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I. INTRODUCTION

In July 1999, the Canadian firm Methanex Corporation ("Methanex") notified the United States of its intention to seek approximately $1 billion in damages for the United States's alleged breach of Chapter 11 of the North American Free Trade Agreement ("NAFTA"). NAFTA, a trilateral agreement among the United States, Canada and Mexico (the "Parties"), gives private, foreign investors from each country the right to bring claims against another Party under certain circumstances. Methanex claimed a California measure banning the use of the gasoline additive MTBE discriminated against and expropriated its investments. The case of *Methanex v. United States* highlights two unintended structural shifts that have occurred under Chapter 11 jurisprudence.

The Parties originally intended Chapter 11 to serve as a protective mechanism to be used only in the event a Party arbitrarily and capriciously discriminates against the investments of another Party's investor. However, the textual ambiguity of the chapter's substantive provisions and inherent defects in its procedural framework have resulted in two unintended consequences. First, the economic interests of private investors have been elevated to the same plane as the public policy concerns that drive environmental legislation. Second, foreign investors have access to rights under NAFTA that are unavailable to their domestic counterparts. As a result, Chapter 11 is vulnerable to abuse by investors as a sword against legitimate regulations, including environmental measures.

Methanex v. United States provides insight into this phenomenon and portions of the Methanex Tribunal's decision rectify some of Chapter 11's defects. However, a single decision cannot alter the tide of Chapter 11 jurisprudence, and the NAFTA Free Trade Commission and the Parties

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must take action to establish bright line standards.

Part II of this Article provides context to the Chapter 11 case of *Methanex v. United States*, including the facts leading to Methanex's claim and the consequences of the claim's potential success. Part III describes Chapter 11's function as envisioned by the Parties and its subversion by the Chapter's shortcomings. Part IV assesses the Methanex Tribunal's decision and finds that its expropriation analysis realigns the Chapter with its intended purpose. In addition, the Tribunal's rulings on jurisdiction and equitable treatment alleviate some of the discrepancy between rights afforded to foreign and domestic investors. Part V discusses what actions should be taken to ensure the progress accomplished by the *Methanex* decision is not thwarted by future claims or decisions. Part VI of the Article identifies the outstanding procedural defects of Chapter 11 and provides suggestions for their repair.

II. BACKGROUND TO METHANEX V. UNITED STATES

A. The Ban on MTBE

Methanex v. United States is a Chapter 11 case that arose out of legislation passed by California during the last decade. The MTBE Public Health and Environment Protection Act of 1997 ("Act") set forth research topics involving methyl tertiary-butyl ether's ("MTBE") effects on public health and the environment.[1] MTBE is a gasoline additive manufactured from methanol and isobutylene.[2] Gasoline manufacturers began using MTBE in 1979 as a source of octane as lead was phased out of gasoline and, more recently, as an oxygenate to meet the requirements of the Clean Air Act Amendments of 1990 ("CAA").[3] Oxygenates promote more complete engine combustion by raising the oxygen content of gasoline, thereby reducing harmful tailpipe emissions from motor vehicles.[4]

The CAA created two separate programs designed to reduce automobile emissions. The oxygenated fuel program mandated the use of oxygenated fuels during winter months in forty urban areas throughout twenty-three different states that failed to meet federal carbon monoxide standards.[5] The second, the reformulated gasoline program, requires the

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[1] Methanex Corp. v. United States, Final Award of the Tribunal on Jurisdiction and Merits, 44 I.L.M. 1345, 1410–12 pt. III, ch. A, ¶¶ 1–2 (NAFTA Ch. 11 Arb. Trib. 2005), *available at* http://www.state.gov/documents/organization/51052.pdf [hereinafter Final Award].

[2] MTBE In Fuels, U.S. Envtl. Prot. Agency, http://www.epa.gov/mtbe/gas.htm (last visited Mar. 7, 2007).

[3] *Id.*

[4] *Id.*

[5] ARTURO KELLER ET AL., HEALTH AND ENVIRONMENTAL ASSESSMENT OF MTBE: REPORT

use of reformulated gas that meets stringent oxygen content requirements year-round in areas that are designated as severe ozone attainment areas.[6] Neither program mandates the type of oxygenate to be utilized in gasoline. However, MTBE quickly became the oxygenate of choice among refiners due to its availability, relatively low cost, and chemical composition.[7]

The use of reformulated gasoline has had a notable impact upon air quality throughout the United States. The Environmental Protection Agency ("EPA") announced in September 1999 that reformulated gasoline, including gasoline containing MTBE, contributed to "considerable air quality improvements and benefits for millions of [U.S.] citizens."[8] The agency characterized MTBE as a "cost-effective fuel blending component" that yielded reductions in carbon monoxide, nitrous oxide, volatile organic compounds, and benzene.[9]

Despite its clean air benefits, the California legislature believed MTBE posed environmental and public health risks due to its seepage into groundwater.[10] MTBE is the element in gasoline most likely to contaminate groundwater due to its high degree of solubility, its tendency to move at the same or faster velocity than the water it contaminates, and its failure to biodegrade to the same degree as other gasoline components.[11] Primary sources of MTBE groundwater contamination include leaking underground gasoline storage tanks ("USTs"), gasoline distribution systems, and surface spills due to automobile tanker truck accidents.[12] Upon seeping into groundwater, MTBE is carried into drinking water supplies by precipitation runoff and groundwater flow.[13] Even low levels of MTBE can make water supplies undrinkable due to its turpentine-like taste and odor.[14] Acute

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TO THE GOVERNOR AND LEGISLATURE OF THE STATE OF CALIFORNIA AS SPONSORED BY SB 521 15 (1998), *available at* http://tsrtp.ucdavis.edu/mtberpt/vol1.pdf [hereinafter UC REPORT].

[6] *Id.*

[7] *Id.*

[8] U.S. ENVTL. PROT. AGENCY [EPA], REP. NO. 420-R-99-021, ACHIEVING CLEAN AIR AND CLEAN WATER: THE REPORT OF THE BLUE RIBBON PANEL ON OXYGENATES IN GASOLINE 2 (1999), *available at* http://www.epa.gov/otaq/consumer/fuels/oxypanel/r99021.pdf [hereinafter EPA REPORT].

[9] *Id.* at 91.

[10] Lucien J. Dhooge, *The Revenge of the Trail Smelter: Environmental Regulation as Expropriation Pursuant to the North American Free Trade Agreement*, 38 AM. BUS. L.J. 475, 477 (2001).

[11] EPA REPORT, *supra* note 8, at 76.

[12] *See id.* at 16–17; *see also* Methanex Corp. v. United States, Amended Statement of Defense of Respondent United States of America, at 12–13 (NAFTA Ch. 11 Arb. Trib. 2003) *available at* http://www.state.gov/documents/organization/27063.pdf.

[13] Dhooge, *supra* note 10, at 499–500.

[14] Concerns About MTBE, U.S. Envtl. Prot. Agency, http://www.epa.gov/mtbe/water.htm#concerns (last visited Mar. 8, 2007).

effects include headaches, nausea, dizziness, and disorientation.[15] Although its long-term human health effects are unclear, laboratory animal experiments suggest it can cause maternal and fetal defects.[16]

Concern in California intensified after a University of California report noted that numerous municipalities, such as Santa Monica, Santa Clara County, and the Lake Tahoe region, had been forced to shut down public water drinking systems due to MTBE contamination.[17] The California legislature directed researchers to conduct studies in order to determine whether MTBE had contaminated drinking water supplies in other areas of the state.[18] The researchers were to report their findings and provide policy options, accompanied by a cost-benefit analysis, based on the scientific data collected during the studies.[19] The Act also authorized Governor Gray Davis to initiate a phase-out plan if the study revealed MTBE posed unjustified threats to the public or environment.[20]

The study that resulted, Health and Environmental Assessment of MTBE: Report to the Governor and Legislature of the State of California as sponsored by SB 521 ("UC Report"), revealed that MTBE had contaminated several of the state's drinking water sources from a variety of sources, including USTs.[21] The UC Report concluded that treatment and monitoring costs were potentially in excess of $1 billion due to MTBE's solubility, position as the oxygenate of choice in California, and the costly remediation methods of removing MTBE from water.[22] As a result, the UC Report recommended increasing the availability of ethanol (also an oxygenate) as an alternative to MTBE if, after further study, "ethanol was found to provide a net energy savings and have a minimal environmental impact."[23] Ethanol is a domestically-produced, biodegradable oxygenate that is manufactured from renewable sources, such as corn crops, and therefore does not pose the same water pollution risks as does MTBE.[24]

A series of public hearings on the content of the UC Report revealed

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[15] Dhooge, *supra* note 10, at 505.

[16] *Id.* at 506.

[17] *See* Methanex Corp. v. United States, Amended Statement of Defense of Respondent United States of America, at 15–18 (NAFTA Ch. 11 Arb. Trib. 2003) *available at* http://www.state.gov/documents/organization/27063.pdf; *see also* Dhooge, *supra* note 10, at 502–03.

[18] Final Award, *supra* note 1, pt. III, ch. A, ¶¶ 1–2.

[19] *Id.*

[20] *See* MTBE Public Health and Environmental Protection Act of 1997, 1997 Cal. Legis. Serv. Ch. 816 (West).

[21] UC REPORT, *supra* note 5, at 11–13.

[22] Final Award, *supra* note 1, at pt. III, ch. A, ¶¶ 8–13.

[23] *Id.* ¶ 16.

[24] Envtl. & Clean Air Benefits, Am. Coal. for Ethanol, http://www.ethanol.org/environment.html, (last visited Mar. 8, 2007).

there was substantial public support for banning MTBE as a gasoline additive.[25] Subsequently on March 25, 1999, Governor Davis effectuated a phase-out of the use of MTBE by Executive Order D-5-99, which stated the chemical's threat to water sources outweighed its clean air benefits.[26] In addition to the phasing out of MTBE, the Executive Order directed state agencies to implement a remediation program for MTBE contamination, a plan to protect drinking water supplies from further contamination, and an evaluation of the environmental impact and health risks associated with the use of ethanol as an alternative oxygenate.[27] The state legislature formally endorsed the Executive Order with the passage of Senate Bill 989, which authorized the relevant state agencies to carry out the directives contained in the Order.[28]

Within months, California gasoline refiners agreed to cease using MTBE and produce ethanol-blended gasoline in its place. In addition, thirteen states soon followed suit by imposing their own restrictions on the use of MTBE as a gasoline oxygenate, with New York, Connecticut, and Michigan being the only states to impose a complete ban on the chemical.[29]

B. Methanex Corporation

Methanex Corporation is a Canadian producer and marketer of methanol, the primary ingredient of MTBE. At the time Executive Order D-5-99 passed, Methanex accounted for seventeen percent of global capacity for methanol production, with one-third of its sales of methanol used in the fuel sector to produce MTBE.[30] Because California accounted for approximately forty percent of the U.S. reformulated gasoline market, and MTBE-blended gasoline was the dominant choice among California refiners, the ban had immediate and substantial effects on Methanex's sales.[31] Within ten days of Governor Davis' issuance of the Executive Order, Methanex experienced market capitalized losses of $150 million.[32]

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[25] Final Award, *supra* note 1, at pt. III, ch. A, ¶ 18.

[26] *Id.* at ¶¶ 21–22. The ban was to initially be completed by December 31, 2002 but was later extended by one year. EPA, STATE ACTIONS BANNING MTBE (STATEWIDE) 1 (2004) [hereinafter STATE ACTIONS], *available at* http://www.epa.gov/ mtbe/420b04009.pdf.

[27] Dhooge, *supra* note 10, at 509–10.

[28] *Id.* at 510–11.

[29] STATE ACTIONS, *supra* note 26.

[30] Final Award, *supra* note 1, at pt. II, ch. D, ¶ 3.

[31] Methanex Corp. v. United States, Notice of Submission of a Claim to Arbitration under the Arbitraton Rules of the U.N. Commission on International Trade Law and the North American Free Trade Agreement (NAFTA Ch. 11 Arb. Trib. 1999) *available at* http://www.state.gov/documents/organization/8773.pdf.

[32] Julia Ferguson, *California's MTBE Contaminated Water: An Illustration of the Need for an Environmental Interpretive Note on Article 1110 of NAFTA*, 11 COLO. J. INT'L. ENVTL.

The company conveyed its objections to the EPA and Governor Davis during the following months, claiming the Governor ignored MTBE's air quality benefits and failed to consider less drastic alternatives.[33] Failing to make any headway, on July 2, 1999 Methanex notified the United States of its intention to initiate international arbitration for the recovery of damages pursuant to Chapter 11 of NAFTA.[34] After submitting a series of complaints, Methanex's final version alleged that California's legislation breached NAFTA Articles 1102, 1105 and 1110 because it denied Methanex's investment fair and equitable treatment, discriminated against a foreign investment, and amounted to an expropriation.[35] The case wound its way through the NAFTA arbitration system for six years until the Methanex Tribunal issued its Final Award on August 3, 2005.

Methanex's claim is the first and only Chapter 11 claim filed against the United States challenging an environmental measure. But the arbitration has more than jurisprudential significance. Methanex sought damages of $970 million for loss suffered by Methanex, its American subsidiaries, and its investors.[36] If successful, these damages would be drawn from the U.S. treasury and would therefore hold all Americans accountable for California's actions. Further, Methanex alleged its compensable losses included the depreciation of Methanex stock on international securities markets due to the Executive Order's impact on the global price of methanol.[37] The claim thus, in effect, alleged that regulators must take into account a regulation's effect not only on investments within state borders, but also its nationwide and global impact. Potential liability seemed limitless, especially in light of the fact that other states had or were in the process of placing restrictions and prohibitions on the use of MTBE. Due to the lack of an appellate process under NAFTA, the Tribunal's decision could have essentially thwarted every state's attempt to limit the use of MTBE within its borders.

III. CHAPTER 11 OF NAFTA

NAFTA is a trade agreement among the United States, Mexico and

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L. & POL'Y 499, 500 (2000).

[33] Dhooge, *supra* note 10, at 512.

[34] *Id.* at 478.

[35] *See* Methanex Corp. v. United States, Claimant Methanex Corporation's Second Amended State of Claim, Methanex Corp. v. United States, ¶¶ 291–320 (NAFTA Ch. 11 Arb. Trib. 2003), *available at* http://www.state.gov/documents/organization/15035.pdf [hereinafter Methanex Claim].

[36] *Id.* at ¶¶ 321–27.

[37] Dhooge, *supra* note 10, at 518.

Canada that entered into effect on January 1, 1994.[38] It seeks to liberalize trade among the nations by eliminating trade barriers, promoting fair competition and creating an open investment climate.[39] Under NAFTA, each Party also pledged to promote sustainable development and further environmental regulatory policies.[40]

Chapter 11 of the treaty guarantees comprehensive protection of the investments of one Party's investors in the territory of another. It applies to measures adopted by a Party relating to investors of another Party and their investments within its territory.[41] The Chapter sets out three objectives:

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

Section A encompasses Articles 1101 through 1114, which set forth the substantive rights of investors and the duties of the Parties with respect to investments.[43] Each Party must treat investors from another Party no less favorably than it does its own investors and, at a minimum, must provide private investors from another Party with "fair and equitable treatment."[44] Chapter 11 also forbids the Parties from expropriating investments made by foreign investors within their territory, except under certain circumstances in which "expropriation" is permitted so long as the Party compensates the foreign investor for its loss.[45] The section permits a Party to enact measures "it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental concerns," provided that such measures are "otherwise consistent" with Chapter 11.[46]

Section B of Chapter 11 sets forth the procedure "for the settlement of

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[38] NAFTA Secretariat, Frequently Asked Questions and Answers, http://www.nafta-sec-alena.org/DefaultSite/index_e.aspx?DetailID=282#1 (last visited Apr. 27, 2007).

[39] North American Free Trade Agreement, U.S.-Mex.-Can., 32 ILM 289.605 Dec. 11, 1994, *available at* http://www.nafta-sec-alena.org/DefaultSite/index_e.aspx?DetailID=78 [hereinafter NAFTA].

[40] *Id.*

[41] *Id.* art. 1101.

[42] Daniel M. Price & P. Bryan Christy, III, *An Overview of the NAFTA Investment Chapter: Substantive Rules and Investor-State Dispute Settlement*, *in* The North American Free Trade Agreement: A New Frontier in International Trade and Investment in the Americas, 165, 173 (Judith H. Bello et. al. eds., 1994).

[43] *See* NAFTA, *supra* note 39, arts. 1101–14.

[44] *Id.* arts. 1102, 1105.

[45] *Id.* art. 1110.

[46] *Id.* art. 1114.

investment disputes that assures both equal treatment among investors of the Parties in accordance with the principle of international reciprocity and due process before an impartial tribunal."[47] It is the only portion of NAFTA which allows foreign investors to sue host governments directly.[48] Under Chapter 11, private investors are empowered to bring claims against a Party by Articles 1116 and 1117.[49] The investor may bring a claim alleging it incurred loss or damage as a result of a Party's breach of Chapter 11, and it may also bring a claim on behalf of an enterprise incorporated in the Party's territory that it "owns or controls directly or indirectly."[50] The dispute can be arbitrated in a single proceeding if the two claims arise out of the same alleged breach.[51]

An investor must wait six months from learning of a Party's breach before submitting its claim to the international tribunal, which consists of one arbitrator appointed by each of the disputing Parties and a third appointed by agreement of the disputing Parties.[52] The tribunal may award monetary damages, with interest, restitution of property and arbitration costs, or any combination of the three.[53] It may not, however, order a Party to pay punitive damages.[54] The decisions of the tribunal are not meant to be binding "except between the disputing [P]arties and in respect to the particular case."[55]

A. The Unrealized Potential of Chapter 11

The rights afforded foreign investors under Chapter 11, if exercised properly, promote the underlying purpose of NAFTA by protecting investments against arbitrary and capricious government action. During negotiations, one of the main driving forces behind the Chapter 11 process was the concern of arbitrary interference by Mexico with foreign investments.[56] The United States and Canada sought "to liberalize the investment regime in Mexico, where constraints on foreign investment were widespread and accompanied by a view of the national ability to

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[47] *Id.* art. 1115.

[48] *See* NAFTA Secretariat, Overview of the Dispute Settlement Provisions of the North American Free Trade Agreement (NAFTA), http://www.nafta-sec-alena.org/DefaultSite/index_e.aspx?DetailID=8 (last visited Apr. 27, 2007).

[49] *Id.* arts. 1116–17.

[50] NAFTA, *supra* note 39, arts. 1116(1), 1117(1).

[51] *Id.* art. 1117(3).

[52] *Id.* art. 1123.

[53] *Id.* art. 1135.

[54] *Id.*

[55] *Id.* art. 1136.

[56] *See* Howard Mann & Konrad von Moltke, *NAFTA's Chapter 11 and the Environment: Addressing the Impacts of the Investor-State Process on the Environment* 12 (Int'l Inst. for Sustainable Dev., Working Paper, 1999), *available at* http://www.iisd.org/pdf/nafta.pdf.

expropriate foreign investments that reflected a very bifurcated North-South view of the relationship between a state and a foreign investor."[57] Mexico, in turn, viewed Chapter 11 as a way by which foreign investors' trepidation would be alleviated by the protection and security the chapter provides their investments.[58] Its intended purpose, therefore, was to protect investors against arbitrary government takings or discriminatory action. In this capacity, the function served by Chapter 11 is analogous to the right of American citizens to bring claims and force a judicial review of an alleged arbitrary and capricious government action.

However, the substantive and procedural deficiencies of Chapter 11 enable private investors to use its provisions as a "sword" against legitimate environmental regulations. Textual ambiguity, susceptibility to broad interpretations, secretive proceedings, and the lack of binding precedent all tilt the scales of Chapter 11 protection in favor of private investors at the expense of a Party's ability to plan and anticipate potential challenges to environmental measures. In addition, these shortcomings, coupled with the availability of monetary damages, place foreign investors at an advantage over their domestic counterparts. Although there has not been a flood of Chapter 11 challenges to environmental regulations, a single decision can have a sweeping effect both monetarily and on a Party's policy decisions.

The arbitration proceeding at the focus of this paper, *Methanex v. United States*, illustrates this phenomenon. The facts leading to the arbitration, the claims filed by Methanex, and the damages sought by the company together demonstrate the tension between Chapter 11 and environmental regulation, and the potentially far-reaching effects Chapter 11 cases can have on environmental policy. Significantly, the Tribunal's final decision provides several valuable solutions that, although not fully addressing Chapter 11's deficiencies, give valuable insight into the reform that is needed.

IV. THE FINAL AWARD: METHANEX V. UNITED STATES

A. Expropriation and a Party's Right to Regulate the Environment

The analysis employed by the Tribunal to determine whether the California measure expropriated Methanex's investment in violation of Article 1110 realigns Chapter 11 with its intended function as a shield against arbitrary and capricious government action. Article 1110 illustrates the problem with Chapter 11 that poses one of the greatest threats to a Party's ability to enact environmental measures: critical terms left undefined that are susceptible to expansive and arbitrary interpretations.

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[57] *Id.*

[58] Dhooge, *supra* note 10, at 544–45.

Article 1110 forbids Parties from "directly or indirectly nationaliz[ing] or expropriat[ing] an investment of an investor of another Party in its territory or tak[ing] a measure tantamount to nationalization or expropriation of such an investment ("expropriation")."[59] Parties may, however, "expropriate" an investment if the expropriation is "(a) for a public purpose; (b) on a non-discriminatory basis; (c) in accordance with due process of law and Article 1105(1)" and if the Party compensates the investor in accordance with NAFTA's provisions.[60]

NAFTA does not clarify what measures or actions amount to an "expropriation" or "indirect expropriation," just as Article 1102 fails to clarify what is meant by "like circumstances" and Article 1105 does not identify what constitutes the "fair and equitable treatment" that Parties are obligated to afford foreign investors.[61] The chapter makes repeated reference to "international law" but does not direct tribunals to refer to any particular source or body of international law.[62] The apparent open-endedness of Article 1110 is augmented by the fact that its protections are not confined to a certain class of investments, since NAFTA contains a practically all-encompassing definition of "investment."[63]

At a minimum, the due process requirement under international law prohibits arbitrary and capricious actions by the expropriating state and requires available and meaningful judicial review.[64] Regulatory measures are therefore generally subject to challenges on two separate grounds. First, measures are challenged on the basis that the government lacks the requisite constitutional, statutory or administrative power.[65] Domestic challenges to state bans of MTBE were based on this concept. The now-defunct Oxygenate Fuels Association ("OFA"), a trade association representing MTBE and methanol producers, sought to enjoin the ban in California and New York on the grounds that neither state was authorized to enact the legislation because the ban was preempted by the CAA.[66] OFA argued the ban conflicted with the CAA's goals since it allegedly subrogated MTBE's clean air benefits to its potential threat to groundwater.[67] OFA failed in

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[59] NAFTA, *supra* note 39, art. 1110.

[60] *Id.* Article 1105(1) provides that "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." *Id.* art. 1105(1).

[61] *See id.* arts. 1102, 1105, 1110.

[62] *See, e.g., id.* art. 1105(1).

[63] *Id.* Article 1139's definition of "investment" encompasses virtually any enterprise and all forms of property including interests arising from the commitment of capital and other resources. *Id.* art. 1139.

[64] Dhooge, *supra* note 10, at 520–21.

[65] *Id.* at 523–25.

[66] *See* Oxygenated Fuels Ass'n, Inc. v. Davis, 331 F.3d 665 (9th Cir. 2003).

[67] *See Id.*

both cases. The Ninth Circuit found that the CAA did not preempt California's ban on MTBE because the ban did not conflict with its goals.[68] Congress left states wide latitude to enact environmental and public health legislation, and the court did not find any evidence that indicated Congress intended gasoline producers to have an unrestrained choice of oxygenates.[69] Similarly, the District Court of New York ruled that OFA failed to prove the MTBE ban interfered with the execution of the objectives of Congress in enacting the CAA.[70]

Assuming the government has the authority to enact the measure, the rules distinguishing between compensable and non-compensable expropriations becomes less clear. The answer may turn on whether the purpose of the measure is to discriminate, or in the alternative, some commentators present the issue as a question of the degree to which the purported regulatory measure interferes with the investment.[71] Thus, an environmental measure that significantly interferes with an investment may constitute an "indirect expropriation" regardless of whether its purpose is to discriminate against foreign investors.[72] The tribunal arbitrating the Chapter 11 case *Metalclad v. Mexico* applied such a standard to determine whether Metalcad was entitled to compensation for the loss it incurred due to a municipality's refusal to issue an operating permit for its hazardous waste landfill.[73] In fact, the tribunal declared that even "incidental interference" with a foreign investor's investment that deprived it "in whole or in significant part, of reasonably-to-be-expected economic benefit" could constitute a compensable expropriation under Article 1110.[74]

Extending investment protection even further, the *S.D. Meyers* tribunal placed the burden on the defending Party to show its measure was necessary, stating that "where a state can achieve its chosen level of environmental protection through a variety of equally effective and reasonable means, it is obliged to adopt the alternative that is most consistent with open trade."[75] These interpretations call into question a Party's power to enact environmental regulations, especially given the fact that even an investor's access to the U.S. market was recognized by at least

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[68] *See Id.*

[69] *See Id.*

[70] *See* Oxygenated Fuels Ass'n, Inc. v. Pataki, 293 F. Supp. 2d 170 (N.D.N.Y. 2003).

[71] Dhooge, *supra* note 10, at 525.

[72] *Id.*

[73] Joel C. Beauvais, Student Article, *Regulatory Expropriations Under NAFTA: Emerging Principles & Lingering Doubts,* 10 N.Y.U. ENVTL. L.J. 245, 269 (2002).

[74] *Id.*

[75] Methanex Corp. v. United States, Claimant Methanex Corporation's Reply to the Amicus Curiae Submissions of EarthJustice and the International Institute for Sustainable Development, ¶ 20 (NAFTA Ch. 11 Arb. Trib. 2004), *available at* http://www.state.gov/documents/organization/31979.pdf [hereinafter Methanex Reply].

one tribunal as being a "property interest subject to protection under Article 1110," and thus entitled to Chapter 11 protection.[76]

The problem with these interpretations is that they place private investment and public policy interests on the same plane, essentially suggesting that public funds should be used to pay for a government's right to regulate the environment. This suggestion is inconsistent with NAFTA's text and the "polluter-pays" principle that guides American environmental law.[77] NAFTA's Preamble embodies the Parties' intent to create "a predictable commercial framework . . . in a manner consistent with environmental protection," and to "[s]trengthen the development and enforcement of environmental laws and regulations."[78] Article 1114 provides that nothing shall be construed to prevent a Party from enforcing measures that are needed to ensure investment activity in its territory is undertaken in a manner sensitive to environmental concerns.[79] The North American Agreement on Environmental Cooperation (NAAEC), a side agreement to NAFTA, elaborates the Parties' desire to "establish their own levels of domestic environmental protection . . . [to ensure] high levels of environmental protection."[80] Nothing in these agreements suggests that investment protection takes precedence over environmental regulation; rather they indicate quite the opposite. Further, it is unlikely the United States would have agreed to such a notion given the prevalence of the polluter-pays principle in American law, under which the public is considered to own the environment and is entitled to compensation by any person who causes injury to it.[81]

Admittedly, *Metalclad* is the only case in which a private party prevailed under an Article 1110 claim. However, these interpretations are documented and relied upon by claimants, as evidenced by Methanex's reliance on *S.D. Meyers, Metalclad* and *Pope & Talbot* in its complaint.[82] Further, even if the private investor is ultimately unsuccessful, the defending Party must still devote extensive time and resources to mounting its defense.

The Tribunal's analysis pertaining to "expropriation" under Article 1110 reasserts a Party's right to enact environmental measures by removing bona fide regulations from the scope of Chapter 11. Methanex argued that

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[76] Final Award, *supra* note 1, pt. IV, ch. D, ¶ 17.

[77] *See* Dhooge, *supra* note 10, at 548–49.

[78] NAFTA, *supra* note 39, at pmbl.

[79] *Id.* art. 1114.

[80] North American Agreement on Environmental Cooperation art. 3, Sept. 8, 1993, 32 I.L.M. 1480.

[81] *See* Dhooge, *supra* note 10, at 548–49.

[82] *See, e.g.*, Methanex Claim, *supra* note 35, at ¶¶ 251, 294, 308; Final Award, *supra* note 1, pt. IV, ch. D, ¶¶ 4–5.

the California measure amounted to a compensable "expropriation" because it interfered with Methanex's reasonably to-be-expected economic benefit of its "customer base, goodwill, and market for methanol" in the state, and there were viable alternatives, such as fixing leaking USTs, that were more consistent with open trade.[83] Rejecting this argument, the Tribunal established a bright line rule which warrants a complete recitation:

> [A]s a matter of general international law, a non-discriminatory regulation for a public purpose, which is enacted in accordance with due process and, which affects, inter alios, a foreign investor or investment is not deemed expropriatory and compensable unless specific commitments had been given by the regulating government to the then putative foreign investor contemplating investment that the government would refrain from such regulation.[84]

In addition, although acknowledging intangible assets such as "such as goodwill and market share [for methanol in California] may . . . 'constitute . . . an element of the value of an enterprise and as such may have been covered by some of the compensation payments'" for expropriation cases, the Tribunal ruled they cannot form the basis for an expropriation claim.[85] Under the Tribunal's ruling, Article 1110 protection is limited to foreign investors that have suffered tangible loss due to a discriminatory regulation, as it was intended.

B. Jurisdiction and National Treatment: Leveling the Playing Field Between Foreign and Domestic Investors

The portions of the Tribunal's decision relating to jurisdiction and Article 1102's national treatment requirement ameliorate the incentive among investors to seek Chapter 11 protection solely on the basis that it provides advantages in comparison to the remedies available under domestic law. As an initial matter, foreign investors' ability to seek monetary damages for a Party's breach of Chapter 11 provides an incentive for multinational corporations to claim foreign nationality status.[86] For example, in *Glamis Gold Ltd. v. United States*, Glamis Gold is challenging a U.S. measure as a Canadian corporation on the grounds that federal and California restrictions on open-pit mining operations discriminated and expropriated the investments of its subsidiaries.[87] The twist, which

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[83] *Id.* at ¶ 322; *see also* Final Award, *supra* note 1, pt. IV, ch. D, ¶¶ 2–5.

[84] Final Award, *supra* note 1, pt. IV, ch. D, ¶ 7.

[85] *Id.* at ¶¶ 17–18.

[86] *See* Dhooge, *supra* note 10, at 547.

[87] *See* Glamis Gold Ltd. v. United States, Notice of Intent to Submit a Claim to Arbitration (NAFTA Ch. 11 Arb. Trib. 2003), *available at* http://www.naftaclaims.com/Disputes/ USA/Glamis/Glamis-Intent.pdf.

highlights the advantages given to foreign investors by Chapter 11, is that the mining rights can only be obtained by American corporations.[88] Thus, Glamis Gold is taking advantage of the arbitration rights given to foreign entities to enforce mining rights only granted to domestic entities.

Even absent these unusual circumstances, the availability of monetary damages for all Chapter 11 claims, not just those pertaining to expropriation, creates a significant advantage for companies that are able to claim NAFTA protection over those limited to challenging measures in domestic courts.[89] Methanex took advantage of the benefits bestowed by the United States upon domestic entities by operating in the United States via wholly-owned subsidiaries incorporated under Delaware law.[90] However, rather than using domestic law to challenge the California measure under which it would be limited to injunctive relief, Methanex instead chose to claim monetary damages on behalf of itself and its American subsidiaries under Chapter 11.[91] Further, if Methanex prevailed, neither the United States nor California would be obligated to compensate domestic methanol manufacturers even if they were equally affected by the same measure.

The Tribunal's adoption of a narrow jurisdictional test is correct because it limits the right to bring Chapter 11 claims to those foreign investors that are targeted by regulations on the basis of their nationality in violation of NAFTA. Article 1101(1) provides that Chapter 11 applies to measures adopted by a Party "relating to" another Party's investors and their investments.[92] The Tribunal rejected Methanex's contention that "relating to" simply meant "to affect," and required Methanex to show there was a legally significant connection between the California measure and Methanex's investments.[93] The "relating to" requirement would be satisfied "if the purpose of the measure [was] an intent to harm foreign-owned investors or investments on the basis of nationality."[94] The Tribunal ultimately determined Methanex failed to show that Governor Davis or the California legislature intended to discriminate against Canadian or Mexican investors with the MTBE ban and therefore ruled it did not have

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[88] Judith Wallace, *Corporate Nationality, Investment Protection Agreements, and Challenges to Domestic Natural Resources Law: The Implications of Glamis Gold's NAFTA Chapter 11 Claim*, 17 GEO. INT'L ENVTL. L. REV. 365, 368–69 (2005).

[89] *See Id.* at 383.

[90] *See* Final Award, *supra* note 1, pt. II, ch. A, ¶¶ 5–6.

[91] Methanex Claim, *supra* note 35, at ¶¶ 321–27.

[92] NAFTA, *supra* note 39, art. 1101(1).

[93] Methanex Corp. v. United States, Preliminary Award on Jurisdiction and Admissability, ¶ 147 (NAFTA Ch. 11 Arb. Trib. 2002), *available at* http://naftaclaims.com/Disputes/USA/Methanex/MethanexPreliminaryAwardJurisdiction.pdf.

[94] *Id.* art. 152.

jurisdiction.[95]

The Tribunal's analysis of Methanex's claim that the measure violated Article 1102 has a similar effect. Article 1102 provides that Parties must accord investors and investments of another Party "treatment no less favorable that that it accords, in like circumstances," to its own investors and investments.[96] "Treatment no less favorable" amounts to "the most favorable treatment accorded" to domestic investors and investments.[97] The Tribunal rejected Methanex's "like circumstances" test, which was based on a trade-law notion that products, and therefore their producers, that are capable of serving similar end uses are in "like circumstances."[98] Methanex relied on this test to argue it was denied equal treatment under Article 1102 because it was in "like circumstances" with domestic ethanol producers that were not affected by the MTBE ban.[99] Rather, the Tribunal ruled, foreign investors are in "like circumstances" with their domestic counterparts, or in this case domestic methanol producers who were equally affected by the MTBE ban.[100] Further, the Tribunal's assertion that trade law standards should not be blindly incorporated into investment law acknowledges that Chapter 11 proceedings require a more in-depth analysis into public policy concerns that have been noticeably absent from prior Chapter 11 cases.[101]

The narrow "relating to" and "like circumstances" tests correctly limit standing to private investors targeted by environmental regulations and limit relief to those targeted on the basis of nationality. In addition, the Tribunal's order for Methanex to pay the United States's arbitration and legal costs of approximately four million dollars serves as an additional disincentive to investors from filing baseless claims.[102]

V. PROTECTING THE PROGRESS OF METHANEX

The NAFTA Free Trade Commission ("FTC") should adopt the test and standards employed by the Methanex Tribunal to ensure the progress is not undermined by subsequent proceedings. Under NAFTA, a tribunal's decision binds only the Parties, not future tribunals.[103] This has resulted in

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[95] Final Award, *supra* note 1, pt. IV, ch. E, ¶ 22.

[96] NAFTA, *supra* note 39, art. 1102.

[97] *Id.*

[98] Methanex Claim, *supra* note 35, at ¶¶ 304–05.

[99] *Id.* ¶ 304.

[100] *Id.* ¶¶ 18–22.

[101] *See e.g.*, Metalclad Corp. v. Mexico, ISCID Case No. ARB(AF)/97/1, Award (Aug. 30, 2000), 40 ILM 36 (2001), in which the Tribunal ruled that environmental concerns did not justify a Mexican municipality's refusal to provide Metalclad with a building permit needed for its operation of a hazardous waste landfill; *see also* Beavais, *supra* note 73, at 268.

[102] *See* Final Award, *supra* note 1, pt. V, ¶ 13.

[103] *See* NAFTA, *supra* note 39, art. 1136.

a widely disparate group of rulings from which private investors can choose based on which rulings are most amenable to their claim, thus making it difficult for Parties and their sub-national components to anticipate challenges to proposed environmental regulations.

FTC rulings, on the other hand, are binding on all tribunals and can therefore eliminate much of the uncertainty surrounding Chapter 11 arbitration.[104] The Tribunal's minimum standard of treatment analysis under Article 1105 illustrates the effectiveness of FTC rulings at resolving debates and clarifying ambiguous portions of Chapter 11. Article 1105 requires Parties to provide investors of another Party "treatment in accordance with international law, including fair and equitable treatment."[105] As aforementioned, Chapter 11 does not refer to any specific source of international law. The traditional minimum international standard of "fair and equitable treatment" originated in the U.S.-Mexico Claims Tribunal's decision in *Neer* in 1926, under which a state breached the standard only if its conduct was "shocking, egregious, and outrageous."[106]

Recent Chapter 11 tribunal decisions indicated the standard evolved to include "fairness elements" in addition to the minimum international law standard, such as the prohibition against differentiating between foreign and nationals.[107] The most expansive interpretation occurred in *Pope & Talbot* when the tribunal ruled the manner in which a Canadian government entity conducted an audit violated Article 1105.[108] The tribunal ruled there was no "threshold limitation that the conduct complained of [had to] be 'egregious,' 'outrageous,' or 'shocking,' or otherwise extraordinary."[109] Rather, the "naked assertion of authority" satisfied the claimant's burden.[110]

Methanex grasped onto these interpretations and argued that the Tribunal should evaluate "fair and equitable treatment" according to a heightened standard that encompasses more than a mere prohibition on arbitrary and discriminatory measures.[111] The California measure breached

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[104] *Id.* art. 1131; HOWARD MANN, PRIVATE RIGHTS, PUBLIC PROBLEMS: A GUIDE TO NAFTA'S CONTROVERSIAL CHAPTER ON INVESTOR RIGHTS 12, 20 (Int'l Inst. for Sustainable Dev., 2001), *available at* http://www.iisd.org/pdf/trade_citizensguide.pdf.

[105] NAFTA, *supra* note 39, art. 1105.

[106] Courtney C. Kirkman, *Fair and Equitable Treatment: Methanex v. United States and the Narrowing Scope of NAFTA Article 1105*, 34 LAW & POL'Y INT'L BUS. 343, 390 (2002).

[107] *Id.* at 389.

[108] *Id.* at 354–55.

[109] Pope & Talbot, Inc. v. Canada, Award on the Merits of Phase 2, ¶ 118 (NAFTA Ch. 11 Arb. Trib. 2001), *available at* http://www.dfait-maeci.gc.ca/tna-nac/documents/Award_Merits-e.pdf (footnote omitted).

[110] *Id.* ¶ 174.

[111] *See* Methanex Corp. v. United States, Claimant Methanex Corporation's Counter-Memorial on Jurisdiction, at 8-11 (NAFTA Ch. 11 Arb. Trib. 2001), *available at* http://www.state.gov/documents/organization/3939.doc.

the "fairness elements" of Article 1105, Methanex claimed, because there were less disruptive alternatives available, such as repairing leaking tanks, and because the measure discriminated against Methanex in favor of domestic ethanol producers.[112]

The FTC resolved the debate regarding whether a heightened or traditional standard applied upon issuing guidelines in July 2001. The guidelines explicitly limit the scope of the standard to customary international law, which does not prohibit discrimination between foreign and national investors per se.[113] Bound by the FTC decision, the Tribunal was able to dispose of Methanex's contention without engaging in a cumbersome analysis and effectively upheld *Neer* as the prevailing standard.[114] Although the FTC should have explicitly stated whether *Neer* was in fact the "customary" international standard, the value of FTC rulings is evidenced by the Tribunal's Article 1105 analysis. By adopting the Tribunal's bright line expropriation rule, "relating to" jurisdictional test, and "like circumstances" test, the FTC could ameliorate many of the problems caused by the vagueness of Chapter 11's critical terms.

VI. POST-METHANEX RECOMMENDATIONS

The procedural advantages offered to private investors by Chapter 11, although addressed in part by the Methanex Tribunal, remain in need of the greatest reform. The arbitration system, adept at managing disputes between private commercial interests, is not currently equipped to handle the major public policy issues that arise during Chapter 11 cases. Arbitration proceedings have historically taken place in secrecy and without any participation from non-disputing Parties.[115] Yet final decisions are binding on the Parties and are insulated from judicial review.[116] The combination of secretive proceedings and binding awards is especially an issue when investors challenge state regulations because states are bound by NAFTA's provisions but are not permitted to participate in the arbitration proceedings.[117] In the United States, this means that the federal government assumes the defense for regulations it may not agree with or, due to its distance from the local population, fully understand. The fact that states often provide the experimental ground for progressive environmental policy increases the discomfort with the federal government's assumption of

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[112] *See* Methanex Reply, *supra* note 75, at ¶¶ 9–10.

[113] *See* Final Award, *supra* note 1, pt. IV, ch. C, ¶¶ 9–10, 14.

[114] *Id.* ¶¶ 11–12.

[115] *See, e.g.*, NAFTA, *supra* note 39, art. 201(2); MANN, *supra* note 104, at 11.

[116] *See, e.g.*, NAFTA, *supra* note 39, art. 201(2); MANN, *supra* note 104, at 11.

[117] NAFTA, *supra* note 39, art. 201(2). Parties, on the other hand, are permitted to make submissions to the Tribunal regarding the interpretation of NAFTA's provisions. *Id.* art. 1128.

defending policy decisions made by fifty different governments.

Methanex made a significant step toward transparency by opening participation to non-disputing entities. The Tribunal's decisions to accept written amici briefs and broadcast the final hearings on the merits via closed circuit television marked the first time a tribunal permitted outside participation in the history of investment arbitration under NAFTA.[118] Although the Tribunal made only one citation to the amici briefs in its Final Award, its decision provided the impetus for the FTC's promulgation of a standardized procedure by which non-disputing entities can participate in future Chapter 11 arbitrations.[119] Several tribunals have since relied on the FTC guidelines to assert their authority to accept amici briefs, including the tribunal currently arbitrating *Glamis Gold*.[120] In *Glamis Gold*, a submission by the Quechan Indian Nation argued in support of the environmental value of the California measure.[121] As a sovereign nation whose reservation is directly impacted by the mining rights at issue, the Tribe is entitled to present its views to the Tribunal given the fact that California may repeal its ban on mining rights should the final award be issued in favor of Glamis.[122]

Opening participation to Parties' sub-national components and other interested non-disputing entities is an important step toward transparency, albeit insufficient to resolve all of Chapter 11's procedural inadequacies. One of the most damaging loopholes is the Chapter's lack of gate-keeping devices. Initial pleadings under Chapter 11, in the form of a notice of intent to submit a claim to arbitration, are usually a simple chronological statement of facts that are not subject to summary judgment motions.[123] Defending governments must therefore devote resources to creating a defense to even the most baseless of claims.

The Tribunal's "relating to" and "like circumstances" tests, if adopted

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[118] *See* Final Award, *supra* note 1, pt. II, ch. C, ¶ 26; HOWARD MANN, THE FINAL DECISION IN METHANEX V. UNITED STATES: SOME NEW WINE IN SOME NEW BOTTLES, 12 (International Institute for Sustainable Development, 2005), *available at* http://www.iisd.org/pdf/2005/ commentary_methanex.pdf [hereinafter New Wine]. The International Institute for Sustainable Development and Earthjustice on behalf of itself, Bluewater Network Communities for a Better Environment, and Center for International Environmental Law, submitted amici briefs to the Tribunal.

[119] *See* NAFTA Free Trade Commission, Statement on Non-disputing Party Participation (Oct. 7, 2003), *available at* http://www.ustr.gov/assets/Trade_Agreements/Regional/NAFTA/asset_upload_file45_3600.pdf.

[120] Glamis Gold, Ltd. v. United States, Decision on Application and Submission by Quechan Indian Nation (NAFTA Ch. 11 Arb. Trib. 2005), *available at* http://www.state.gov/documents/organization/53592.pdf.

[121] Glamis Gold, Ltd. v. United States, Quechan Indian Nation Application for Leave to File a Non-Party Submission (NAFTA Ch. 11 Arb. Trib. 2005), *available at* http://www.state.gov/documents/organization/52531.pdf.

[122] *Id.*

[123] Wallace, *supra* note 88, at 383.

by the FTC, will limit investors' ability to mount successful claims. However, even under these tests the United States still had to invest substantial resources to mount a six-year long defense, and the Tribunal engaged in a 300-page analysis of Methanex's claim before concluding it lacked jurisdiction. The extensive time and resources needed to ward off claims enables private investors to use the threat of a Chapter 11 claim to influence a Party's public policy decision. In at least one instance, the mere *threat* of a claim induced a Party to settle rather than mount a defense.[124] Methanex asserted that even if California repealed the measure it would still seek damages for losses incurred up until that point.[125] For these reasons, NAFTA should be amended to include procedural hurdles, such as summary judgment and the requirement that claimants must waive any right to seek relief in domestic court if they bring a NAFTA claim on behalf of their domestic subsidiaries. These changes will not only discourage frivolous claims but also prevent Parties from having to evaluate whether the policy reasons driving the regulation in dispute are worth the defense costs of extensive arbitration proceedings.

VII. CONCLUSION

Chapter 11 serves an important role in realizing NAFTA's goals of creating a fluid investment market between Canada, the United States, and Mexico. It provides foreign, private investors with a protective shield against arbitrary and capricious government action and an avenue of redress should a Party breach its obligations under NAFTA. However, the protection afforded to private investors should not come at the expense of the right of a Party and its sub-national components to enact progressive environmental measures. Nor should foreign investors be given greater rights than domestic investors, especially when the reincorporation process in different jurisdictions is undertaken with relative ease. To realign Chapter 11 with its intended purpose, the NAFTA FTC should adopt the Methanex Tribunal's standards for expropriation, including what constitutes a protected investment, its jurisdictional "relating to" test and its "like circumstances" test. In addition, tribunals should continue accepting amici submissions and expanding upon the participatory role of non-disputing Parties with a vested interest in the challenged regulation. Lastly, the Parties should amend NAFTA to include an equivalent to summary judgment and a requirement that all claimants and their subsidiaries must

[124] *Id.* In 1997, U.S.-based Ethyl Corporation brought a $200 million claim against the Canadian government arguing its ban on the gasoline additive MMT, which Ethyl manufactured, was discriminatory and an expropriation under several Chapter 11 articles. Canada quickly settled before the dispute reached a NAFTA Tribunal on the merits, agreeing to rescind the ban and pay Ethyl $13 million. Beauvais, *supra* note 73.

[125] Ferguson, *supra* note 32, at 510–11.

waive their right to challenge a measure in a domestic court upon filing a Chapter 11 claim.