

CRS Report for Congress

Received through the CRS Web

Foreign Investor Protection Under NAFTA Chapter 11

Updated September 29, 2003

name redacted
Legislative Attorney
American Law Division

Foreign Investor Protection Under NAFTA Chapter 11

Summary

Chapter 11 of the North American Free Trade Agreement (NAFTA) affords various protections to investors of one signatory nation having investments in the territory of another. Such foreign-investor protections exist in the large majority of modern bilateral investment treaties, but NAFTA is different. NAFTA is apparently the only instance where such protections, including a mechanism for resolving investor-state disputes by binding arbitration, have been made available for use against the United States by countries (Mexico and Canada) that invest heavily in the U.S. NAFTA, that is, has created not only the *legal possibility* of investor claims against the United States, but the *actual occurrence* of them as well.

The “actual occurrence” of several multi-million-dollar arbitration claims against the U.S. under Chapter 11 has sparked a lively debate as to the precise content of the substantive obligations it imposes on the NAFTA parties – and as to whether the claims of foreign investors might chill enforcement of legitimate government regulation in the public interest. While the U.S. has won each of the three finally decided arbitrations to date, one could argue that the hour is still early. In response to such concerns, the Bipartisan Trade Promotion Authority Act of 2002 instructs U.S. negotiators of future trade agreements to ensure that foreign investors in this country receive “no greater substantive rights” than U.S. investors under U.S. law. The Act does not apply to NAFTA.

Part I of the report summarizes the arbitration procedure used when an investor from one NAFTA party believes that another NAFTA party (or one of its political subdivisions) has breached an obligation under Chapter 11, and the investor suffered loss as a result.

Part II examines one of the two most-debated Chapter 11 obligations imposed on the parties: the “fair and equitable treatment” of foreign investors. An important clarification of this phrase came in 2001, when the Free Trade Commission established under NAFTA declared that fair and equitable treatment creates no free-standing standard, but refers only to existing customary international law establishing minimum standards of treatment for aliens. However, customary international law offers few clear principles.

Part III treats the other widely debated Chapter 11 provision, on indirect expropriation. A claim of indirect expropriation is made when an investor believes that his/her investment in another NAFTA country has been so severely regulated as to have been effectively expropriated. Such claims have long been recognized in international law; the importance of NAFTA is that it has given rise to a significant number of them, including, for the first time, several against the United States. As with fair and equitable treatment, the meaning of indirect expropriation is uncertain, owing to scarce precedent, though it is clear the impact must be substantial.

Finally, Part IV describes the roughly 20 claims filed so far under NAFTA Chapter 11, including the six against the U.S.

Contents

Introduction	1
Bipartisan Trade Promotion Authority Act	4
I. NAFTA Chapter 11 Arbitration Procedure	5
Before the Claim is Filed	5
After the Claim is Filed	6
The Final Award and Afterwards	7
II. Fair and Equitable Treatment	9
III. Indirect Expropriation	11
IV. Claims Filed Under NAFTA Chapter 11	14
Claims against the United States	15
Claims against Canada	17
Claims against Mexico	19

Foreign Investor Protection Under NAFTA Chapter 11

Introduction

Beginning in 1962, over 1,800 bilateral investment treaties have been negotiated throughout the world, the large majority after 1990.¹ The United States itself is a party to 46, and several more are now, or soon will be, under negotiation.² The purpose of these agreements is to protect foreign investment in the host country, and – important here – to provide a binding arbitration mechanism for resolving disputes between investor and host country. Almost always, U.S. bilateral investment treaties have been with developing countries or emerging economies, which invested minimally in the U.S. Thus, there was little occasion for foreign-investor claims against the U.S.

Closely tracking the foreign-investor protections in the modern bilateral investment treaties is the investment chapter – Chapter 11 – of the trilateral North American Free Trade Agreement (NAFTA).³ This report focuses on NAFTA Chapter 11 because since NAFTA took effect on January 1, 1994, it has been apparently the only instance where an investor-state arbitration mechanism has been made available for use against the United States by countries (Mexico, and especially Canada) that invest heavily in the United States. NAFTA, that is, has created not only the *legal possibility* of foreign-investor claims against the United States, as the bilateral investment treaties do, but the *actual occurrence* of them as well.

The “actual occurrence” of NAFTA Chapter 11 claims against the U.S. has sparked a vigorous and multifaceted debate in this country. Is there any precise content to the substantive obligations imposed on the signatory nations by Chapter 11? Are there infringement of sovereignty or delegation issues, as when NAFTA arbitration panels review decisions of U.S. courts?⁴ Should panel proceedings be

¹ The number exceeds 2,000 if regional investment treaties are included.

² Four of the 46 treaties have not yet entered into force. For a description of the U.S. bilateral investment treaty program and a listing of the treaties, go to [<http://www.state.gov/e/eb/rls/fs/22422.htm>]. See also Kenneth J. Vandeveld, *The Bilateral Investment Treaty Program of the United States*, 21 Cornell Int'l L. J. 201 (1988).

³ H. Doc. No. 103-159, vol. 1, pp. 712 et seq.; 32 I.L.M. 289 (1993) (chs. 1-9), 32 I.L.M. 605 (1993) (chs. 10-22). The North American Free Trade Agreement Implementation Act, enacted Dec. 8, 1993, is at 19 U.S.C. § 3301 et seq.

⁴ See, e.g., Curtis A. Bradley, *International Delegations, the Structural Constitution, and Non-Self-Execution*, 55 Stan. L. Rev. 1557 (2003); Patrick Tangney, *The New* (continued...)

required to be open to the public, given their importance for larger public policy issues in the respondent nation? Should panel decisions be reviewable by domestic courts? Most significantly, might Chapter 11 claims by foreign investors, and the prospect of large damages awards, chill the enforcement of legitimate government regulations enacted in the public interest, such as those protecting the environment?⁵ Underlying this last question is the concern of some that Chapter 11 may confer greater rights on foreign investors in this country than are available to U.S. investors under domestic law. This concern in connection with the expropriation provisions in the proposed Multilateral Agreement on Investment⁶ reportedly helped scuttle the agreement, the negotiating text of which “originally incorporated a compensation requirement identical to that of NAFTA.”⁷

While the United States has won each of the three finally decided NAFTA Chapter 11 claims against it, some observers argue that the hour is still early and that one or two of those wins were in easy cases. Other voices contend to the contrary that such concerns are overblown, and that granting foreign investors greater protection than is available to locals (if, in fact, that is the case under NAFTA), and a dispute-resolution mechanism to back it up, are justifiable as a quid pro quo for obtaining an acceptable degree of protection abroad for U.S. investors. Nor, they argue, should the United States give up on the time-tested mechanism of international arbitration, simply because it is now on the receiving end of investor claims.⁸

The Chapter 11 claims filed so far have alleged violations of the following substantive obligations imposed on the United States, Canada, and Mexico by that chapter –

- **Article 1102: National Treatment.** Each NAFTA party must “accord to investors of another party treatment no less favorable than that it accords, in like circumstances, to its own investors”
- **Article 1103: Most-Favored-Nation Treatment.** Each party must afford investors of another party, and their investments, “treatment no less

⁴ (...continued)

Internationalism: The Cession of Sovereign Competences to Supranational Organizations, 21 Yale J. Int’l L. 395 (1996).

⁵ Several of the Chapter 11 cases submitted to arbitration so far involve environmental regulation. See section IV of this report. See generally David A. Gantz, *Reconciling Environmental Protection and Investor Rights Under Chapter 11 of NAFTA*, 31 Env’tl. L. Rptr. 10646 (2001); J. Martin Wagner, *International Investment, Expropriation, and Environmental Protection*, 29 Golden Gate U. L. Rev. 465 (1999).

⁶ Negotiated under the auspices of the Organization for Economic Cooperation and Development.

⁷ Vicki Been and Joel C. Beauvais, *The Global Fifth Amendment?: NAFTA’s Investment Protections and the Misguided Quest for an International “Regulatory Takings” Doctrine*, 78 N.Y.U. L. Rev. 30 (2003).

⁸ See, e.g., Guillermo Aguilar Alvarez and William W. Park, *The New Face of Investment Arbitration: NAFTA Chapter 11*, 28 Yale J. Int’l L. 365 (2003).

favorable than that it accords, in like circumstances” to investors and investments of investors of any other party, or of a non-party.

- **Article 1104: Standard of Treatment.** Each party must afford investors of another Party, and their investments, “the better of the treatment required by Articles 1102 and 1103.”
- **Article 1105(1): Minimum Standard of Treatment.** “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.”
- **Article 1106: Performance Requirements.** No party may impose specified requirements on the investments of investors of a party or non-party, including “to export a given level or percentage of goods or services” or “to achieve a given level or percentage of domestic content.”
- **Article 1110: Expropriation and Compensation.** “No Party may directly or indirectly nationalize or expropriate an investment of an investor of another Party in its territory or take a measure tantamount to nationalization or expropriation of such an investment ..., except (a) for a public purpose; (b) on a non-discriminatory basis; (c) in accordance with due process of law and Article 1105(1); and (d) on payment of compensation”

These Chapter 11 obligations mirror those in many earlier (and later) bilateral investment treaties.

Of the Chapter 11 provisions listed, Articles 1105 and 1110 have garnered far and away the most attention. The ambiguity of key phrases in those provisions – “fair and equitable treatment” in Article 1105, and “indirectly ... expropriate” in Article 1110 – plays into the fear of some, and the hope of others, that foreign investors in the U.S. may use Chapter 11 arbitration to obtain more favorable rulings than are available under U.S. law to native investors. An illustration is Glamis Gold Ltd., a Canadian company that recently filed a notice of intent to seek arbitration under Chapter 11, based on environmental hurdles erected by California to a mining proposal by its U.S. subsidiary. According to a report, the company “acknowledges that it is preparing the Chapter 11 complaint because it is easier than trying to get compensation through the U.S. courts.”⁹

Part I of this report reviews the NAFTA arbitration procedure set in motion when an investor from a NAFTA signatory country files a Chapter 11 claim. Parts II and III then summarize the debate over the two NAFTA Chapter 11 articles now generating the most heat: Article 1105(1), calling for “fair and equitable treatment,” and Article 1110, on expropriation and compensation. Finally, Part IV offers nutshell summaries of the NAFTA claims filed so far.

⁹ Inside U.S. Trade, Aug. 8, 2003.

Note: NAFTA arbitral decisions (called “awards”) cited in this report can be found at websites operated by the U.S. Department of State, [<http://www.state.gov/s/l/c3439.htm>]; the Canadian government, [<http://www.dfait-maeci.gc.ca/tna-nac/NAFTA-e.asp>]; or a private attorney [<http://www.naftalaw.org>].

Bipartisan Trade Promotion Authority Act

Though this report homes in on NAFTA, it should not neglect future trade agreements entirely. This brings up the Bipartisan Trade Promotion Authority Act (TPA),¹⁰ enacted August 6, 2002, which governs the negotiation of U.S. free trade agreements after that date.¹¹ The TPA sets out “principal trade-agreement negotiating objectives” for the U.S. in the area of foreign investment. What is important here, several of these objectives directly respond to criticisms leveled at NAFTA Chapter 11 over the years, seeking to ensure that its perceived flaws are not replicated in later trade agreements. A prominent example is the TPA instruction that U.S. trade negotiators ensure in future trade agreements “that foreign investors in the United States are not accorded greater substantive rights with respect to investment protections than United States investors in the United States”¹² This “no greater rights” goal was included largely to address concerns that foreign investors in this country may (once the nascent case law develops further) receive more favorable treatment for their NAFTA indirect-expropriation claims than do Americans investing here under domestic “regulatory takings” law.

While “no greater rights” guards against divergence from U.S. law on the high side, other TPA provisions will work to minimize divergence in either direction. Thus, the TPA instructs U.S. trade negotiators to pursue standards for both expropriation and fair and equitable treatment that are “consistent with United States legal principles and practice.”¹³ As to fair and equitable treatment, the TPA declares that U.S. legal principles include “the principle of due process.”

Other TPA provisions seeking to ameliorate perceived defects in Chapter 11 call for mechanisms in future trade agreements that eliminate frivolous claims, enhance opportunities for public input into the formulation of government positions, provide for an appellate body, and create greater transparency (e.g., by making all hearings public).

¹⁰ Pub. Law No. 107-210, Title XXI.

¹¹ Being prospective only, the TPA does not direct the renegotiation of any NAFTA provisions.

¹² TPA § 2102(b)(3); 19 U.S.C. § 3802(b)(3). The legislative history makes abundantly clear that this language does not apply to procedural issues, such as exhaustion of remedies and access to appellate procedures. H.R. Conf. Rep. 107-624, at 156 (2002).

¹³ TPA § 2102(b)(3)(D)-(E); 19 U.S.C. § 3802(b)(3)(D)-(E). *See generally* Ethan Shenkman, *Could Principles of Fifth Amendment Takings Jurisprudence Be Helpful in Analyzing Regulatory Expropriation Claims Under International Law?*, 11 N.Y.U. Envtl. L. J. 174 (2002).

These TPA provisions already have shaped the investor-state dispute provisions in the two free trade agreements – with Chile and Singapore – signed by the United States since its enactment.¹⁴ These agreements are likely to be a model for the next generation of foreign-investor provisions in U.S. free trade agreements. (Now under negotiation by the U.S. are two regional free trade agreements – Central American Free Trade Agreement and U.S.-South African Customs Union Free Trade Agreement – and several bilateral free trade agreements.) In light of the prototype status of Chile and Singapore, this report indicates the changes from NAFTA to those agreements in footnotes throughout Parts I, II, and III.¹⁵

Parenthetically, the TPA does not legally apply to bilateral investment treaties, which are approved by Senate advice and consent rather than the bicameral passage and presidential signature route of free trade agreements. Nonetheless, one may expect that as a practical matter, the TPA provisions governing foreign-investor protections in free trade agreements will be influential in U.S. negotiation of future bilateral investment treaties as well.

I. NAFTA Chapter 11 Arbitration Procedure

Before the Claim is Filed

When an investor from a NAFTA party believes that another NAFTA party (or a political subdivision thereof) has breached an obligation under the Agreement, and the investor has suffered loss as a result, NAFTA instructs that the investor should attempt first to negotiate a resolution.¹⁶ Pursuit of negotiation is not mandatory, however – nor is resort to the courts under domestic law.¹⁷ NAFTA gives the investor the right to file a claim for arbitration against the allegedly offending nation at any time,¹⁸ as long as the investor delivers written notice of its intention to file a

¹⁴ Implementing legislation was signed by the President on September 3, 2003: Pub. Law No. 108-77 (Chile); Pub. Law No. 108-78 (Singapore).

¹⁵ See generally John D. Echeverria, *Changes in the Investor-State Litigation Process As a Result of the Chile and Singapore Trade Agreements*, found at [<http://www.georgetown.edu/gelpi/papers/investorstate.pdf>].

¹⁶ Article 1118.

¹⁷ An exception recently was recognized in the final award in *The Loewen Group, Inc. v. United States* (2003). When the Chapter 11 claim is based on a *judicial* action of the respondent, the claimant first must exhaust opportunities for appellate review.

¹⁸ Articles 1116 (claim by an investor of a party on its own behalf), and 1117 (claim by an investor of a party on behalf of an enterprise). The principal difference between claims brought under the two articles is that with Article 1116 claims, any damages recovered are paid directly to the investor; with Article 1117 claims, damages recovered are paid to the enterprise, not the investor. To date, most arbitration claims under NAFTA Chapter 11 have been filed under Article 1117.

claim at least 90 days before filing¹⁹ and the claim is filed more than six months after the events giving rise to the claim.²⁰

Nor need the investor obtain the permission or participation of its own government, a departure from the customary practice in international law whereby grievances of individuals against foreign governments are asserted by their governments on their behalf. The investor, however, must waive its right to a proceeding before any agency or court as to the measure alleged to be a NAFTA breach, except for proceedings seeking “extraordinary relief” not involving monetary damages (such as an injunction).²¹

The claim must be filed against the party (i.e., the national government) even if the allegedly offending conduct was by a political subdivision (state or local government) of the party.

After the Claim is Filed

Following the investor’s filing of a claim, the investor and the respondent nation select the members of the arbitration tribunal. (There is no permanent, standing tribunal.) The panel generally comprises three arbitrators.²² The disputants also select a place of arbitration.²³

Besides the filings of the parties, the tribunal may receive input from experts appointed by it to report back on factual issues,²⁴ and from NAFTA signatories other than the respondent on questions of NAFTA interpretation.²⁵ In addition, Chapter 11 tribunals have ruled that they have the power to accept amicus briefs from outside

¹⁹ Article 1119.

²⁰ Article 1120. Another time constraint ensures that claims are not filed too *late*: an investor may not make a claim if more than three years have passed from when the investor (or the enterprise) first acquired, or should have first acquired, knowledge of the alleged breach and knowledge that the investor (or enterprise) has incurred loss or damage. Articles 1116, 1117.

²¹ Article 1121(1)(b). Where an investor makes a claim on behalf of an enterprise, both the investor and the enterprise must waive the right to local proceedings. Article 1121(2)(b).

²² Article 1123. One arbitrator is appointed by each of the disputing parties, with the third, presiding arbitrator chosen by agreement of such parties. If the disputing parties cannot agree on the presiding arbitrator, that person is appointed by the Secretary-General of the World Bank’s International Centre for the Settlement of Investor Disputes (commonly called “ICSID”), regardless of whether the investor has elected to use the ICSID or United Nations Commission on International Trade Law (commonly called “UNCITRAL”) arbitration rules.

Arbitrators typically are drawn from the ranks of international-law academics and practitioners, and former government officials.

²³ So far, the United States has been chosen as the place of arbitration for all claims in which the United States is a respondent.

²⁴ Article 1133.

²⁵ Article 1128. This provision does not authorize the tribunal to receive opinions by the non-respondent Parties on the application of NAFTA provisions to the facts of the case.

groups,²⁶ but that they are without power to allow intervention as a party.²⁷ In response to the concerns of some observers as to the lack of transparency in NAFTA arbitral proceedings, the Free Trade Commission established under NAFTA instructed arbitral panels to make public all documents submitted to, or issued by, them, subject to limited redaction.²⁸ However, there is still no obligation to allow public access to panel proceedings, unless both parties agree.²⁹

The arbitral tribunal must decide the issues “in accordance with [NAFTA] and applicable rules of international law.”³⁰ Amplifying on “in accordance with [NAFTA],” the Agreement states that the parties shall interpret its provisions in light of its objectives, including “facilitat[ing] the cross-border movement of goods and services” and “increas[ing] substantially investment opportunities in the territories of the Parties.”³¹ But there is no *stare decisis* as in American law.³² Previous decisions of NAFTA tribunals are binding only as between the disputing parties and with respect to the particular case,³³ though obviously a well-reasoned earlier opinion may prove influential.

The Final Award and Afterwards

If the tribunal decides for the investor, it may award only compensation (compensatory damages, interest, and costs, but not punitive damages) or restitution

²⁶ The rulings came in *Methanex Corp. v. United States and United Parcel Service of America v. Canada*, and were limited to proceedings under the UNCITRAL arbitration rules. In both cases, the tribunals deferred to a later stage whether to actually accept the amicus briefs.

²⁷ See, e.g., *United Parcel Service v. Canada Award on Jurisdiction* (2002). Both the Chile and Singapore agreements authorize arbitral panels to accept and consider amicus briefs, but are silent as to intervention.

²⁸ The Free Trade Commission consists of the three trade ministers of the NAFTA signatories and is charged with, among other things, resolving questions of NAFTA interpretation. Article 2001(1). The Commission’s interpretations are binding on the arbitration tribunals. Article 1131(2).

The particular Commission interpretation referred to in the text was issued July 31, 2001, and is the only one the Commission has rendered so far.

²⁹ Reflecting the TPA mandate, the transparency of investor-state arbitrations is extensively addressed in the Chile and Singapore agreements. A wide variety of documents related to the arbitration are to be made available to the public, and hearings are to be open to the public – with appropriate exceptions for confidential or privileged information.

³⁰ Article 1131(1).

³¹ Article 102.

³² *Stare decisis* is the long-established doctrine in American law that once a court has laid down a principle of law, it will adhere to that principle in future cases, unless there is compelling reason not to do so.

³³ Article 1136.

of property.³⁴ Injunctive relief is not available. Unlike World Trade Organization dispute panels, NAFTA arbitration tribunals cannot recommend that signatories change their laws or policies. A fortiori, they cannot compel such changes.

In the event of a compensation award based on the action of a nation's *political subdivisions*, the obligation to pay nonetheless accrues to the national government – which, after all, was the respondent. It is beyond NAFTA's concern whether the respondent nation may or should seek reimbursement from its political component; that is solely a domestic matter. The United States has yet to enact any such reimbursement mechanism. By contrast, U.S. law does speak to how inconsistency with NAFTA affects the *validity* of a state law. No state or local law, says the NAFTA implementing statute, may be declared invalid due to NAFTA inconsistency – whether or not preceded by a NAFTA panel declaring such inconsistency – except in an action brought by the United States to declare the law invalid.³⁵ Such actions by the U.S. are to be used only as a last resort, when cooperative efforts fail.³⁶

What if either claimant or respondent is unsatisfied with the tribunal's decision? NAFTA creates no appellate body,³⁷ but the party can seek limited relief in the courts, under either the Convention on the Recognition and Enforcement of Foreign Arbitral Awards,³⁸ or the arbitration statute of the place of arbitration. By either avenue, the grounds for review usually are narrower than with judicial appeals of actions by the complainant's own government. Under Article V of the Convention, a party nation may refuse recognition and enforcement of the decision on proof to a court that the decision deals with a matter beyond the scope of the submission to arbitration, is contrary to the public policy of that country, or offends other Article V provisions. Under the Federal Arbitration Act, grounds for a district court to set aside the arbitral decision include that the arbitrators were manifestly partial or guilty of misconduct, or "exceeded their powers."³⁹ Neither of these avenues for review allows the court to second-guess the arbitral tribunal on the merits.

³⁴ Article 1135. An award of restitution of property must provide that the respondent nation may pay monetary damages in lieu of restitution.

³⁵ North American Free Trade Agreement Implementation Act § 102(b)(2)-(3); 19 U.S.C. § 3312(b)(2)-(3). *See also* *Sanitary Dist. of Chicago v. United States*, 266 U.S. 405, 425-26 (1925) (Attorney General may sue state to enjoin actions inconsistent with U.S. treaty obligations; no statute is needed to authorize such suits).

³⁶ North American Free Trade Agreement, Statement of Administrative Action 12, *reprinted in* H. Doc. 103-159 vol. 1, at 450 (1993).

³⁷ The TPA establishes as a principal negotiating objective of the U.S. the creation of just such an appellate body. 19 U.S.C. § 3802(b)(3)(G)(iv). The Chile and Singapore agreements obligate the parties to "consider" within three years whether to establish a bilateral appellate body.

³⁸ 21 UST 2517, TIAS 6997 ("New York Convention"). This treaty entered into force for the United States on December 29, 1970.

³⁹ 9 U.S.C. § 10(a).

II. Fair and Equitable Treatment

NAFTA Article 1105, titled “minimum standard of treatment,” instructs in its much-debated section 1 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.

This standard dates back to negotiating efforts at multilateral investment treaties after World War II, and is included, with some variation, in the vast majority of recent bilateral investment treaties. A key purpose is to guarantee the foreign investor a minimum standard of treatment not contingent on domestic law in the event that national treatment and most-favored-nation treatment by the host country are not adequate.⁴⁰ But what constitutes “fair and equitable treatment”? Notwithstanding the ubiquity of the phrase, there is little case law or other authoritative interpretation. What little exists is quite recent.⁴¹ States one commentator:

The concept of fair and equitable treatment is not precisely defined. It offers a general point of departure in formulating an argument that the foreign investor has not been well treated by reason of discriminatory or other unfair measures being taken against its interests. It is, therefore, a concept that depends on the interpretation of specific facts for its content. At most, it can be said that the concept connotes the principle of non-discrimination and proportionality in the treatment of foreign investors.⁴²

For NAFTA purposes, the most important clarification of the fair and equitable standard is that by the Free Trade Commission, issued July 31, 2001. This clarification was issued in response to “what [the NAFTA Parties] apparently feared was a growing propensity of arbitral tribunal to interpret Article 1105 expansively,”⁴³ which had resulted in several government-adverse tribunal awards under the Article.⁴⁴ Quoting the relevant part in full –

⁴⁰ See, e.g., United Nations Conference on Trade and Development, *Fair and Equitable Treatment* 16 (1999).

⁴¹ See generally J.C. Thomas, *Reflections on Article 1105 of NAFTA*, 17 Foreign Investment L.J. (ICSID) 21, 22 (2002) (Article 1105(1) is “the most hotly disputed of all Chapter Eleven obligations”).

⁴² Peter Muchlinski, *MULTINATIONAL ENTERPRISES AND THE LAW* 625 (1995).

⁴³ Alan C. Swan, *NAFTA Article 1105: Regulatory Reform and the Search for Good Governance*, paper delivered at Symposium on the Emerging Law of Foreign Investment, presented by the D.C. Bar International Law Section, Jan. 8, 2003 (on file with author).

⁴⁴ See, e.g., S.D. Meyers Partial Award (2000).

1. Article 1105(1) prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to investments of investors of another Party.⁴⁵
2. The concepts of “fair and equitable treatment” and “full protection and security” do not require treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens.
3. A determination that there has been a breach of another provision of the NAFTA, or of a separate international agreement, does not establish that there has been a breach of Article 1105(1).

With a single exception, the Commission document has been accepted by all Chapter 11 panels to consider the issue as a proper “interpretation” of NAFTA, binding on future NAFTA panel decisions.⁴⁶ The Commission interpretation resolves a longstanding debate as to whether “fair and equitable treatment” equates with the minimum standard of international law or rather states an independent, self-contained standard.⁴⁷ Under NAFTA at any rate, it does the former – and no more; the tribunal may not set out its own idiosyncratic standard. The Commission interpretation also means of necessity that a customary international law minimum standard of treatment of aliens actually exists with regard to investments.⁴⁸

At the same time, the Commission interpretation gives no hint as to the substantive content of the relevant customary international law to which it refers. To be sure, the arbitral decisions rendered under NAFTA Chapter 11 shed a bit more light, but not much. The decisions tell us that (1) the customary international law

⁴⁵ “Customary international law results from a general and consistent practice of states followed by them from a sense of legal obligation.” RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW § 102(2) (1986). It is to be contrasted with other sources of international law: international agreements and “general principles common to the major legal systems of the world.” *Id.* See also Statute of the International Court of Justice art. 38, 59 Stat. 1055, 1060, 1976 U.N.Y.B. 1052, 1055 (identifying “international custom, as evidence of a general practice accepted as law” as one of four sources of international law).

⁴⁶ Article 1131(2) says that an “interpretation” of NAFTA by the Commission is binding. The panel in *Pope & Talbot, Inc. v. Canada*, however, concluded that the FTC document was not an interpretation, but rather an “amendment,” which, under Article 2202, must be adopted by a different procedure than was used by the Commission. This conclusion was dictum, however, in that the tribunal explicitly found it had no need to rule on the matter. *Award in Respect of Damages* (2002).

⁴⁷ See Rudolf Dolzer and Margrete Stevens, *BILATERAL INVESTMENT TREATIES* 59-60 (ICSID 1995).

⁴⁸ In the Chile and Singapore agreements, the provisions regarding “minimum standard of treatment” are changed relative to NAFTA Article 1105(1) to reflect each component of the Commission interpretation. Thus, the new agreements make explicit that (1) the minimum standard of treatment is “in accordance with customary international law”; (2) fair and equitable treatment does not require treatment beyond what is required by customary international law; and (3) breach of another provision of the agreement, or of a separate international agreement, does not establish a breach of minimum standard of treatment.

that is the touchstone for Article 1105(1) is the customary international law of today, not that of long ago, reflecting among other things the explosion in bilateral investment treaties since the 1960s; (2) what is unfair and inequitable need not equate with the outrageous or egregious, nor does it require bad faith or malicious intent; (3) what is unfair and inequitable depends on the facts of each case; and (4) something more than illegality or lack of authority under the domestic law of the party is required. With specific regard to *judicial* actions of the respondent Party, the decisions say that the test is whether, having regard to accepted standards in the administration of justice, the court's decision was "clearly improper and discreditable."⁴⁹ A decision that is in breach of municipal law and is discriminatory against the foreign litigant amounts to manifest injustice under international law. All three NAFTA signatories have urged at various times that the threshold for "fair and equitable" be set "high."

The paucity of substantive content in "fair and equitable" is an issue partly because unlike the international law of indirect expropriation, there is for "fair and equitable" no precise counterpart in American law to consult for guidance. The development of the indirect-expropriation concept in international law may, particularly under the TPA mandate for post-NAFTA agreements, take some cue from U.S. regulatory takings law. In contrast, while "fair and equitable" clearly offers a parallel to due process principles in the U.S. (noted in the TPA), it may implicate a host of other principles as well. Nor is due process law, or at least substantive due process law, a model of clarity.

III. Indirect Expropriation

International law has long protected foreign-owned property not only from direct expropriation (seizure or formal appropriation), but from "indirect expropriation" as well.⁵⁰ In an indirect-expropriation claim, the property owner claims that mere government regulation or other conduct, in the absence of seizure or formal appropriation, has had an adverse effect tantamount to expropriating the property – notwithstanding that title to the property remains with the owner. No claim is made that such conduct exceeds government police powers. The importance of NAFTA Chapter 11 is that it has spawned a significant number of indirect-expropriation claims, including, for the first time, several against the United States.

The filing of these indirect-expropriation claims under Chapter 11 likely draws some impetus from their domestic-law first cousin: regulatory takings claims under

⁴⁹ See, e.g., *The Loewen Group v. United States Final Award*, par. 133. Reflecting the TPA mandate, the Chile and Singapore agreements state that "fair and equitable treatment includes the obligation not to deny justice in criminal, civil, or administrative adjudicatory proceedings in accordance with the principle of due process embodied in the principal legal systems of the world"

⁵⁰ See RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW § 712, Comment g, and Reporters' Notes no. 6 (1986).

the Fifth Amendment's Takings Clause.⁵¹ The two concepts share a fundamental premise: that government regulation may in some cases so severely affect the economic use of private property as to amount to something – “expropriation” in international law, “physical taking” or “occupation” in U.S. law – that courts have long agreed deserves compensation. This equating of severe regulation with physical takings and occupations debuted in U.S. law in a 1922 Supreme Court decision,⁵² and has been a staple of the Court's decisions since the late 1970s. With the arrival of the NAFTA indirect-expropriation claims in the 1990s, the equating of the two is gaining wide attention internationally.

Let's look at the NAFTA language addressing expropriation, then consider the questions it raises. Article 1110 states –

No Party may directly or indirectly nationalize or expropriate an investment of an investor of another Party in its territory or take a measure tantamount to nationalization or expropriation of such an investment (“expropriation”), except:

- (a) for a public purpose;
- (b) on a nondiscriminatory basis;
- (c) in accordance with due process of law and Article 1105(1); and
- (d) on payment of compensation in accordance with paragraphs 2 through 6.⁵³

The phrases “indirectly ... expropriate” and “measure tantamount to ... expropriation” are not defined.⁵⁴ NAFTA states only that arbitral tribunals are to resolve investor-

⁵¹ The Takings Clause of the Fifth Amendment, U.S. Constitution, states: [N]or shall private property be taken for public use, without just compensation.” The law of regulatory takings is the body of standards developed by U.S. courts for determining when a regulatory interference with the use of private property is so severe or irrational as to effect a “taking” of that property, requiring just compensation under the Clause. *See generally* Stephen L. Kass, *Regulatory Takings Debate Reopened: Surprising, Potentially Significant, Context is NAFTA Chapter 11*, N.Y. L. J. sec. 2, September 11, 2000.

⁵² *Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393 (1922).

⁵³ “Paragraphs 2 through 6” specify that compensation shall be equal to the fair market value of the expropriated investment immediately before the expropriation took place, shall not reflect any change in value due to the intended expropriation, and shall include interest from the date of expropriation to the date of payment.

⁵⁴ Here, the Chile and Singapore agreements differ significantly from NAFTA. The former *do* offer a loose definition of indirect expropriation. That definition tracks almost verbatim the prevailing regulatory takings test enunciated by the U.S. Supreme Court in the leading case of *Penn Central Transp. Co. v. New York City*, 438 U.S. 104 (1978). Presumably, this close tracking is due to the TPA's “no greater rights” and “consistent with United States legal principles” mandates.

Regrettably, the *Penn Central* standard remains ill-defined. Moreover, there is no guarantee that arbitration panels convened under Chile/Singapore will look to U.S. case law for guidance in interpreting the *Penn Central*-inspired indirect-expropriation definition in those agreements. As the following footnote mentions, the standard is ultimately one of

(continued...)

state disputes “in accordance with this Agreement and applicable rules of international law.”⁵⁵

Also important is Article 1110's broad definition of “investment”⁵⁶ – the threshold term defining *what* cannot be expropriated without compensation. An “investment” may take the form of (1) an “enterprise” (defined to mean “any entity constituted or organized under applicable law, whether or not for profit, and whether privately-owned or governmentally-owned, including any corporation, trust, partnership, sole proprietorship, joint venture or other association”⁵⁷), (2) equity securities and certain debt securities of an enterprise, (3) certain loans to enterprises, (4) an interest in an enterprise that entitles the owner to share in its income or profits, or in its assets on dissolution, (5) property, tangible or intangible, acquired in the expectation or used for the purpose of economic benefit or other business purposes, or (6) interests arising from the commitment of capital or other resources to economic activity.

The question, yet again, is whether NAFTA arbitral panels will interpret the agreement in rough conformity with U.S. law, in this case that on regulatory takings. Or will the panels head off in some other direction, and if so, what? If that new direction is more investor-friendly than U.S. law, might Article 1110 inhibit federal and state regulators seeking to apply legitimate environmental, public health and safety, and land use restrictions? On the other hand, only one arbitral decision under Article 1110 thus far has been in favor of the claimant (see Section IV).

Tribunal awards to date have provided only minimal elaboration on what constitutes an indirect expropriation. One decision said that the concept includes “incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use or reasonably-to-be-expected economic benefit of property.”⁵⁸ Another clarified that legitimate police-power regulation can constitute indirect expropriation, even if nondiscriminatory, though

⁵⁴ (...continued)

customary international law. Perhaps that is why the Chile and Singapore drafters added a provision clarifying that “[e]xcept in rare circumstances, nondiscriminatory regulatory actions by a Party ... to protect legitimate public welfare objectives, such as public health, safety, or the environment, do not constitute indirect expropriations.”

Finally, Chile/Singapore delete any mention of measures “tantamount to” expropriation..

⁵⁵ Article 1131(1). The Chile and Singapore agreements add the word “customary,” saying that the concept of expropriation in the agreements takes its cue from “customary international law.” One may well ask, of course, how the agreements can set forth *two* definitions of indirect expropriation: customary international law and the *Penn Central* standard in the previous footnote. Possibly the agreements’ drafters believed that the two definitions are similar, or hoped that they will be in the future.

⁵⁶ Article 1139.

⁵⁷ Article 201(1).

⁵⁸ *Metalclad Corp. v. United Mexican States Award*, par. 103 (2000), *partially overturned on jurisdictional grounds*, 89 Brit. Col. L.R. 3d 359 (2001).

the deprivation must be “substantial.”⁵⁹ “Significant” and “substantial,” of course, have a wide range of possible meanings.

A comparison of Article 1110 text and U.S. regulatory takings law suggests some areas of potential divergence, depending on how the still-embyonic Article 1110 case law develops. First, a takings claim under U.S. law requires as a prerequisite a harm to “property.” Under the terms of NAFTA Chapter 11, a claim depends instead on harm to an “investment,” broadly defined in the Chapter (see above) to include some interests not generally viewed as property in U.S. law.⁶⁰ The significance of this textual divergence may be minimized if tribunals ultimately adopt the U.S. position that Chapter 11's silence notwithstanding, the claimant must have a property right in the investment in order for the claim to be cognizable.⁶¹

Second, U.S. takings law firmly embraces the concept of the “relevant parcel,” under which a court must analyze a regulatory taking claim by reference to the plaintiff’s entire property, and the entire bundle of rights held therein. In short, a court must look at not only what the property owner lost, but what he/she still has. NAFTA decisions have yet to make any broad pronouncements in this realm, though some awards suggest that the right to sell in a specific market may be considered property separate from the remainder of plaintiff’s interests in the business.⁶²

Third, one component of the U.S. regulatory takings test is the degree to which the government has interfered with the “reasonable investment-backed expectations” of the property owner. Certain circumstances routinely have been viewed by U.S. courts as undercutting the reasonableness of such expectations – for example, the claimant’s decision to enter voluntarily a highly regulated field, or to buy a parcel of land *after* a regulatory scheme is in place. NAFTA tribunals, on the other hand, have yet to speak extensively to the relevance of the reasonableness of the claimant’s expectations.

Though the U.S. executive branch has long debated internally the meaning of “indirect expropriation,” it has as yet not pursued a formal clarification by the Free Trade Commission, as it did in the case of Article 1105.

IV. Claims Filed Under NAFTA Chapter 11

The following lists all claims filed under NAFTA Chapter 11 since its inception, as revealed by the leading web sites. The *Ethyl Corporation* claim against Canada

⁵⁹ Pope & Talbot v. United States Award, pars. 99, 102 (2000)

⁶⁰ The Chile and Singapore free trade agreements, by contrast, specify that an action by a party cannot be an expropriation unless it conflicts with a “property right or property interest” in an investment.

⁶¹ See, e.g., Memorial on Jurisdiction and Admissibility of Respondent United States of America, Methanex Corp. v. United States (filed Nov. 13, 2000).

⁶² See, e.g., Pope & Talbot v. United States Award, par. 96 (2000).

was the first to be filed, in 1997. Today, a total of about 20 claims have been filed, with several notices of intent to file (not included here) pending.

Eight of the filed Chapter 11 claims have produced final arbitral decisions as to fair and equitable treatment, of which four found violations.⁶³ Five of the filed Chapter 11 claims have produced final arbitral decisions as to indirect or “tantamount to” expropriation claims, of which one (*Metalclad*) found an expropriation.

Claims against the United States

There have been three final dispositions of NAFTA Chapter 11 claims against the United States, all in its favor. The three rulings came in *The Loewen Group*, *Mondev International*, and *ADF Group*.

1. *Methanex Corp. v. United States*. Methanex Corp., a Canadian firm, produces methanol. Methanol is a key component of MTBE, a substance added to gasoline to boost octane and meet federal oxygenate requirements. Asserting that MTBE was contaminating drinking water supplies in California, the Governor ordered a phase-out of MTBE in gasoline sold there by December 31, 2002. In 2002, the Governor delayed the total removal requirement until December, 2003.

Methanex’ NAFTA claim, filed in 1999, claims that California’s action violates Articles 1102, 1105, and 1110 with regard to its indirectly owned U.S. companies, which sell methanol for MTBE in California. It contends that the state-recited environmental concerns are a sham – that the phase-out was motivated largely by a desire to favor a MTBE competitor, ethanol, generally manufactured from biomass feedstocks (such as corn) produced in the United States. The claim seeks US\$970 million, based on profits Methanex allegedly will lose if California’s ban takes effect.

In 2002, the arbitral tribunal ordered Methanex to submit a fresh pleading alleging facts that more specifically relate California’s action to Methanex. This order was prompted by NAFTA Article 1101, which requires that challenged measures be those “relating to” investors of another Party. Methanex’ new pleading was filed November, 2002, and a hearing is scheduled for June, 2004.

2. *Mondev International, Ltd. v. United States*. Mondev, a Canadian firm, embarked upon a commercial real estate development in Boston, through a Massachusetts limited partnership it owned. Allegedly contrary to the partnership’s agreement with the city, the city refused to allow it to exercise its option to acquire a critical parcel of land. The city’s motivation, according to Mondev, was political: the parcel’s value by 1988 was far higher than the partnership would pay under the formula in its agreement with the city, and the city did not want the benefit to go to a foreign investor. The partnership ultimately lost in the Massachusetts Supreme Court.

⁶³ Both the “eight” and the “four” numbers include *The Loewen Group*, where the discussion of fair and equitable treatment was explicitly dicta.

Mondev filed its NAFTA claim in 1999, asserting that due to the actions of the city, its redevelopment agency, and the Massachusetts high court, the United States had violated Articles 1102, 1105, and 1110. It sought US\$50 million. In 2002, the arbitration panel rejected all of Mondev's claims, on the grounds of NAFTA's non-retroactivity (the critical events occurred prior to NAFTA's taking effect in 1994) and the fact that any failure of the Massachusetts courts to decide the remaining breach of contract and tort claims in accordance with Massachusetts law did not offend NAFTA.

3. *The Loewen Group, Inc. v. United States.* A suit was filed in a Mississippi state court against The Loewen Group, a Canadian funeral home operator. The plaintiff was a local businessman and competitor of Loewen, whose claim involved various contract disputes with the company.. The state jury verdict against Loewen was for \$500 million, including \$400 million punitive damages, and the trial judge entered judgment on the verdict. Subsequently, both the trial court and the Mississippi Supreme Court refused to reduce the \$625 million bond required under state law to obtain a stay of execution pending appeal. According to Loewen, this forced it to abandon its appeal of the judgment and to settle an \$8 million case for \$175 million.

Loewen's claim, filed 1998, alleged violations of Articles 1102, 1105, and 1110 based on the large verdict, the trial court's refusal to vacate it, and the refusal to reduce the bond amount.⁶⁴ It sought US\$725 million. Loewen argued that the verdict was the product of a trial "infected by repeated appeals to the jury's anti-Canadian, racial, and class biases."

On June 26, 2003, the arbitral panel dismissed Loewen's claims for lack of jurisdiction. Loewen had, since the filing of its NAFTA claim, filed for bankruptcy reorganization and emerged as a U.S. corporation. NAFTA, however, cannot be invoked between an investor and its own national government. In addition, where a claim is based on judicial action, as here, there must be final action by the Party's judicial system. Loewen, however, had failed to petition the U.S. Supreme Court.

Finally, the panel reached the merits, though the jurisdictional dismissal made it unnecessary. It branded the state-court trial "a miscarriage of justice ..." and said that "[t]he total award ... appears to be grossly disproportionate to the damages suffered" These facts, it declared in dicta, violated fair and equitable treatment under Article 1105.

4. *ADF Group, Inc. v. United States.* ADF Group, a Canadian corporation that designs and erects structural steel, claimed damages for alleged injuries from the federal Surface Transportation Assistance Act of 1982. The Act and regulations require that federally funded state highway projects use only domestically produced

⁶⁴ This was the first claim against the United States filed under Chapter 11. *Loewen Group* was defended initially by the Department of Justice, eventually by the Department of Justice and Department of State jointly. All subsequently filed NAFTA Chapter 11 claims against the United States are or were defended solely by the Department of State.

steel. ADF asserted violations of Articles 1102, 1103, 1105, and 1106, and sought US\$90 million.

On January 9, 2003, the arbitral panel dismissed all of ADF's claims. Because the domestic content requirement constituted procurement, it concluded, the company was exempt from Articles 1102, 1103, and 1106 pursuant to Article 1108. Nor had an Article 1105 violation been shown.

5. *Canfor Corp. v. United States.* Canfor Corp. is a Canadian forest products company and the largest exporter of softwood to the U.S. All of its softwood lumber destined for the U.S. is purchased by Canfor Wood Products, its wholly owned subsidiary in the U.S. Canfor Corp. asserts losses allegedly suffered as a result of certain U.S. antidumping, countervailing duty, and material injury determinations on softwood lumber. As a result of those determinations, its U.S. subsidiary is required to pay increased duties on softwood lumber products exported to the U.S.

Canfor's claim asserts that the U.S., through these determinations, breached Articles 1102, 1103, 1105, and 1110. Canfor claims damages of not less than US\$250 million.

6. *Kenex, Ltd. v. United States.* Kenex is a Canadian company that, on its own and through a U.S. subsidiary, sells in the U.S. products made from the cannabis plant (including whole hemp grain and derivatives such as hemp oil). The cannabis plant, however, contains THC, a controlled substance under the U.S. Controlled Substances Act when in a form that can enter the human body. (It is the psychoactive ingredient in marijuana.) Under its "Zero THC Policy," the U.S. Drug Enforcement Administration blocked the sale of Kenex' products in the U.S.

Kenex asserts violations of Articles 1102 through 1105, and seeks damages of US\$20 million.

Claims against Canada

1. *S.D. Meyers, Inc. v. Canada.*⁶⁵ S.D. Meyers, a U.S. company, recycles PCB-contaminated waste.⁶⁶ The company, on its own and through its Canadian affiliate, had purchase orders to treat PCB waste from Canadian holders of such waste, including schools, universities, hospitals, and electric utilities. Canada, however, adopted a temporary ban between November 1995 and February 1997 on the export of PCB waste, forcing S.D. Meyers' customers to have their waste handled at higher prices by a Canadian competitor. (In June, 1997, months after Canada lifted the export ban, a U.S. court ruled that EPA lacked authority under the Toxic Substances

⁶⁵ See generally Brian T. Hodges, Note, *Where the Grass is Always Greener: Foreign Investor Actions Against Environmental Regulations Under NAFTA's Chapter 11*, S.D. Myers, Inc. v. Canada, 14 Geo. Int'l. Envtl. L. Rev. 367 (2001).

⁶⁶ PCB stands for "polychlorinated biphenyls."

Control Act for its general rule allowing import of PCB waste into the U.S.⁶⁷ As a result, the court voided the rule. Since then, import of private PCB waste into the U.S. has, for the most part, been unlawful as a matter of U.S. law.)

S.D. Meyers argued that the Canadian ban treated its Canadian affiliate differently than Canadian investors. Its claim, under Articles 1102, 1105, 1106, and 1110, was filed 1998 and sought US\$20 million.

In the initial liability phase of the proceedings, the NAFTA tribunal found in 2000 that the Canadian ban breached Articles 1102 and 1105, since Canada had closed its border to protect the market share of Canadian competitors from U.S.-based competition. The ban did not breach Article 1110, however, since it only delayed S.D.Meyers' entry into the Canadian market by 18 months. In 2002, the tribunal issued a damages award against Canada, requiring it to pay S.D. Meyers CAN\$6.05 million plus interest for discrimination against the company. Because Canada voluntarily withdrew the export ban in 1997 before the NAFTA claim was filed, the award will have no effect on existing law.

In 2001, Canada applied to a Canadian court to set aside the tribunal's liability award on the ground that elements of the ruling exceeded the tribunal's jurisdiction and were contrary to the public policy of Canada. This action is still pending.

2. *Ethyl Corp. v. Canada.* Canada banned interprovincial and international sale of MMT, a gasoline octane enhancer suspected of adverse health effects. The only MMT supplier in Canada was a subsidiary of U.S.-based Ethyl Corp., which in 1997 filed under Chapter 11 alleging that the ban violated Articles 1102, 1106, and 1110. Ultimately Canada suspended the ban and agreed to pay Ethyl about \$13 million to compensate it for legal fees and other inconveniences. Possibly contributing to Canada's willingness to settle was the success of a challenge to the MMT ban filed by four Canadian provinces with a domestic arbitration panel, which found the ban to be arbitrary.

3. *Pope & Talbot, Inc. v. Canada.* Canada participates in the Canada-U.S. Softwood Lumber Agreement. Pope & Talbot, an Oregon-based company, filed a claim in 1998 asserting that such participation violated Articles 1102, 1103, 1105, 1106, and 1110 by allocating certain fee-free export permits under the Agreement in a way that placed the sawmills of its Canadian subsidiary at a competitive disadvantage in exporting lumber to the U.S. Pope & Talbot initially sought damages totaling over \$507 million.

In 2000, the tribunal issued a partial decision dismissing the investor's claims under Articles 1106 and 1110. In 2001, a second arbitral decision rejected the Article 1102 claim and one of the Article 1105 claims. As to another Article 1105 claim, regarding the treatment of the subsidiary in the verification review process, the tribunal held in 2002 that Canada had breached Article 1105 and awarded US\$461,566 in damages and interest.

⁶⁷ *Sierra Club v. EPA*, 118 F.3d 1324 (9th Cir. 1997).

4. *United Parcel Service of America v. Canada.* UPS claims that Canada Post, which UPS alleges is a letter mail monopoly, engages in anti-competitive practices by using its postal monopoly infrastructure to reduce the costs of delivering its non-monopoly parcel services. UPS alleges violations of Articles 1102 and 1105, and seeks \$160 million in damages.

In 2002, the tribunal rejected the Article 1105 claim, on the ground that there is no customary international law prohibiting or regulating anti-competitive behavior.

Claims against Mexico

1. *Metalclad Corp. v. United Mexican States.* In the early 1990s, Mexico issued federal permits for a Mexican company to construct a hazardous waste facility in the state of San Luis Potosi. Assertedly in reliance on representations that all necessary permits had been granted, U.S.-based Metalclad Corp. exercised its option to buy the Mexican company and its permits. Thereafter, both the state and municipality objected to the facility, citing environmental concerns and community opposition, with the result that the facility, though completed, was never opened.

In 1997, Metalclad filed a claim against Mexico, seeking \$90 million. It alleged that Mexico, by permitting or tolerating the actions of its state and municipality blocking the hazardous waste facility, violated Articles 1105 and 1110. In 2000, the NAFTA panel agreed with both claims, awarding the company \$16.685 million.⁶⁸

Mexico challenged the arbitral award in the British Columbia (Canada) Supreme Court, the first occasion on which a *court* has considered a NAFTA Chapter 11 award.⁶⁹ (A British Columbia court was dictated by the disputants' choice of Vancouver as the place of arbitration.) Canada and the Province of Quebec were allowed to intervene. In 2001, the court set aside the arbitral panel's finding of a violation under Article 1105, but affirmed the expropriation found under Article 1110.⁷⁰ Afterward, the parties settled for an amount slightly smaller than the original arbitral award.

⁶⁸ See Stephen L. Kass and Jean M. McCarroll, *The Metalclad Decision Under NAFTA's Chapter 11*, N.Y. L. J., Oct. 27, 2000, p. 3 (arguing that in light of *Metalclad*, the authors' previous optimism that Chapter 11 claims would not chill environmental enforcement in NAFTA countries may have been premature).

Recently, an arbitral tribunal rendered a similar decision against Mexico in a claim arising under the bilateral investment treaty between Mexico and Spain. In *Técnicas Medioambientales TECMED S.A. v. Mexico*, Case No. ARB (AF)/00/2 (May 29, 2003), the tribunal found that a Mexican agency's failure to renew a toxic waste plant's license was not based on public health concerns, but rather on opposition from local residents. Accordingly, it held that the fair and equitable treatment and "tantamount to expropriation" guarantees in the treaty had been violated, and awarded the Spanish investor \$5.5 million.

⁶⁹ See generally Chris Tollefson, *Metalclad v. United Mexican States Revisited: Judicial Oversight of NAFTA's Chapter Eleven Investor-State Claim Process*, 11 Minn. J. of Global Trade 183 (2002).

⁷⁰ *United Mexican States v. Metalclad Corp.*, 89 Brit. Col. L.R. 3d 359 (2001), available at [<http://www.worldbank.org/icsid/cases>].

2. *Azinian v. United Mexican States.* A Mexican company having U.S. investors held the concession for wastewater collection and disposal in a Mexican city. The company defaulted on certain obligations under the concession agreement, which the city terminated.

The U.S. investors, alleging violations of Articles 1105 and 1110, claimed \$14 million. The NAFTA panel rejected the claim in 1999, ruling that the city's alleged breach of its concession agreement did not state a claim for expropriation under Article 1110. "[A] foreign investor ...," it said, "may enter into contractual relations with a public authority, and may suffer a breach of that authority, and still not be in a position to state a claim under NAFTA." And, under the circumstances of the case, if there was no violation of Article 1110, there was none of Article 1105 either.

This was the first Chapter 11 arbitral decision on the merits.

3. *Marvin Roy Feldman Karpa (CEMSA) v. United Mexican States.* A U.S. national owned all the stock of a Mexican corporation (CEMSA). He alleges that Mexico's refusal to rebate export excise taxes to the corporation, as provided by Mexican law, was intended to force the corporation out of business and thus was "tantamount to expropriation" under Article 1110. The asserted motive was to shut down the company's cigarette exporting business and to give the producers a monopoly on exports. He also claims a violation of Article 1102.

In 2002, the tribunal rejected the Article 1110 claim, but upheld that under Article 1102 and awarded damages.

4. *Waste Management, Inc. v. United Mexican States.* In 1998, USA Waste Services, Inc. (now Waste Management) filed a claim under Articles 1105 and 1110. The claim was that a Mexican state and municipality had granted a 15-year concession to USA Waste's Mexican subsidiary for public waste management services, but failed to comply with payment and other duties in the agreement despite full performance by the subsidiary. It also asserted that a Mexican bank that had issued an unconditional guarantee for the payment arbitrarily refused to honor its guarantee. USA Waste claims damages of \$60 million.

5. *Fireman's Fund Insurance Co. v. United Mexican States.* Fireman's Fund, a U.S. insurance company, claims that Mexico violated Articles 1102, 1105, 1110, and 1405 by facilitating the purchase of debentures denominated in Mexican pesos and owned by Mexican investors, but not facilitating the purchase of debentures denominated in U.S. dollars and owned by Fireman's Fund. Both series of debentures were issued by the same Mexican financial services corporation

6. *GAMI Investments v. United Mexican States.* In a claim filed in 2002, GAMI Investments, Inc. a U.S. corporation, contends that in 2001, Mexican authorities issued a decree for the stated purpose of revitalizing the Mexican sugar industry. GAMI alleges that pursuant to that decree, Mexican authorities expropriated sugar mills owned by subsidiaries of a Mexican company in which GAMI claims to hold a 14% interest. GAMI asserts violations of Articles 1102, 1105, and 1110, and seeks damages of over \$55 million.

7. *International Thunderbird Gaming Corp. v. United Mexican States.* The corporation, a Canadian company, owns and operates gaming and entertainment facilities. It seeks damages for alleged injuries resulting from the regulation and closure of its gaming facility by the Mexican government, citing Articles 1102, 1103, 1104, 1105, and 1110. It seeks damages of \$100 million.

8. *Robert J. Frank v. United Mexican States.* Mr. Frank asserts that in 1999, Mexico expropriated beachfront property belonging to him. He alleges violations of Articles 1102, 1103, 1105 and 1110.

9. *Adams v. United Mexican States.* U.S. citizens purchased lots and built vacation homes in a resort they believed belonged to the Mexican government. Mexican courts later held that the lots had been unlawfully expropriated by the Mexican government and ordered them returned to their original owners. The American investors claim that the judicial decree violates Articles 1102, 1105, and 1110, and seek damages of \$75 million.

EveryCRSReport.com

The Congressional Research Service (CRS) is a federal legislative branch agency, housed inside the Library of Congress, charged with providing the United States Congress non-partisan advice on issues that may come before Congress.

EveryCRSReport.com republishes CRS reports that are available to all Congressional staff. The reports are not classified, and Members of Congress routinely make individual reports available to the public.

Prior to our republication, we redacted names, phone numbers and email addresses of analysts who produced the reports. We also added this page to the report. We have not intentionally made any other changes to any report published on EveryCRSReport.com.

CRS reports, as a work of the United States government, are not subject to copyright protection in the United States. Any CRS report may be reproduced and distributed in its entirety without permission from CRS. However, as a CRS report may include copyrighted images or material from a third party, you may need to obtain permission of the copyright holder if you wish to copy or otherwise use copyrighted material.

Information in a CRS report should not be relied upon for purposes other than public understanding of information that has been provided by CRS to members of Congress in connection with CRS' institutional role.

EveryCRSReport.com is not a government website and is not affiliated with CRS. We do not claim copyright on any CRS report we have republished.