principles that are drawn from beyond the text of Article XX. Whereas the panel cited the overarching purpose of the WTO multilateral trading system,⁵⁹⁶ the Appellate Body cited established principles of international law that are synonymous with the text of the Article XX chapeau.

The MAI distinguishes itself from GATT in the way that it provides for sovereignty protection through country-specific exceptions rather than general multilateral exceptions.⁵⁹⁷ The MAI article on country-specific exceptions has no provision comparable to the chapeau of GATT Article XX.⁵⁹⁸ If MAI countries were to defend their laws by invoking country-specific “carve-out” exceptions, then MAI dispute panels could theoretically accept that defense as absolute because of the absence of GATT-style provisions in the text that guard against abuse. However, it is more likely that MAI panels would follow the reasoning of the *Shrimp/Turtle* Appellate Body. That would mean invoking international law to interpret the exception as “limited and conditional” and subject to a test of whether use of the exception *unreasonably* impinges on a treaty obligation.⁵⁹⁹ Such a reasonableness test could include whether the measure being defended is “necessary” (i.e., the least-trade or least-investment-restrictive alternative), whether it is calculated to gain an unfair advantage, or whether it could otherwise be more compatible with the obligation.⁶⁰⁰

It is also possible that MAI panels could follow the broader reasoning of the *Shrimp/Turtle* panel report. While the WTO Appellate Body rejected that reasoning, it did so because the reasoning was not consistent with the textual formula of the Article XX exceptions and chapeau provisions against abuse of the exceptions. The MAI, however, has neither the GATT-style general exceptions nor provisions against the abuse of exceptions,

595. *Id.* ¶ 156.

596. See *Shrimp/Turtle Panel*, *supra* note 590, ¶ 7.44.

597. The MAI limits general exceptions (apart from expropriation, compensation, and protection from strife) to “essential security interests” and “public order,” defined as protecting a fundamental interest of society. *MAI Negotiating Text*, *supra* note 7, art. VI(General Exceptions)(1)-(3).

598. See generally *id.* art. IX.

599. See *Shrimp/Turtle*, *supra* note 584, ¶ 158. In this regard, the argument of the *Shrimp/Turtle* plaintiffs could be used by MAI panels to reject any country-specific carve-out exception that results in “a fundamental redistribution of rights and obligations . . . one that handed nations with large markets the means to coerce other states to conform their environmental laws, conservation and health policies with those of the importing party as a condition of exercising rights that were otherwise guaranteed by [the agreement].” *Shrimp/Turtle Panel*, *supra* note 590, ¶ 3.207, at 97 (Legal Arguments).

600. See *Shrimp/Turtle*, *supra* note 584, ¶ 158.

which the Appellate Body cited as the basis of error by the lower panel. Thus, there are no textual reasons why MAI panels could not follow the lead of the *Shrimp/Turtle* panel and invalidate any country-specific carve-out that is used to defend measures that limit market access based on unilateral criteria. The panel reasoned that, "[m]arket access for goods could become subject to an increasing number of conflicting policy requirements for the same product and this would rapidly lead to the end of the WTO multilateral trading system."⁶⁰¹ The panel found that a single law need not threaten the global trading system by itself to be threatening. Rather, the risk comes from the potential that other nations could adopt the same type of law.⁶⁰²

The rules of the Vienna Convention could also limit the viability of U.S. "carve-out" exceptions, even if MAI panels do not adopt the reasoning of GATT or WTO cases.⁶⁰³ Another MAI country could ask a dispute panel to invalidate a U.S. exception because it violates either of two provisions of the Vienna Convention. These provisions provide that countries may enter an exception unless (1) the agreement allows only specified exceptions not including the one being challenged,⁶⁰⁴ and (2) the exception is incompatible with the object and purpose of the agreement.⁶⁰⁵

Article 19 of the Vienna Convention governs "reservations," which the Convention defines broadly to include any "unilateral statement, however phrased or named, made by a State . . . whereby it purports to exclude or modify the legal effect of certain provisions of the treaty in their application to that State."⁶⁰⁶ Thus, the international law of "reservations" would cover the MAI's country-specific exceptions. The MAI replaces "reservations" with "exceptions" in order to avoid the Vienna Convention's rule that reservations are reciprocal in nature.⁶⁰⁷ The MAI exceptions also do not follow the Vienna Convention rule that countries may object to reservations, which suspends the reservation and the applicable treaty provisions

601. *Shrimp/Turtle Panel*, *supra* note 590, ¶ 7.45, at 285 (Findings).

602. *See id.*

603. *See* Vienna Convention on the Law of Treaties, *opened for signature* May 23, 1969, 8 I.L.M. 679 [hereinafter Vienna Convention]; RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 313 (1987) [hereinafter RESTATEMENT THIRD]. *See generally* Henry J. Bourguignon, *The Belilos Case: New Light on Reservations to Multilateral Treaties*, 29 VA. J. INT'L L. 347 (1989); Logan Piper, *Reservations to Multilateral Treaties: The Goal of Universality*, 71 IOWA L. REV. 295 (1985); Michael F. Glennon, *Treaty Process Reform: Saving Constitutionalism Without Destroying Democracy*, 52 U. CIN. L. REV. 84 (1983); Jean Kyongun Koh, *Reservations to Multilateral Treaties: How International Legal Doctrine Reflects World Vision*, 23 HARV. INT'L L.J. 71 (1982); IAN SINCLAIR, *THE VIENNA CONVENTION ON THE LAW OF TREATIES* (2d ed. 1984); D.W. Bowett, *Reservations to Non-Restricted Multilateral Treaties*, 48 BRIT. Y.B. INT'L L. 67 (1976-77).

604. *See* Vienna Convention, *supra* note 603, art. 19(b); RESTATEMENT THIRD, *supra* note 603, § 313(1)(b).

605. *See* Vienna Convention, *supra* note 603, art. 19(c); RESTATEMENT THIRD, *supra* note 603, § 313(1)(c).

606. Vienna Convention, *supra* note 603, art. 2(1)(d). *See* RESTATEMENT THIRD, *supra* note 603, § 313 cmt. a.

607. *See* MAI *Negotiating Text*, *supra* note 7, art. IX(A) n.1.

between the excepting and the objecting countries.⁶⁰⁸ The Vienna Convention clearly defers to such internal treaty interpretation rules.⁶⁰⁹ Without more than a reference in one oblique footnote, however, it is unclear how the MAI drafters intend to free the MAI from the option that the Vienna Convention gives to participating countries to object to a reservation within twelve months of its entry into force.⁶¹⁰

The second constraint of the Vienna Convention is that the application of country-specific exceptions must prove compatible with the object and purpose of the MAI. This constraint is consistent with the reasoning of the *Shrimp/Turtle* Appellate Body opinion, which sought to balance the rights and obligations of WTO members based on the Article XX exceptions and good faith principles of international law.⁶¹¹

From the perspective of compatibility with the object and purpose of the MAI, the grandfathering exceptions are the least objectionable. The "list A" exceptions of the MAI⁶¹² (grandfathered measures) are country-specific. They are also highly specific as to scope, subject to standstill, and constitute the agenda for future negotiations on rollback. Since this closed list of existing measures would be the result of bargaining, at least among the original parties to the MAI, it is arguably a fair and noncoercive part of the MAI framework. A challenge to a "list A" exception is most likely to come under the MAI's internal scope and specificity requirements, as explicitly provided under the Vienna Convention.⁶¹³

The "list B" exceptions of the MAI, which would cover the U.S. "carve-out" exceptions, are a different matter. They are opposed by some OECD countries because they are open categories of future lawmaking power and, as proposed by the United States, are general categories that include large segments of the economy. To the extent that the United States would

608. Vienna Convention, *supra* note 603, art. 21(3); RESTATEMENT THIRD, *supra* note 603, § 321(3).

609. Vienna Convention, *supra* note 603, art. 20(5). The current rule also provides that acquiescence for 12 months in the face of the a reservation amounts to acceptance of the reservation. See RESTATEMENT THIRD, *supra* note 603, § 313 n.1 & cmt. e. Listing a country-specific exception that "carves out" an economic sector or category of law is, in effect, a counter-offer to the terms of a multilateral agreement. At one time, the rule was that rejection of a country-specific exception (or broadly defined, a reservation) amounted to a rejection of the entire agreement as between the reserving and the objecting parties. See RESTATEMENT THIRD, *supra* note 603, § 313 n.1. The current rule is that if one country objects to another country's reservation, the original terms of the agreement remain in effect, absent the benefits of a reservation for the reserving country with respect to the objecting country. This is particularly the case when a multilateral agreement has a "legislative" character of providing benefits to private actors (such as foreign investors), not just to the participating states themselves. An underlying assumption, however, is that the reservation is compatible with the object and purpose of the agreement. See RESTATEMENT THIRD, *supra* note 603, § 313 n.1. See Reservations to the Convention on the Prevention and Punishment of the Crime of Genocide, 1951 I.C.J. 15 (advisory opinion) [hereinafter Genocide Advisory Opinion].

610. *Id.* See also Piper, *supra* note 603, at 320.

611. See WALLACH, *supra* note 564.

612. See MAI *Negotiating Text*, *supra* note 7, art. IX(Introduction to Annex A of the Agreement listing country-specific exceptions).

613. See *supra* note 609.

defend a measure that has extra-territorial effect or “coercive” influence on the policy of other nations, the exceptions run counter to the principles of the *Shrimp/Turtle* ruling.

The argument for challenging country-specific “carve-out” exceptions as a distortion of the balance of MAI rights and obligations would be strongest if brought by a developing country that later accedes to the MAI. The argument would sound much like the complaint of India, Pakistan, Thailand, and Malaysia in the *Shrimp/Turtle* case, which was that the nation with the largest import market was using the general exceptions to protect lawmaking authority that was applied to coerce them into expensive compliance measures to meet unilateral U.S. standards.⁶¹⁴ These nations are not part of the original bargaining process over country-specific exceptions, and they would not enjoy reciprocal use of exceptions taken by OECD members.⁶¹⁵

While the *Shrimp/Turtle* decision and the Vienna Convention provide broad arguments for a dispute panel to invalidate a country-specific exception, they provide little guidance on the exact scope exceptions that would effect a “redistribution of rights and obligations” or violate the “purposes and objectives” of the MAI. One clue lying on the surface of the *Shrimp/Turtle* decision is the argument that the United States should not be able to use its economic power (denial of access to its own market) to get around the WTO’s rule-based system.⁶¹⁶ Professor Jackson describes treaty rights and obligations in terms of a legal spectrum spanning between power and rule, with most agreements falling somewhere in the middle. A power-based agreement is one that enables countries to negotiate disputes by utilizing their political and economic clout. A rule-based agreement is one that requires countries to settle disputes by resort to the disciplines of the agreement only.⁶¹⁷

The degree of power orientation of a country-specific exception could serve as a guide to the likelihood that the exception could be invalidated by a dispute panel. The closer the exception comes to exercising economic or political power of a large-market country (or state), the closer it comes to “coercion” as defined in *Shrimp/Turtle*. The use of a power curve analysis to challenge country-specific exceptions would look behind the form of the exception, such as the broad exceptions for subsidies or procurement, to the way that the exception is applied to protect laws that use economic leverage to the disadvantage of foreign investors.

While the *Shrimp/Turtle* case focused on a law with explicit extraterritorial purposes, a power curve analysis of exceptions based on MAI objectives would look for effects on foreign competition, not just explicit

614. See *Shrimp/Turtle Panel*, *supra* note 590, ¶ 3.207, at 97 (Legal Arguments).

615. Accession of non-OECD countries to the MAI would require approval by a supermajority of OECD countries if the decision cannot be made by consensus. See *MAI Negotiating Text*, *supra* note 7, arts. XII(Accession)(2), XII(Parties Group)(7).

616. See *Shrimp/Turtle*, *supra* note 584, ¶ 3.207, at 97 (Legal Arguments).

617. See JOHN H. JACKSON, *THE WORLD TRADING SYSTEM: LAW AND POLICY OF INTERNATIONAL ECONOMIC RELATIONS* 85-88 (1989); Schaefer, *supra* note 13, at 622.

purposes. In other words, the more effective a state law is at influencing the location of investments or the competitiveness of domestic investors to the disadvantage of foreign investors, the more likely it is that the law could be challenged, regardless of whether it is protected by a country-specific exception. For example, a procurement preference for environmental technology that is easily exported ranks low on the power curve. It would not frustrate the objectives of the MAI because foreign investors have effective access to that market. A procurement preference for recycled content in heavy commodities like newsprint falls in the middle of the power curve. It is more likely to place foreign firms at a competitive disadvantage because of shipping or reinvesting costs. A procurement preference that penalizes paper producers that engage in clear-cutting or furniture producers that operate in countries that promote forestry with forced labor is high on the power curve. The curve discriminates in terms of production methods that are either designed to influence policy of other jurisdictions, much more likely to affect foreign as compared with domestic firms, or both.

It is difficult to predict the viability of country-specific exceptions, save that a MAI dispute panel has ample grounds under international law to look behind the form of an exception and question whether it redistributes power under the MAI, coerces other nations with less economic power or otherwise frustrates the investor-protection objectives of the MAI.

Taken as a whole, the assurance by U.S. negotiators that country-specific exceptions will protect U.S. state sovereignty interests is less than the sum of its parts. First, the "List A" for existing nonconforming laws to be "grandfathered" would do nothing to affect MAI constraints on future law-making. Second, the exceptions do not cover the laws of most tribal governments, which limit access to vast coal, mineral, timber, water, and other resources. Third, the level of technical specificity required to make an exception creates many options for narrowing the scope of MAI disciplines covered, and economic sectors and state laws actually listed. Fourth, the "List B" categories that would "carve-out" future sovereignty protection are opposed by other OECD countries and are thus still negotiable. Fifth, even if the "List B" categories survive as part of the MAI, there is a reasonable risk that dispute panels will invalidate the exceptions as applied to laws that use political or economic power of states to the disadvantage of foreign investors. And finally, if the MAI comes into force, MAI negotiators envision a long-term process of ratcheting back those exceptions into compliance with the MAI through future rounds of negotiation.

Conclusion

The goals of the MAI are generally consistent with economic interests that are protected by the U.S. Constitution. But unlike the MAI, the Constitution balances those interests against the competing purposes of noneconomic regulation, just as it balances federal and state power. Federal courts defer to significant state roles in terms of regulation, subsidies,

and market participation. The MAI aims to subtract from the lawmaking capacity of state, local, and tribal governments. It would alter the delicate balance of power that the Constitution creates between levels of government and between government and private investors. Defined as this balance of power, U.S. state sovereignty deserves greater attention from the Americans who have a role in the process of MAI negotiations and congressional action.

The MAI would act as a virtual amendment to the U.S. Constitution, but for the buffering role of the United States government, which could control enforcement of the agreement against state, local and tribal governments. This federal buffer, however, is significantly weakened because investor-to-state dispute resolution reduces federal control of the negotiating process that exists with state-to-state dispute resolution. The federal buffering role does not alter the fact that the MAI would give that power to the federal government, which alters the political balance of power within the federal system. The MAI's shift in power is from the states to the federal government, but the shift in political leverage is from government to private investors. The risk of monetary damages would also put fiscal pressure on the federal government to intervene on behalf of investors rather than state and local governments.

The power shift in federalism is already happening under the WTO agreements. Federal officials have mediated challenges under the Agreement on Government Procurement (selective purchasing related to human rights), the General Agreement on Trade in Services (boycotts of Swiss bank subsidiaries related to treatment of Holocaust family assets), and the Agreement on Technical Barriers to Trade (labeling requirements).

The MAI would enable multinational corporations to avoid the WTO diplomatic process by giving them their own forum to sue nation-states directly for damages based upon 14 investor-protection standards that go beyond the scope of existing agreements. Nonetheless, U.S. negotiators advertise the MAI as an insignificant sovereignty threat based on country-specific reservations. These reservations, however, (1) have not overcome the opposition of European countries, and (2) do not yet conform to MAI standards of technical specificity for purposes of later standstill and rollback. Perhaps more importantly, federal officials have been relying on the assumption that country-specific exceptions can protect future lawmaking from being effectively challenged if it limits market access or otherwise uses state economic or political power to place foreign investors at a competitive disadvantage. That assumption was rejected by the *Shrimp/Turtle* dispute panel for purposes of GATT Article XX. The stage is set for investors to challenge U.S. exceptions to the MAI using the same arguments.

Reliance on country-specific exceptions is not likely to afford full sovereignty protection for U.S. states. The appendix to this article addresses the risk in this reliance by providing a detailed outline of other options for maintaining the constitutional balance of federalism and investor protection. These options include:

- *Stronger congressional oversight.* If the goal of U.S. negotiators is less than full protection for U.S. producers, then a more candid disclosure of the legal impact of the MAI will achieve truth in advertising. Options for a more open process of disclosure and congressional oversight are summarized below in Part I.A of the appendix on options for balancing federalism and investor protection.
- *Implementing legislation.* If, on the other hand, the goal is to protect state sovereignty, the most politically expedient approach is the category of options for implementing legislation, which Congress can adopt unilaterally. These are summarized in Part I.B below.
- *General exceptions or carve-outs.* Multilateral options, while more difficult to develop and adopt, go to the root of the problem. Part II.A of the outline borrows from the model of GATT general exceptions to suggest the options that would prove most appropriate for the MAI. These same options could also be adopted as carve-outs rather than as exceptions, which would put sovereignty safeguards on a stronger foundation.
- *Limits on dispute resolution.* Another multilateral approach would be to set limits on dispute resolution, either through limits on investor standing or claims, or through broader limits on the investor-to-state dispute process.

With all of its checks and balances, the United States Constitution created the most successful free trade area in the world. The MAI would no doubt open up more foreign markets to U.S. investors, but it would also change the constitutional balance of power between states and the federal government and between government and foreign investors. This tradeoff is not necessary. In the previous decade, foreign investment coming into the United States increased an average of 24% each year, a ten-year increase of 202%.⁶¹⁸ Foreign investment going out of the United States into other countries increased an average of 34% each year, a ten-year increase of 785%. Should the United States change its constitutional balance of power in order to increase investment outflows from 785% to 1,000%?

There are many tools to restructure the MAI or its emerging progeny into a framework that respects the balance of power within federal systems: general exceptions or carve-outs, limits on dispute settlement, implementation of legislation, and a more open and analytic process for congressional oversight of negotiations. Best of all, the strategy of defining sovereignty by subtraction should be replaced with the wisdom of positive checks and balances on the exercise of power. In the words of Professor Conrad Weiler:

Above all, the Founders did not justify the dangers and risks of the first common market merely in terms of expected economic benefits and then let the chips fall where they may; they attempted to simultaneously devise a political solution to the problems as well as the opportunities of free trade,

618. OECD, INTERNATIONAL DIRECT INVESTMENT STATISTICAL YEARBOOK tbls. II, III (1996).

and they did this, as all else in the Constitution, in a federal fashion.⁶¹⁹

619. Conrad Weiler, *Global Trade Challenges to State Powers: Are There Federalistic Limits to the Commerce Power? A Look at US Constitutional Law and the EU's Subsidiarity Principle* 32 (Aug. 29-Sept. 1, 1996) (Paper for the 1996 annual meeting of the American Political Science Association) (on file with author).

Appendix:
Options for Balancing Federalism & Investor Protection

I. Unilateral Options

A. Process for Congressional Oversight and Approval

The MAI did not receive public attention until a full year after the original deadline for negotiations.⁶²⁰ By adopting the following options, Congress could strengthen the process of disclosure and create an open forum for testing the assumptions of U.S. negotiators. If Congress does not adopt the following options, Congress will again vote “yes or no” on a global agreement without time to analyze how the agreement affects U.S. sovereignty interests. These options are not a substitute for structural change of the MAI. However, they would strengthen public participation and accountability to inform the negotiating process.

1. *Legal Impact Statement*

Congress could require that before the President signs a trade or investment agreement (e.g., at least 180 days), the responsible federal officials must give Congress a legal impact statement. The statement could include the potential impact of the agreement on federal, state, local, or tribal capacity for lawmaking, law enforcement, or procurement, and on capacity of the United States to implement or enforce any international agreement on the environment, labor, or human rights. In addition, the President could include in this analysis the legal significance of proposing any agreement as a treaty, as opposed to an executive agreement.

2. *Disclosure of Legislative History*

Congress could require that before the President signs a trade or investment agreement (e.g., at least 180 days), the federal officials must give Congress a report that discloses material that is analogous to legislative history:

- *Complaints or requests from other countries* related to federal, state, local, or tribal capacity for lawmaking, law enforcement, or procurement; and on capacity of the United States to implement or enforce any international agreement on the environment, labor, or human rights.
- *Requests or suggestions from industry, members of advisory committees, and nonprofit organizations*, including the record of communications from these parties regarding the negotiations.

3. *Hearings*

Before Congress approves a proposed trade or investment agreement it should hold public hearings, take public comments, and publish the record. This is already congressional practice. However, without the previous steps, the hearings would prove superficial.

620. *Multilateral Agreement on Investment: Win, Lose or Draw for the U.S.?*, *supra* note 9 (statement of Ileana Ros-Lehtinen, chairperson of the Subcommittee on International Economic Policy and Trade).

4. *Congressional Approval*

The ultimate oversight power comes with congressional delegation of negotiating authority and later approval of a trade or investment agreement. Congress could adopt a positive and permanent statement of non-economic goals that compliment the usual goals for negotiation of a trade or investment agreement. For example, the goals could address (1) preserving constitutional principles of democracy, and (2) preserving U.S. international commitments to democracy, environmental protection, and human rights. The goals would apply to any agreement that Congress must approve, including fast-track agreements.

The options listed in this section would create a significant fiscal burden on the Office of United States Trade Representative because of the staff time necessary to support stronger legal analysis and congressional oversight. However, Congress has already anticipated that need by appropriating an additional \$1 million to the USTR budget in order to identify the effect of the MAI and other agreements on state and local laws.

B. *Implementing Legislation*

Without congressional implementing legislation, the MAI would give investors direct access to enforce their rights in domestic courts.⁶²¹ However, Congress can build on the sovereignty provisions it adopted for NAFTA and the WTO agreements to block this option, require congressional action before the MAI can preempt a state law, and provide other safeguards as follows.

- (1) *Standing.* Congress could copy the NAFTA and WTO implementing legislation to provide that only the federal government, not a private party or a foreign government, may use domestic courts or agencies to enforce the terms of the MAI.⁶²²
- (2) *Legal effect.* Congress provided (in the NAFTA and WTO implementing legislation) that a provision of the agreement has no legal effect if it is inconsistent with "United States" (federal) law, but this provision does not extend to state or tribal law.⁶²³ In implementing legislation for the MAI, Congress could extend the "no legal effect" treatment to all

621. See *MAI Negotiating Text*, *supra* note 7, art. V(Investor-State Procedures)(D)(2)(a).

622. See 19 U.S.C. § 3312(c) (1993); 19 U.S.C. § 3512(c) (1994).

623. See 19 U.S.C. § 3312(a) (1993); 19 U.S.C. § 3512(a) (1994). The following subsection distinguishes "state law" from "United States law." It provides that, "No state law, or the application thereof, may be declared invalid as to any person or circumstance on the ground that the provision or application is inconsistent with the Agreement, except in an action brought by the United States for the purpose of declaring such law or application invalid." 19 U.S.C. §§ 3312(b)(2), 3512(b)(2)(A) (1994). For purposes of this section, however, "state law" is defined to include (i) any law of a political subdivision of a State; and (ii) any State law regulating or taxing the business of insurance. 19 U.S.C. §§ 3312(b)(3), 3512(b)(3) (1994). The result of this subtle drafting is that state law enjoys no protection from the legal effect of NAFTA or the Uruguay Round Agreements, except for local and state laws that regulate or tax insurance business. However, a court may declare the latter two categories of "state law" invalid if the action is brought by the U.S. government. As for other categories of state law, this section provides no

laws of a state, local, or tribal government. This would provide parity to subnational law. Extending the “no legal effect” language to subnational law would inhibit legal action by the federal government to preempt state law directly under the MAI. Instead, Congress would have to preempt state law under the MAI by repealing it (assuming that the WTO implementing language is used for the MAI). Through this action Congress could avoid a sweeping preemption of state law that could result from making such broad MAI terms as “treatment . . . required by international law”⁶²⁴ applicable to state law.⁶²⁵ If Congress chooses not to change federal or state law, the MAI would still provide investors with a remedy for damages through an international arbitration process.⁶²⁶

(3) *Subnational Consultation and Self-defense.* In the WTO implementing legislation, Congress strengthened informal commitments under NAFTA. These informal commitments provided state and local officials notice of WTO challenges to their laws, an opportunity to participate in defending against those challenges, and notice of any U.S. complaint against subnational laws in another country.⁶²⁷ MAI implementing legislation could follow this model.

— *Meaningful notice.* State officials do not receive notice “on a continuing basis of matters under the [WTO agreements] that . . . will potentially have a direct impact on[,] the States.”⁶²⁸ These matters include a WTO challenge to a Massachusetts procurement law or relationship of WTO obligations to MAI negotiations. In addition, the risk of retaliatory challenges to state law may prove a greater

protection from legal challenges under NAFTA or the Uruguay Round Agreements. Tribal law receives no mention and no protection.

624. *MAI Negotiating Text*, *supra* note 7, art. IV(1).

625. In June 1997, the Supreme Court ruled that Congress had exceeded its power under the Fourteenth Amendment to enforce the constitutional right to free exercise of religion. *City of Boerne v. Flores*, 521 U.S. 507 (1997). The Court struck down the Religious Freedom Restoration Act (RFRA), which prohibited any law that “substantially burdens” the exercise of a person’s religion, even if the law had nothing to do with religion and was permissible under the First Amendment. The Court held that Congress exceeded its authority by attempting to impose RFRA’s quasi-constitutional standard on state and local governments, noting that,

[RFRA’s] sweeping coverage ensures its intrusion at every level of government, displacing laws and prohibiting official actions of almost every description and regardless of subject matter . . . [T]his is a considerable congressional intrusion into the States’ traditional prerogatives and general authority to regulate for the health and welfare of their citizens.

Id. at 2170. The *Boerne* decision is distinguishable because it interprets congressional power under First Amendment religious freedom. However, its approach to preemption of state law without clear standards of congressional accountability is analogous to the issues presented if the U.S. government sought to preempt state law under the MAI. See Karen Ryan Denvir et al., *Survey of 1997 Nonprofit Case Law (January-June)*, 32 U.S.F. L. REV. 365, 391 (1998).

626. See *MAI Negotiating Text*, *supra* note 7, art. V(Investor-State Procedures)(D)(2)(c).

627. Compare 19 U.S.C. § 3312(b) (1994) with 19 U.S.C. § 3512(b), (c), (d) (1994).

628. See 19 U.S.C. § 3512(b)(1)(B)(i) (1994).

risk than an unprompted challenge.⁶²⁹ A country that wants to counter-sue the United States is likely to challenge laws at all levels of government. Therefore, a meaningful process of consultation should provide states notice of all imminent complaints by the time the United States is consulting with other governments. Additionally, the process should ensure that states are aware of disputes that directly involve them, and regulations that could alter sovereignty protection.

- *Meaningful parties to notify.* The United States Trade Representative sends notice of WTO issues to governors' representatives. While this system is efficient for the USTR, it ignores separation of powers at the state level and effectively excludes state legislatures and attorneys general, both of whom have a more significant jurisdictional interest in WTO (or MAI) legal impact than do governors. Federal notice should go to the relevant branch of state government.
 - *Meaningful consultation.* The consultation process envisioned by the WTO implementing legislation presumes that "consultation" will actually occur. For example, federal consultation with the intergovernmental policy advisory committees (IAC) on trade⁶³⁰ is efficient because such an advisory committee integrates multiple branches of state government, and enables state officials to develop expertise. MAI implementing legislation should retain IPAC consultation requirements. Most of the notice and consultation requirements, which already exist for NAFTA and WTO agreements, are not seriously implemented. MAI implementing legislation could strengthen these provisions by limiting federal enforcement options against states if notice and consultation requirements are not followed.
- (4) *Notice of Adverse Decision and Hearings.* Congress could mandate that when a dispute panel rules against a U.S. federal or subnational law, the USTR must notify Congress. Subsequently, Congress must hold hearings on the issue before they or the Executive Branch takes any action to enforce the decision. On the eve of the congressional vote on the WTO agreements in 1994, Senator Robert Dole proposed a process for congressional oversight of adverse WTO panel decisions.⁶³¹ The Dole proposal required analysis of an adverse WTO decision by a

629. After the United States challenged a New Brunswick statute in the *Beer I* case, Canada challenged 210 state and local laws in the *Beer II* case, prevailing in 60 of these challenges. See *Alcoholic and Malt Beverages*, *supra* note 33, at 206.

630. See 19 U.S.C. § 3512(b)(1)(A) (1994).

631. See *A Bill to Establish a Commission to Review the Dispute Settlement Reports of the World Trade Organization and for Other Purposes*, S. 16, 104th Cong. (1995). Bill S. 16 was never reported from the Senate Finance Committee, primarily for reasons that had little to do with the merits of the review commission. Members of the Senate Finance Committee contested bill S. 16 because they opposed another Dole initiative to promote a WTO complaint to pressure Colombia and Costa Rica to withdraw from a banana framework agreement with the European Union. See Daniel Mazuera, *The Americas: A Trade Dispute Gone Bananas*, *WALL ST. J.*, Nov. 17, 1995, at A19; *Opponents of Dole Banana Bill Step Up Fight Against Measure*, *INSIDE U.S. TRADE*, Oct. 27, 1995, at 28.

panel of federal judges, prior to congressional hearings or consideration of a motion to withdraw from the WTO. With or without the aid of a review panel, Congress could create a formal process for review of decisions from MAI panels (or any other panels) that are adverse to U.S. sovereignty interests.

- (5) *Enforcement of Arbitration Awards.* The MAI would provide investors a choice of international arbitration fora, each with its own rules for enforcement of awards.⁶³² These include arbitration under the International Center for Settlement of Investment Disputes (ICSID),⁶³³ the ICSID Additional Facility,⁶³⁴ rules of the United Nations Commission on International Trade Law (UNCITRAL),⁶³⁵ and rules of the International Chamber of Commerce (ICC).⁶³⁶ If Congress can use implementing legislation to bar access to U.S. courts under NAFTA and the WTO agreements,⁶³⁷ then it can likewise limit the arbitration rules that it will recognize for enforcement of awards against the United States. For example, Congress might not recognize ICSID, which would require MAI nations to automatically enforce arbitration awards. Instead, Congress could support the less automatic process that is

632. See *MAI Negotiating Text*, *supra* note 7, art. V(Investor-State Procedures)(D)(2)(c). The MAI includes no provisions of its own for enforcement of arbitration awards. See *id.* art. V(Investor-State Procedures)(D)(18).

633. ICSID is an arbitration agency created by the World Bank in 1966. Convention on the Settlement of Investment Disputes Between States and Nationals of Other States, *opened for signature* Mar. 18, 1965, 17 U.S.T. 1270, T.I.A.S. No. 159 [hereinafter ICSID]. ICSID was submitted for ratification in March 1965 and entered into force on October 14, 1966, after ratification by 20 countries. See *id.* art. 68(2). It is the only arbitration convention that provides for both adjudication and enforcement of its judgments. ICSID signatories waive sovereign immunity and, in federal systems, ICSID judgments are enforceable in sub-federal courts at the discretion of the national government. See *id.* art. 54(1).

634. The ICSID Additional Facility rules are designed for disputes where only one party to the dispute has signed the ICSID Convention and the dispute does not result from an "ordinary commercial transaction." Rules Governing the Additional Facility for the Administration of Proceedings by the Secretariat of the ICSID, Sept. 27, 1978, art. 4(3), 21 I.L.M. 1446 [hereinafter ICSID Additional Facility Rules].

635. The U.N. General Assembly adopted UNCITRAL rules in 1976 to guide investor-to-investor dispute settlement before international arbitration bodies such as the International Chamber of Commerce. See *United Nations Commission on International Trade Law (UNCITRAL)*, U.N. GAOR, 31st Sess., Supp. No. 39, at 182 (1976). Parties to commercial contracts often specify that they will use UNCITRAL rules to resolve a dispute under their contract. Because UNCITRAL rules were designed for private investor disputes and not investor-to-state disputes, some OECD countries oppose using UNCITRAL rules for arbitration of claims under the MAI. See *MAI Negotiating Text*, *supra* note 7, art. V(Investor-State Procedures)(D).

636. The International Chamber of Commerce (ICC) founded an International Court of Arbitration in 1923. In 1995 alone, the ICC received 427 new requests for arbitration involving 1,012 parties from 93 countries. Contractual claims against nation-states or their agencies accounted for 14.1% of the parties. Several ICC cases involved claims exceeding \$1 billion; 62% of the claims exceeded \$1 million. See *1995 Statistical Report, in THE ICC INTERNATIONAL COURT OF ARBITRATION BULLETIN* 3-6 (1996).

637. See 19 U.S.C. § 3312(c) (1993); 19 U.S.C. § 3512(c) (1994).

available under the New York Convention,⁶³⁸ which provides rules for enforcing awards under the ICSID Additional Facility,⁶³⁹ UNCITRAL or the ICC.⁶⁴⁰ Whereas ICSID awards “are binding and shall not be subject to any appeal,”⁶⁴¹ the New York Convention provides a significant role for domestic courts,⁶⁴² which need not enforce an award if it is “contrary to the public policy” of the United States.⁶⁴³ In effect, the New York Convention provides a role for Congress to define the public policy interests that domestic courts should consider in whether or not to enforce an award by a MAI dispute panel. In fact, there is already a model for this option in the implementing legislation for NAFTA and the Uruguay Round agreements, which provides that the agreements do not “amend or modify any law of the United States, including any law relating to (i) the protection of human animal, or plant life or health, (ii) the protection of the environment, or (iii) worker safety . . . unless specifically provided for in this Act.”⁶⁴⁴

In the context of MAI implementation, Congress could create a similar list of essential public policy goals. Congress could expand the NAFTA/WTO implementation language to cover other policy interests such as GATT Article XX exceptions, state sovereignty, congressional authority to adopt unilateral measures that implement multilateral agreements on human rights, environmental protection, or core labor standards. A more inclusive outline of essential policy interests is discussed below under multilateral general exceptions.

II. Multilateral Options

A. General Exceptions or Carve-Outs

The fact that the MAI includes only two of the thirteen GATT general exceptions is not only a break from tradition, it also creates a presumption that MAI negotiators chose to exclude consideration of policy objectives that they did not include in the general exceptions.⁶⁴⁵ The *Shrimp/Turtle* panel followed this logic when it cited a GATT exception (products of prison labor) that has been interpreted to permit limits on market

638. See Convention on the Recognition and Enforcement of Foreign Arbitral Awards, June 10, 1958, 21 U.S.T. 2518, 330 U.N.T.S. 38-65 (codified at 9 U.S.C. §§ 201-08 (1988)) [hereinafter New York Convention].

639. See ICSID Additional Facility Rules, *supra* note 634, art. 20.

640. See MAI Negotiating Text, *supra* note 7, art. V(Investor-State Procedures)(D)(3), (5).

641. ICSID, *supra* note 633, art. 53(1).

642. The New York Convention was implemented by the United States Arbitration Act, 9 U.S.C. §§ 201-08 (1994).

643. 9 U.S.C. § 202 (1994).

644. 19 U.S.C. § 3312(a)(2) (1993); 19 U.S.C. § 3512(a)(2) (1994).

645. The maxim of construction is *expressio unius est alterio exclusius*. See WILLIAM N. ESKRIDGE, JR. & PHILIP P. FRICKEY, *CASES AND MATERIALS ON LEGISLATION: STATUTES AND THE CREATION OF PUBLIC POLICY* 637 (2d ed. 1995); George H. Taylor, *Structural Textualism*, 75 B.U. L. REV. 321, 343 (1995); Felix Frankfurter, *Some Reflections on the Construction of Statutes*, 47 COLUM. L. REV. 527 (1947).

access⁶⁴⁶ as authority for not permitting limits on market access under other general exceptions.⁶⁴⁷ This reasoning maximizes the jurisdiction of multilateral agreements and minimizes legislative jurisdiction under domestic constitutional law.

Even if the MAI included all of the options for general exceptions, they still would not offer the level of sovereignty protection that U.S. negotiators claim that their country-specific exceptions can provide. Any additional general exceptions to the MAI would include the kind of language that introduces the exception for maintaining public order.⁶⁴⁸ That language sets a series of tests, including "discrimination," "disguised restriction" and "necessary," all of which trade panels used under GATT to define a contested measure as outside the scope of the exception or to limit the jurisdiction of the nation seeking to defend the measure.⁶⁴⁹ The *Shrimp/Turtle* panel went even further and found that general exceptions cannot apply to measures that limit market access because use of the exception in that way would threaten the world trading system.⁶⁵⁰

The increasingly limited scope of general exceptions has led Canadian provincial officials to advocate sovereignty protections within categories like GATT Article XX, but in the form of "carve-outs" rather than general exceptions.⁶⁵¹ There are several examples of general carve-outs already in the MAI. From a state and local point of view, the most prominent one is taxation carve-outs.⁶⁵²

The logic of a general carve-out is that it would limit the scope of the agreement, whereas a general exception operates within the set of expected benefits of the agreement as a whole. Having stated the logic, however, it would have to be accepted by a dispute panel, which would have as much latitude to interpret a carve-out as a general exception. Nonetheless, the very concept of limiting the jurisdiction of an agreement like the MAI may hold up, considering that there is no other provision on the scope of the agreement except for the universal definition of "investment" as "every kind of asset."⁶⁵³

With both approaches in mind, general exceptions versus general carve-outs, the following options are offered as merely a classification of

646. See GATT, *supra* note 111, art. XX(e).

647. See *Shrimp Report*, *supra* note 104, ¶ 3.165, at 78 (Legal Arguments).

648. That provision reads:

Subject to the requirement that such measures are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between Contracting Parties, or a disguised investment restriction, nothing in this Agreement shall be construed to prevent any Contracting Party from taking any measure necessary for the maintenance of public order.

MAI *Negotiating Text*, *supra* note 7, art. VI(General Exceptions)(3).

649. See Steve Charnovitz, *The Environmental Exceptions in GATT Article XX*, J. WORLD TRADE 49 (1992); Steve Charnovitz, *The Moral Exception in Trade Policy*, 38 VA. J. INT'L L. 689 (1998).

650. See *Shrimp Report*, *supra* note 104, ¶ 7.51, at 287 (Findings).

651. See British Columbia, *Testimony Regarding the MAI*, *supra* note 556, at 11.

652. See MAI *Negotiating Text*, *supra* note 7, art. VIII(1)-(3).

653. See *id.* art. II(Definitions)(2).

legitimate purposes that merit consideration for protection of sovereign legislative authority. The few MAI general exceptions are noted with a subheading.

The following options are offered as a classification of legitimate purposes that merit consideration for protection of sovereign legislative authority.

1. *Security Interests*

Other than a narrow scope of public order, the only general exception of the MAI is for security interests. The exception, however, does not cover provisions on expropriation or protection from strife.⁶⁵⁴ This means, for example, that the MAI provides an investor with a claim for losses sustained in military action taken to enforce resolutions of the U.N. Security Council.⁶⁵⁵ The following are related to security interests:

- MAI: Reservation of power to protect “essential security interests.”⁶⁵⁶
- MAI: Nondisclosure of information related to security interests.⁶⁵⁷
- MAI: Reservation of power to implement obligations under the United Nations Charter to protect international peace and security.⁶⁵⁸

2. *National Economic Security*

While some of the following legislative purposes are based on humanitarian values, they all have direct economic consequences to the security of a nation’s human and economic resources.

- Relating to products of prison labor.⁶⁵⁹
- Protection of national treasures of artistic, historical or archaeological value.⁶⁶⁰
- Relating to importation or exportation of gold or silver.⁶⁶¹
- Restrictions on exports of domestic materials that are necessary for a domestic processing industry during periods when the domestic price is held below the world price under government price controls.⁶⁶²
- Restrictions on exports of domestic materials that are in short supply.⁶⁶³

654. See *id.* art. VII.

655. See discussion of expropriation *supra* Part II.

656. See *MAI Negotiating Text*, *supra* note 7, art. VI(General Exceptions)(2)(a) (defines essential security interests to include: (i) action taken in time of war; (ii) non-proliferation policies related to weapons of mass destruction; and (iii) production of arms and ammunition). See also NAFTA, *supra* note 116, art. 2102(b); GATT, *supra* note 111, art. XXI(b).

657. See *MAI Negotiating Text*, *supra* note 7, art. VI(General Exceptions)(2)(b); NAFTA, *supra* note 116, art. 2102.1(a); GATT, *supra* note 111, art. XXI(a).

658. See *MAI Negotiating Text*, *supra* note 7, art. VI(General Exceptions)(2)(c); NAFTA, *supra* note 116, art. 2102.1(c); GATT, *supra* note 111, art. XXI(c).

659. See GATT, *supra* note 111, art. XX(e); NAFTA, *supra* note 116, art. XXI.1.

660. See GATT, *supra* note 111, art. XX(f); NAFTA, *supra* note 116, art. XXI.1.

661. See GATT, *supra* note 111, art. XX(c); NAFTA, *supra* note 116, art. XXI.1.

662. See GATT, *supra* note 111, art. XX(i).

663. See *id.* art. XX(j).

- Measures necessary for collection of direct taxes or avoidance of double taxation.⁶⁶⁴

3. Domestic Regulatory Powers

Most of the GATT general exceptions are designed to preserve traditional regulatory powers. The Chairman's proposal for MAI limits on performance requirements recognizes three of these exceptions (health, conservation, and compliance) for two of its limits.⁶⁶⁵ The options for regulatory general exceptions or carve-outs include:

- MAI: Preservation of public order.⁶⁶⁶
- Protection of public morals.⁶⁶⁷
- Protection of human or animal life or health.⁶⁶⁸
- Conservation of exhaustible resources.⁶⁶⁹
- Environmental protection, generally.⁶⁷⁰
- Protection of consumers and workers.⁶⁷¹
- Enforcement of otherwise consistent laws.⁶⁷²

4. Domestic Constitutional Limits

Two principal doctrines could serve this purpose:

- Balancing test for regulatory measures under the Commerce Clause.⁶⁷³

664. See GATS, *supra* note 114, art. XIV(d), (e).

665. The proposed revision to performance requirements is:

4. Provided that such measures are not applied in an arbitrary or unjustifiable manner, or do not constitute a disguised restriction on investment, nothing in paragraphs 1(b) [achieve a given level of domestic content] and 1(c) [preference for domestic goods or suppliers] shall be construed to prevent any Contracting Party from adopting or maintaining measures, including environmental measures:

(a) necessary to secure compliance with measures that are not inconsistent with the provisions of this Agreement;

(b) necessary to protect human, animal or plant life or health; or

(c) necessary for the conservation of living or non-living exhaustible natural resources.

MAI *Negotiating Text*, *supra* note 7, Annex 2(Environmental Related Matters)(6). See also 144 CONG. REC. H7262-77 (daily ed., Aug. 6, 1998) (amend. by Rep. Kucinich).

666. See *id.* art. VI(General Exceptions)(3) n.2 ("where a genuine and serious threat is posed to one of the fundamental interests of society"); GATS, *supra* note 114, art. XIV(a) n.2; AGP, *supra* note 181, art. XXIII(2) n.5.

667. See GATT, *supra* note 111, art. XX(a); GATS, *supra* note 114, art. XIV(a); AGP, *supra* note 181, art. XXIII(2); NAFTA, *supra* note 116, art. XXI.1.

668. See GATT, *supra* note 111, art. XX(b); GATS, *supra* note 114, art. XIV(b); AGP, *supra* note 181, art. XXIII(2); NAFTA, *supra* note 116, art. XXI.1.

669. See GATT, *supra* note 111, art. XX(g); NAFTA, *supra* note 116, art. XXI.1.

670. See AGP, *supra* note 181, United States Annex II n.3; 19 U.S.C. § 3312(a)(2)(ii) (1994); 19 U.S.C. § 3512(a)(2)(ii) (1994).

671. See GATT, *supra* note 111, art. XX(d); GATS, *supra* note 114, art. XIV(c); 19 U.S.C. §§ 3312(a)(2)(iii), 3512(a)(2)(iii) (1994).

672. See GATT, *supra* note 111, art. XX(d); GATS, *supra* note 114, art. XIV(c).

673. See U.S. CONST. art. I, § 8 & amend. X. See *United States v. Lopez*, 514 U.S. 549 (1995); *Maine v. Taylor*, 477 U.S. 131 (1986); *Minnesota v. Clover Leaf Creamery Co.*, 449 U.S. 456 (1981); *Exxon v. Governor of Maryland*, 437 U.S. 117 (1978). See generally TRIBE, *supra* note 212, §§ 6-5, 6-13.

– Market participation exception to the Dormant Commerce Clause.⁶⁷⁴

B. Investor-to-State Dispute Resolution

The potential limits on investor-to-state dispute resolution include:

Limits on investor standing and claims. The MAI would empower even a minority shareholder who resides in an MAI country⁶⁷⁵ to bring a claim on behalf of an enterprise or other investment located anywhere in the world if the claim is based on National Treatment or Most-Favoured-Nation Treatment.⁶⁷⁶ An alternative is provided by NAFTA, which takes a more cautious approach. NAFTA requires that for an investor to make a claim on behalf of an enterprise, the investor must own or control the enterprise.⁶⁷⁷ Nor does NAFTA permit an investor of any kind to “make a claim if more than three years have elapsed from the date on which the investor first acquired, or should have first acquired, knowledge of the alleged breach and knowledge that the investor has incurred loss or damage.”⁶⁷⁸

Limits on investor-to-state dispute process. A much bolder limit on investor-to-state dispute settlement enjoyed a brief life in the taxation article of the MAI; however, it disappeared from later drafts. The May 1997 draft of the article,⁶⁷⁹ which applies the MAI expropriation provisions to taxation, provided that the national government challenged by the claim could refer the dispute to “Competent Tax Authorities of the Contracting Party of the Investor and the Contracting Party to the dispute,”⁶⁸⁰ which would have nine months to “determine that the measure does not involve an expropriation.”⁶⁸¹ If the tax authorities did not so decide, the investor-to-state case could go forward at the request of either government.⁶⁸² This direct form of sovereignty pro-

674. See U.S. CONST. art. I, § 8 & amend. X. See *White v. Massachusetts Council of Constr. Employers, Inc.*, 460 U.S. 204 (1983); *Reeves, Inc. v. Stake*, 447 U.S. 429 (1980); *Hughes v. Alexandria Scrap Corp.*, 426 U.S. 794 (1976); *Atkin v. Kansas*, 191 U.S. 207 (1903).

675. The MAI defines “investor” as (i) a “natural person having the nationality of, or who is permanently residing in, a Contracting Party” and (ii) “a legal person or any other entity organised under the applicable law of a Contracting Party, whether or not for profit, and whether private or government owned or controlled, and includes a corporation, trust, partnership, sole proprietorship, joint venture, association or organisation.” *MAI Negotiating Text*, *supra* note 7, art. II(Definitions)(1).

676. See *id.* art. III. MAI negotiators intended to protect investments beyond a Contracting Party’s territory so as to “not to unduly limit the scope of the agreement, for example by excluding the international activities of established foreign investors and their investments.” *MAI Commentary*, *supra* note 101, art. III(National Treatment and Most Favoured Nation Treatment)(2).

677. See NAFTA, *supra* note 116, art. 1117.1.

678. *Id.* art. 1116.2.

679. Directorate for Financial, Fiscal and Enterprise Affairs, OECD, MULTILATERAL AGREEMENT ON INVESTMENT: THE MAI NEGOTIATING TEXT art. VIII (May 13, 1997).

680. *Id.* art. VIII(4)(b)(i).

681. *Id.* art. VIII(4)(b)(ii).

682. See *id.* art. VIII(4)(b). The entire text of art. VIII.4, which provided for dispute settlement of taxation claims, was bracketed as language that had not reached a sufficient level of consensus at that time.

tection disappeared in subsequent drafts.⁶⁸³ The concept, however, remains available for MAI negotiators to consider not just for taxation, but for broader sovereignty protection.

683. See *MAI Negotiating Text*, *supra* note 7, art. VIII(4) (retaining only the first paragraph authorizing both state-to-state and investor-to-state dispute settlement).