



COVER STORY

The Real Contract On America

What if foreigners, who hold more than 20 percent of the investments in the United States, had expansive rights to sue for monetary damages in front of industry-friendly panels based on their obligations to comply with U.S. environmental laws? It's already happening under Chapter 11 of NAFTA, which authorizes suits based on actions of the federal, state, or local governments that limit the potential value of their investments. U.S. courts are ostensibly bound to order that the awards be paid from the Treasury

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In the mid 1990s, environmentalists and various allies waged a vigorous — and largely successful — campaign to defeat the Contract with America. Dubbed the *Contract on America* by critics, the legislative flagship of the Newt Gingrich era would have revolutionized the regulatory process by, among other things, mandating that the public pay private firms to comply with environmental and public health laws.

Ironically, in the same period, Congress approved another measure remarkably similar to the Contract with America that threatened to produce changes in U.S. environmental law and policy at least as fundamental as the Gingrich proposal — and it is still on the books. Many environmental groups opposed the measure, but some groups (somewhat reluctantly and, in retrospect, with regret) actually supported it. The measure was the North American Free Trade Agreement among the United States, Canada, and Mexico. The key challenge to environmental regulation lies in the then little noticed but now much criticized Chapter 11, which governs “Investment.”

This article shows that Chapter 11 was an extraordinary legal innovation, creating a fundamental threat to the decisionmaking institutions and processes that provide the foundation for U.S. environmental policies. In a nutshell, Chapter 11 authorizes foreign investors operating in this country to sue the United States — before quasi-judicial panels, invoking expansive new rights of action under international law — based on actions of the federal, state, or local governments that restrict the profitability of their investments. It authorizes claimants to sue for monetary relief and, if they prevail, U.S. courts are ostensibly bound to order that the awards be

paid from the U.S. Treasury. The range of government actions that can be challenged through this process is as broad as a lawyer's imagination — garden variety land use regulations, public health measures, tax policies, the judgments of our domestic courts, and so on.

Chapter 11 raises a number of serious, unresolved questions. One question is whether Chapter 11 actually effects the sweeping abrogation of sovereign immunity that its supporters (incredibly) presume. Another issue is whether Congress, by attempting to empower ad hoc panels to issue binding judgments against the United States, has granted judicial power which, under Article III of the Constitution, can only be assigned to judges. Other potential issues might be raised under the Constitution's Equal Protection Clause (is there a rational basis for granting foreign investors greater legal rights than U.S. investors possess?) or under the Treaty Clause (because NAFTA was not approved by two-thirds of the Senate).

NAFTA, neither a treaty nor a statute but merely a congressional-executive agreement, was a strange vehicle for effecting potentially sweeping changes in U.S. environmental and other social policies. As the United States embarks on negotiations designed to extend Chapter 11 worldwide, this article considers the arguments for, and against, Chapter 11. My ultimate conclusion is that Chapter 11 is in fundamental conflict with Americans' most cherished constitutional principles, as well as our environmental protection standards, and should not serve as a model for future trade and investment agreements.

Supporters of Chapter 11 — lobbyists for multinational corporations, for example — do not argue for subjecting U.S. government

decisionmaking to review under this extraordinary new litigation process because U.S. laws or judicial institutions are inadequate to the task of protecting the rights of foreign investors. Rather, their justification rests on the claim that the laws and courts in other countries do not adequately protect U.S. investors. Granting foreign investors broad new rights to sue the United States, according to this argument, is a necessary quid pro quo for the United States to be able to demand that U.S. investors operating abroad can sue through a process that is independent of, and more protective than, other countries' domestic rules and institutions.

Critics — including many state and local officials, as well as environmentalists — contend that the aim of corporations in supporting Chapter 11 is to supplant existing U.S. legal rules and institutions with a new set of rules and institutions more amenable to business interests. The basic objective, they contend, is to create, eventually on a worldwide basis, broader immunity for businesses from legislative and administrative controls, including environmental requirements.

The adoption of Chapter 11 represented a revolutionary departure for the United States. NAFTA is modeled after a series of earlier U.S. investment agreements, mostly with less-developed countries, that admittedly include similar investor-state litigation provisions. But because the countries that entered into these prior agreements had few if any investors in the United States, they served, in practice, only the interests of U.S. investors operating abroad. Prior to NAFTA no foreign investor had sued the United States under an international trade or investment agreement. That changed rapidly once NAFTA was approved, because Mexicans, and (especially) Canadians, are major investors in the United States.

While the NAFTA Chapter 11 litigation process is still in its infancy, environmental laws and regulations already have been the focus of many of the early claims.

- In the *Metalclad* case, a NAFTA panel awarded approximately \$17 million to a U.S.

company based on regulatory obstacles it encountered in its unsuccessful effort to construct a hazardous waste facility in the Mexican state of San Luis Potosi. The panel found a violation of Chapter 11 based on, among other things, the local municipality's restrictions on the use of the property for the proposed facility.

- In the *S.D. Myers* case a U.S. firm engaged in the disposal of PCBs challenged a Canadian ban on their export that had the effect of prohibiting the company from transferring Canadian waste for disposal at the company's facility in the United States. A NAFTA panel found that the export restriction violated several provisions of Chapter 11 and awarded the claimant approximately \$5 million.

- In the *Methanex* case, a Canadian firm is seeking approximately \$1 billion in damages based on a California law barring the use of

MTBE, a suspected carcinogen, as a fuel additive. California adopted the ban in response to studies indicating that MTBE in leaking underground storage tanks is polluting groundwater. The case, which was filed several years ago, is still pending.

These few examples are sufficient to demonstrate that Chapter 11 litigation could have a profound effect on environmental regulatory programs. While claims have only succeeded so far against Mexico and Canada, it appears to be only a matter of time before a NAFTA claimant succeeds in a suit against the United States.

(At the same time, as discussed below, there are significant questions about whether and how a judgment against the United States under Chapter 11 might actually be enforced.)

The fact that Chapter 11 can only be invoked by foreign investors, and not by domestic investors, does not reduce the threat this new dispute-resolution process poses for U.S. environmental policies. Foreigners hold more than 20 percent of investments in the United States, meaning that virtually any type of policy at any level of government could be challenged under this process. Equally important, if NAFTA confers greater

The legacy of Newt Gingrich lives on, in an international equivalent of the Constitution's Takings Clause, potentially requiring compensation for environmental compliance

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Trade Restrictions, Not Environmental Protections, At Risk

United States law provides considerable protection against arbitrary government action or takings of property interests. Through its numerous bilateral investment treaties, free trade agreements, and NAFTA Chapter 11, the United States has sought to secure those same protections for its own investors in other countries — and the ability to enforce those protection obligations through international arbitration. These treaty-based investor protections track closely with long-standing U.S. concepts, such as the Takings Clause of the Constitution. They advance the rule of law in countries where the rule of law is weak; they facilitate direct investment and economic growth; and they serve our country's political and economic interests.

Notwithstanding these benefits, several groups oppose NAFTA's Chapter 11 and seek to weaken its provisions for investor-to-state dispute settlement on the grounds that the provision inhibits the application of environmental, health, and safety regulations. Such groups have argued that, under NAFTA, environmental regulations can be deemed expropriatory, requiring the U.S. government to compensate foreign investors for economic losses caused by such regulations.

These concerns are not supported by the facts. No NAFTA tribunal has ever struck down or even questioned the validity of the application of non-discriminatory, bona fide environmental regulations.

The first NAFTA case to draw fire from environmentalists was *Ethyl Corp. v. Canada*. In that case, the Ethyl Corporation was engaged in the production and trading of a gasoline additive. Ethyl challenged a Canadian measure that banned the importation of and interprovincial trade in the additive. However, Canada settled the case before the NAFTA arbitration tribunal could render a

decision. The settlement was prompted by the ruling of a Canadian interprovincial panel, in a case unrelated to NAFTA, that found the measure to be illegal under Canadian law.

In the *S.D. Myers, Inc. v. Canada* case, the Canadian regulation banning the export of PCB waste to the United States was *discriminatory*. The



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NAFTA tribunal ruled that the ban was expressly enacted to direct environmental services work to Canadian companies — or as Canada's environment minister put it, "to ensure that the destruction of PCBs was done in Canada by Canadians." The measure

challenged in *S.D. Myers* was not a bona fide environmental regulation of general application, but rather a form of protectionism for the benefit of Canadian waste remediation companies.

Methanex Corp v. United States is often cited by environmentalist as the classic example of Chapter 11 inhibiting a government's right to regulate. The facts speak differently. Methanex, a Canadian marketer and distributor of methanol, has challenged a California ban on the in-state use or sale of MTBE, a gasoline additive manufactured using methanol. But on its merits, Methanex's case is expected to fail, in large part because the California measure is non-discriminatory: it affects Methanex no differently than the U.S. methanol industry. The NAFTA tribunal has already rejected a significant portion of Methanex's claims on jurisdictional grounds, and is just now proceeding to consider the merits of the limited claims that remain in the case.

The case of *Metalclad Corp. v. Mexico* again illustrates that typically it is illegitimate government measures, not bona fide environmental regulations, that are subject to NAFTA challenges. Metalclad had received assurances from the Mexican federal government that it had ob-

tained all the necessary permits for a waste disposal facility, but then was prevented from opening the facility by a local government's decision to deny a municipal construction permit. The NAFTA tribunal determined that the denial was in fact politically motivated and based on environmental considerations that were outside the local government's jurisdiction. Importantly, the tribunal did *not* rule that legitimate environmental laws would give rise to governmental liability. Rather, it found that Mexico had misled the investor, made promises it did not keep, imposed non-transparent, post-hoc licensing requirements that did not comply with Mexican law, and ultimately prevented the operation of the facility for arbitrary reasons. On appeal, a Canadian court upheld the NAFTA tribunal's finding that Metalclad's investment had been expropriated.

Investor to state arbitration procedures under Chapter 11 do not prohibit or inhibit the application of non-discriminatory environmental regulations. In the cases decided thus far, no NAFTA panel has struck down or questioned the validity of a bona fide environmental regulation. And while it is possible to posit a situation where a NAFTA panel could find an environmental regulation to inflict expropriation requiring compensation, such acts would also likely be a compensable "taking" under U.S. law as well. Just as the Fifth Amendment to the Constitution has not deterred legitimate environmental regulation, neither will Chapter 11 protections against expropriation.

Many groups are sounding dire warnings about the purported chilling effects of arbitrators' decisions under Chapter 11, but in doing so they ignore or gloss over the actual facts and track record of the NAFTA dispute resolution process. A careful, considered examination of the environment-related Chapter 11 cases to date reveals these to be only false alarms.

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legal rights on foreign investors than U.S. investors possess under U.S. law, it will produce enormous pressure on U.S. policymakers to provide domestic firms with the same type of protection from regulation that foreign firms possess.

The fact that the claims are for monetary relief, and not for injunctive relief, does not reduce the potential for Chapter 11 to interfere with government's ability to regulate. In a formal sense, a successful claim will not compel the government to stop regulating, but will only require the government to pay as a condition of doing so. But, as Justice Oliver Wendell Holmes said in a takings case many years ago, "Government hardly could go on if to some extent values incident to property could not be diminished without paying for every such change in the general law." If a federal regulatory program generated more than a few successful NAFTA claims, the program itself would be at risk. Likewise, if a state or local government program created liabilities for the United States, it is reasonable to suppose that Congress would soon act to preempt the program — and perhaps also attempt to transfer responsibility to pay accrued claims to the state or locality. Finally, there is a suggestion in the NAFTA implementing legislation that the federal government could sue to enjoin a state or local regulation that has been found to violate Chapter 11.

The significance of Chapter 11 has been difficult for the public and environmental policy experts alike to grasp — in large part because it is one component of a larger agreement focused on trade. Not surprisingly, criticism of Chapter 11 has been confused with opposition to free trade policies (such as reductions in tariffs), with supporters of Chapter 11 characterizing criticism of Chapter 11 as an anti free-trade position. In fact, some environmental groups criticize both free trade policies and the investor-state litigation process. In terms of substantive law and policy, however, the debate over the merits of Chapter 11 is entirely distinct from the debate over the merits of reducing barriers to trade in goods and services. One can be a free trader, and still be very concerned about Chapter 11.

Chapter 11 authorizes challenges to virtually any kind of government action, at any level, that impinges on the profitability of investments

The confusion between the investor litigation process and trade issues has meant that environmentalist critics' relatively powerful arguments against Chapter 11 have sometimes been overshadowed by the confusing posture of some critics, environmentalists in particular, on trade itself. Economists are in general agreement that, everything else being equal, reducing barriers to trade allows individual countries to exploit their comparative advantages and offers the prospect of improved social welfare on a worldwide basis. Thoughtful environmentalists do not oppose reaping these potential benefits of free trade in principle. Yet many of these same environmentalists oppose free trade policies because of their capacity to indirectly undermine environmental standards.

Environmentalists' basic concern with free trade derives from the lack of strong environmental protection standards in many other countries. In a competitive global economy, the lower environmental standards in other countries not only endanger the global commons but undermine the competitive position of U.S. companies subject to relatively stringent U.S. standards. This competitive disadvantage creates, in turn, political pressure that threatens to undermine U.S. environmental standards themselves.

Lacking the political strength to effect significant improvements in environmental standards in other countries, either by promoting environmental legislation in foreign countries or through international agreements, environmentalists are left to fight a proxy battle to preserve environmental standards by opposing free trade policies. Given the complex chain of logic by which certain environmentalists come to oppose free trade policies, it is no small wonder that the public is somewhat baffled by the environmentalist position.

Regardless of the complexities, and arguable weaknesses, of the environmental position on trade generally, the emerging consensus among environmentalists and their allies to oppose Chapter 11 appears straightforward and well-founded.

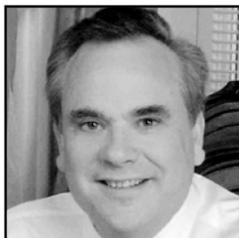
When State Governments Need An International Law Section

California's experience with NAFTA is a cautionary tale for all states and local governments. That experience has come through the claim for expropriation filed by the Canadian firm Methanex, and it brings to mind the rueful saying that no good deed goes unpunished — at least under Chapter 11 of NAFTA. Methanex's Chapter 11 claim seeks compensation for California's enactment of a ban on MTBE in gasoline, a ban adopted to protect its public drinking water supplies. What makes the claim alarming is that the ban is based on both good public policy and sound science, and would be upheld against a regulatory takings challenge in any federal or California court. What makes it even more alarming is that the MTBE ban was adopted with no thought to affecting international trade in any way. Unlike Massachusetts' failed attempt to stop buying goods from firms that do business in Burma, California was not trying to affect foreign policy or foreign trade; it was concerned solely with protecting its natural resources.

NAFTA's Chapter 11 has allowed Methanex to force the federal government — and by extension, California — to justify California's MTBE ban to an arbitral panel that is not made up of judges, that does not apply the legal standards and the deference to administrative agencies and elected policymakers that a federal or state court would apply, and whose sole reason for existence is an agreement to protect and promote international trade. The United States has had to litigate this matter, and California has suffered in uncertainty, for over two years already, with a hearing on the merits not even tentatively scheduled until spring of 2004.

A little background: MTBE is a petroleum-based additive that makes gasoline burn cleaner. But when spilled or leaked into drinking water, it makes that water smell and taste like turpentine at amazingly low

concentrations, rendering it flatly undrinkable. The City of Santa Monica has lost a significant portion of its groundwater wells to MTBE from leaking underground storage tanks at gas stations. MTBE virtually dives through the soil to groundwater, outpacing nearly every other component of gasoline in the swiftness of its movement, and causing contamination that is very difficult, if not impossible, to get out.



Bill Lockyer

Methanex does not make or sell MTBE. Instead, it makes methanol, which is a feedstock to the production of MTBE. When California banned MTBE in gasoline, Methanex lost a major market for its methanol, and it is the disappearance of that market that is the foundation of Methanex's claim. Lacking any takings claim that would not be laughed out of a federal or state court, Methanex filed a claim under NAFTA, alleging that California had committed an act "tantamount to expropriation" of Methanex's property by banning MTBE in gasoline.

The expropriation claim was eventually thrown out by the arbitration panel, but Methanex then shifted its ground to a secondary claim that California's governor deliberately enacted the ban in order to favor ethanol (a supposedly "domestic" product) and to disadvantage methanol (a supposedly "foreign" product), rather than enacting it to protect California's underground drinking water. That kind of deliberate discrimination, easy to allege but hard to prove or disprove, would violate NAFTA. In order to defend against it, California and the federal government are being forced to mount a full case, with toxicology, hydrogeology, and other experts, to prove that the ban was enacted for solid public health and public policy reasons, not to discriminate against "foreign" products.

The entire case has been a pain in the neck and a drain on California's resources. Personally frustrating for

me is that our own lawyers cannot even directly litigate the case, since only the three nations that signed NAFTA, not their political subdivisions, can be targets of a NAFTA claim. The U.S. State Department has defended California's regulations, and has done so ably and vigorously, surprising us with their cooperative attitude towards the state.

However, we may get our chance soon. Methanex has announced plans to seek discovery, including trying to take the deposition of the sitting California governor, to get evidence that would purportedly support its claim of discrimination. It can do that through an obscure federal law that allows a litigant in a foreign or international "tribunal" to ask a federal district court to issue subpoenas for evidence that it can use in that "tribunal." If Methanex tries this, I look forward to our first real chance to fight them directly.

My deepest concern is that the right side doesn't always win, even in a regular court of law. Should Methanex succeed in this arbitration, the federal government, not California, would be liable for the nearly \$1 billion Methanex has claimed. However, U.S. law allows the federal government to sue a state to invalidate a state law that violates NAFTA, and the specter of such a suit hovers in the background throughout this case.

The Methanex case is a cautionary tale for state and local governments. It shows vividly the vulnerability of state and local regulations, adopted with a solid scientific basis and no intent to affect foreign trade, to a claim under NAFTA — or, potentially, under GATT or World Trade Organization agreements — that siphons off critical state resources to defend, can't even be defended directly by the government that enacts it, and may ultimately result in federal preemption of the regulation. I never thought we'd have to set up an international law section in the California Attorney General's office, but that may be what the world has come to.

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Understanding NAFTA Chapter 11 is like trying to appreciate the dimensions of an elephant. As in the Buddhist parable, focusing on specific parts of the elephant is informative about its unique character but incomplete and ultimately misleading. Only by stepping away and viewing it as a whole can one appreciate how remarkable an elephant really is. Like the elephant's trunk and tusks, the features of Chapter 11 can be appreciated for their unique character one by one, but in the end the sheer size and grandeur of this elephant needs to be comprehended before one can conceive of what to do about it. So let's start:

Broad Jurisdiction. First, Chapter 11 vests extraordinarily broad jurisdiction in dispute resolution panels. It authorizes investors to challenge virtually any kind of government action, at any level, that impinges on the profitability of investments. It is defined as applying to government "measures," which has been interpreted to include essentially every type of law, regulation, contract, policy decision, or other governmental action affecting an investor. Actions challenged under Chapter 11 have included, among other things, traditional land use regulations, drinking water protection measures, and limitations on commercial timber sales.

One of the most remarkable conclusions of NAFTA panels has been that "measures" include judicial orders. Thus, in the *Loewen* case, a NAFTA panel has agreed to consider whether a Mississippi trial court's handling of a commercial fraud action against a Canadian firm, as well as the Mississippi Supreme Court's refusal to waive the requirement of a supersedeas bond, violated Chapter 11. In *Mondev*, a panel entertained (but ultimately rejected) a challenge to rulings of the Massachusetts Supreme Judicial Court in a case involving contract and tort claims by a Canadian firm against the City of Boston and the Boston Redevelopment Agency. These decisions create the alarming prospect of routine review of the rulings of U.S. courts by ad hoc NAFTA pan-

els which, as discussed below, possess none of the attributes of impartiality and independence associated with the U.S. judicial system.

Expansive Rights of Action. NAFTA creates a number of rights of action against the United States and the other parties to NAFTA. Several of these rights of action (for example, dealing with "performance requirements" and capital transfers) are specific to international investment activities. The most significant, however, are essentially restatements, in more expansive terms, of the very broad property-protective provisions of the U.S. Constitution.

Thus, the "National Treatment" provision of Chapter 11, which requires that each NAFTA country provide foreign investors "treatment no less favorable than that it accords, in like circumstances, to its own investors," is best understood as a transboundary version of the Equal Protection Clause. The "Minimum Standard of Treatment" provision, which requires each party to "accord to investors of another party treatment in accordance with international law, including fair and equitable treatment and full protection and security," is an international equivalent of the Due Process Clause. Finally, the provision on "Expropriation" states that "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 (d) on payment of compensation. This provision is roughly equivalent to the domestic Takings Clause.

The obvious question raised by these provisions is whether they are supposed to be interpreted to mean the same thing as the analogous provisions of the U.S. Constitution. The answer to this question is clearly "no." NAFTA states that these provisions are supposed to be interpreted according to their terms and "applicable provisions of international law," not in accord with U.S. domestic

Its language and some early decisions demonstrate that Chapter 11's rights of action are more expansive than the Constitution's protections

Citizens Panel Sees Faults And Suggests Reforms

Does the North American Free Trade Agreement's Chapter 11 protect the rights of foreign investors over the environment? That was one of the questions posed at a public workshop I hosted last March in Mexico City as Chair of the Joint Public Advisory Committee of the Commission for Environmental Cooperation—a trinational organization created under a side accord of NAFTA. The meeting galvanized the 150 participants and led JPAC to make several recommendations to the environment ministers of Canada, Mexico, and the United States.

The environment ministers, who compose the governing Council of the CEC, had agreed in June 2002 to facilitate public input into the work of the Chapter 11 Experts' Group of the NAFTA Free Trade Commission. JPAC sought to move the debate forward.

The controversy over Chapter 11 is primarily about its dispute resolution process, which first emerged as an issue in the 1990s, when foreign direct investment (FDI) became one of the main drivers of economic globalization, fueling international trade and development around the world. Global FDI increased from \$230 billion in 1990 to \$1.37 trillion in 2000.

This growth was supported by innovative provisions contained in Chapter 11 and by nearly 2000 bilateral investment treaties worldwide. While the economic benefits generated by the liberalization of investment flows are generally considered positive, the environmental and social impacts associated with the provisions of international investment treaties are the subject of an important debate among governments, academics, the private sector, and civil society.

Indeed, the perceived potential negative effects of Chapter 11, including the chilling effect on regulators and the use of its provisions as a weapon by some multinational corporations against environmental pro-

tection, are fueling distrust. This is one of the factors that ultimately led to the failure of the Multilateral Agreement on Investment, negotiated under the aegis of the OECD, and why an open and transparent debate is needed now more than ever.

For these reasons, the JPAC workshop focused debate on several issues surrounding Chapter 11. For instance, should the adoption of bona fide regulations, including environmental regulations, open the door to claims of expropriation and compensation by foreign corporations? And should an environmental, health, and safety exception be incorporated into Chapter 11 to allow governments the freedom to regulate without fear of having to compensate foreign corporations?

The resulting discussions were, needless to say, dynamic, and extremely productive. Through *Advice to the CEC Council on Seeking Balance between the Interests of the Public and Investors in the Application of Chapter 11*, JPAC recommended that the environment ministers instruct the CEC Secretariat to commission a series of research reports on Chapter 11 and its ramifications. JPAC has advised consideration of such topics as:

- The potential of a chilling effect on national laws and policies, particularly those related to human health and the environment;
- The impact of concentrated investment in specific areas (i.e., border regions and "pollution havens");
- Lessons learned over the past 10 years and how the Chapter 11 experience might contribute to existing and future trade agreements;
- Evaluating the pros and cons of pursuing the development of "interpretative statements" of Chapter 11;
- Analysis of institutional and other capacity-building needs to permit all three countries to properly and equitably implement the Chapter 11 provisions;
- The need for environmental impact and risk assessment prior to the

negotiation of new trade agreements;

- How broader cultural and social issues, including understanding and cultural diversity, can be integrated into the Chapter 11 process; and,

- Assessing the opportunities that past and upcoming bilateral trade agreements might offer to advance improved versions of Chapter 11 and how they might in turn affect the way NAFTA operates.

In addition, public policy concerns remain in the implementation of the Chapter 11 investor-dispute regime. JPAC therefore urged the CEC Council to address these concerns by pursuing improvements to NAFTA and Chapter 11 to ensure transparency, accountability, and legitimacy. Our suggestions include:

- Engaging in and providing resources for public outreach;

- Supporting the establishment of a structured public process (including the ability to attend tribunal hearings, submit amicus briefs, and have access to the information necessary for informed participation); and,

- Including environmental, social, and cultural expertise in the arbitration panels.

Finally, JPAC advised the Council to pursue cooperation with the NAFTA Free Trade Commission to achieve the environmental goals and objectives of NAFTA. Specifically, JPAC believes that active collaboration among trade and environment ministers and officials would demonstrate the governments' commitment to the sustainable development objectives of NAFTA.

At the 10th regular session of the CEC Council in June in Washington, D.C., JPAC will raise these issues directly with the environment ministers in the spirit that informed our meeting in Mexico.

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Gustavo Alanís

law. Indeed, it is the consensus among lawyers litigating Chapter 11 cases that U.S. judicial precedents are not even relevant authority. Chapter 11 claims may roughly duplicate U.S. constitutional claims, but they are adjudicated in a completely different universe.

The next question, assuming U.S. law does not govern, is whether Chapter 11 is more protective, or less protective, of foreign investors than U.S. law. Answering this question based on the language of Chapter 11 is difficult because the language is nearly as delphic as the analogous provisions of the Constitution. Moreover, there is little precedent on the meaning of international law in the investment context. In a sense, the meaning of the provisions of Chapter 11, less than a decade following the adoption of NAFTA, is as indeterminate as the meaning of the analogous provisions of the Bill of Rights when they were freshly minted. It is very difficult to predict in what direction the process of interpretation will take the NAFTA language. In addition, it is uncertain whether the meaning of the provisions of Chapter 11 will ever become truly settled, given that panel decisions are not supposed to have precedential effect and there is no appellate mechanism for resolving conflicts between different panel decisions.

Despite the major uncertainties about how the provisions can and should be interpreted, both the language of Chapter 11 and some of the early panel decisions demonstrate that the rights of action under Chapter 11 are more expansive than the protections provided by the analogous provisions of the Constitution. For example, whereas the Constitution's Takings and Due Process Clauses protect "property" interests, the provisions of Chapter 11 apply to "investments," encompassing a broader range of business interests and activities. In addition, background principles of state property and nuisance law limit the scope of property interests which qualify for protection under the Takings Clause. There is no obvious basis for thinking that the same limitations apply in suits brought under Chapter 11.

Recent panel decisions have adopted interpretations of the provisions of Chapter 11 which are more expansive than the established interpretations of the analogous constitutional provisions. For example, in the *Metalclad* case, it has been observed that the panel adopted "an extremely broad definition of expropriation" which would "include a legitimate rezoning of property by a municipality or other zoning authority." Under U.S. law, by contrast, rezoning decisions are generally viewed as not subject to challenge under the Takings Clause. More recently, in the *Feldman* case, a panel ruled that a mere showing of differential treatment shifts the burden to the government to justify the challenged measure. Applying this standard, the panel reached the conclusion that it was a violation of the "national treatment" provision for Mexican tax authorities not to grant a U.S. investor the same tax rebate that they had granted a Mexican firm. This standard plainly conflicts with the deferential standard applied by U.S. courts in reviewing tax legislation under the Equal Protection Clause.

Broad Abrogation of Immunity. Proceeding to the next part of the elephant, Chapter 11 abrogates, or at least ostensibly abrogates, U.S. sovereign immunity to a far greater degree than Congress has abrogated the immunity of the United States in U.S. courts.

Domestically, Congress has created a complex mosaic on immunity, preserving immunity in some instances and waiving it in other others, carefully balancing the value of providing aggrieved citizens the ability to sue their government against the value of preserving government officials' freedom of action by not over-burdening government with legal challenges. Thus, the Federal Tort Claims Act creates a broad waiver of immunity from tort claims, but preserves government immunity from claims based on the exercise of "discretionary functions." To pick another example, in the Tucker Act, Congress waived immunity from claims for monetary relief that rest on the Constitution. But because the Takings Clause is the only "money-

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mandating" provision of the Constitution, the Tucker Act only waives immunity from monetary claims under the Takings Clause. Plaintiffs cannot sue the United States under the Tucker Act for monetary relief based on the Due Process or Equal Protection Clauses.

Chapter 11 ostensibly dispenses with sovereign immunity altogether, apparently permitting recovery of money damages against the United States to the full extent of the rights of action created by Chapter 11. This, at least, is the interpretation embraced so far by firms that have sued under Chapter 11 and the panels hearing the claims. If this is the correct reading, it would mean that Chapter 11 confers significantly greater rights on foreign investors than U.S. investors possess under U.S. law. For example, all investors, domestic and foreign, can sue in U.S. courts under the Equal Protection Clause and the Due Process Clause for injunctive relief. However, if Chapter 11 is as broad an abrogation of sovereign immunity as supporters contend, foreign investors (but not domestic investors) can also sue for monetary relief on equal protection or due process claims in Chapter 11 proceedings.

One plausible alternative view is that NAFTA cannot actually be read as effecting such a sweeping abrogation of sovereign immunity. The Supreme Court has repeatedly said that Congress can abrogate sovereign immunity only by doing so in express terms. Congress arguably did not effect an express waiver when it approved NAFTA. A waiver of immunity might possibly be inferred from the language of Chapter 11, but Congress merely approved NAFTA and did not actually adopt it as a U.S. statute. The federal legislation implementing NAFTA states that, in the event of a conflict between NAFTA and any provision of U.S. law, U.S. law is to prevail. Because sovereign immunity is a basic, longstanding feature of U.S. law, this provision arguably means that NAFTA cannot properly be viewed as an effective abrogation of immunity. It remains to be seen whether this alternative view prevails, but in the meantime Chapter 11 continues to be implemented under the quite

radical premise that it does away with sovereign immunity completely.

Exclusive Investor-Protection Focus. The broad scope of Chapter 11 is reinforced by the fact that it is part of a larger agreement the single, overarching purpose of which is to promote trade and investment. One of NAFTA's principal, stated objectives is to "increase substantially investment opportunities," and the agreement itself directs that it be interpreted and applied in accordance with this objective. Some panels have taken this mandate as a charge to read Chapter 11 with a distinctly pro-investor, anti-government slant. Thus, rather than placing the burden on a claimant to show that a government action violates NAFTA, some panels have placed the burden on the government to show that it has adopted the least trade-restrictive means to achieve its goals.

This approach contrasts with the traditional approach U.S. courts take in interpreting the property-protective provisions of the Constitution. The primary function of the

Constitution was to create representative institutions operating within a system of separation of powers. The provisions of the Constitution protecting property rights, as important as they are, appear in an appendix, literally a historical afterthought to the Constitution. In keeping with the constitutional design, U.S. courts have read the property-protective provisions of the Constitution narrowly. This deferential approach recognizes that the political branches, not the courts,

Inverting the usual order, panels have placed the burden on the government to show that it has adopted the least trade-restrictive means to achieve its goals

have primary responsibility for setting and resetting social policy.

NAFTA, because of its exclusive emphasis on promoting investment and trade, threatens to invert the United States' traditional constitutional order. There is no suggestion in the text of Chapter 11, and precious little in the panel decisions issued to date, that panels interpreting Chapter 11 should give any particular deference to the policy judgments of elected representatives. Thus, NAFTA as a whole reinforces the conclusion that Chapter 11 was intended to, and likely will, accord foreign investors greater

legal rights to challenge U.S. environmental standards than U.S. investors possess.

Non-Independent Panels. Proceeding further, the panels hearing Chapter 11 claims are very different from traditional U.S. courts, and the differences increase the risk that Chapter 11 litigation will threaten U.S. environmental policies. The Chapter 11 litigation process, though it involves private investors suing governments, was modeled after the international commercial arbitration process originally designed to resolve conflicts between private firms. Panels consist of three members, with one appointed by the claimant, the second by the government defendant, and the third either by agreement of the parties or by an international arbitration organization.

The composition of the panels makes it all but inevitable that their interpretations of Chapter 11 will diverge significantly from U.S. law. The majority of panelists in cases brought against the United States are not U.S. citizens and are not trained in U.S. law. Thus, even if they were required or permitted to consult U.S. precedents — they are not — Chapter 11 panels will tend to create a distinctive body of law. As if to underscore the irrelevance of U.S. law, the United States' chief legal representatives in Chapter 11 proceedings are not lawyers from the Department of Justice but, rather, lawyers assigned to a special unit in the State Department. Furthermore, the rules governing NAFTA proceedings say that the chairpersons of the arbitration panels should have "recognized competence in the fields of law, commerce, industry, or finance." These requirements mean that few if any will have expertise in environmental regulatory policy, creating a substantial risk that panels will have a pro-business (and possibly anti-environmental) bias.

NAFTA panel members also lack most of the attributes of office U.S. lawyers and jurists view as necessary for an independent and impartial judiciary. Panel members' terms are neither for life (like U.S. federal judges) nor even for fixed terms (as in many states), but instead last only for the duration

of the single proceeding for which they are selected. In addition, service on a NAFTA panel is not generally a panel member's exclusive employment. Individuals who specialize in the field of international investment law commonly switch back and forth between the role of panel member in one case and counsel for a claimant in another.

There is a general mandate in the rules governing NAFTA cases that panel members should be persons who can exercise "independent judgment." But the potential for conflicts of interest is pervasive and serious.

Including party-appointed members on the panel raises obvious potential problems of bias. The Model Rules of Professional Conduct effectively sanction such conflicts of interest by creating an exception, for a party-appointed arbitrator on a multi-member panel, from the normal rule that a former judge or arbitrator cannot represent anyone in connection with a matter in which he or she served as a judge or arbitrator. Also, major law firms advertise the experience of their attorneys as

both NAFTA panel members and counsel for NAFTA claimants, implicitly suggesting that service by the firm on NAFTA panels will somehow be of value to clients seeking recovery under Chapter 11.

No Intervention Rights. The Chapter 11 litigation process accords third parties none of the intervention rights, either by right or as a matter of court discretion, that exist under U.S. court rules. Given the frequency with which government policies relating to environmental issues affect the interests of third parties, and the frequency with which government officials fail to defend third-party interests in environmental cases, intervention rights have proven vital to the enforcement of environmental standards. Instead of providing a right of intervention, Chapter 11 allows only the relatively anemic option of amicus participation, and then only apparently with the concurrence of the panel members hearing any particular case.

Concentrated Power in the Executive Branch. Finally, Chapter 11 represents a threat to U.S. environmental laws because it

The composition of the panels makes it all but inevitable that their interpretations of Chapter 11 will diverge significantly from U.S. law

undermines the principle of separation of powers which is so central to the deliberative democratic process in the United States.

Starting with the adoption of trade and investment agreements, Congress considers these agreements pursuant to so-called fast track procedures, under which Congress can approve or reject agreements negotiated by the president, but cannot amend them. These procedures weaken Congress's traditional power to shape the content of legislative measures. In addition, NAFTA panel members selected by the United States are chosen solely by the Executive Branch. This innovation obviously dilutes the traditional power of the Senate to "advise and consent" on nominees to the judicial branch. The fact that panels members are appointed only for single cases similarly dilutes the traditional independence of the judiciary from other branches of government. Finally, NAFTA authorizes the member nations, acting through executive officials, to negotiate binding interpretations of the meaning of specific provisions of Chapter 11. Given the generality of the language of Chapter 11, this power to interpret represents extraordinary power to determine and, in effect, redefine the meaning of Chapter 11.

The radical injury that Chapter 11 inflicts on the principle of separation of powers can be illustrated by imagining what the U.S. constitutional system would look like if it were revised to conform to the NAFTA model. The Executive could demand that Congress approve or disapprove all legislative proposals, with no opportunity in Congress to discuss amendments or revisions. Federal judges would be selected by the president, without any input from the Senate. Finally, if the Executive Branch were displeased with the interpretations its judicial appointees gave to the legislative measures it initiated, it could unilaterally issue interpretive statements that would be binding in future cases. It is no understatement to say that the U.S. system of government as we know it would be destroyed.

The extraordinary concentration of power

in the Executive Branch under Chapter 11 increases the risk that transfer of political control over a single branch of government could bring about a radical change in U.S. environmental policies. The system of separation of powers, though obviously inefficient and time-consuming, ensures that major policy changes occur only after thorough deliberation and based upon broad agreement. Chapter 11 sacrifices the values of deliberation for the sake of efficiency, putting environmental protections (and many other public policies) at risk.

How might the United States revise its approach to the investor-state litigation process to reduce the threat to its environmental policies? The question is a timely one because the Bush administration is actively pursuing a number of bilateral trade and investment agreements with different countries around the world. President Bush recently signed new agreements with Chile and Singapore. These agreements include investor-state litigation provisions that are essentially identical in all important respects to Chapter 11. On the horizon are a Free Trade Agreement of the Americas, and a possible international investment agreement under the auspices of the World Trade Organization.

There has been growing resistance in Congress to the investor-state litigation process. In 2002, Con-

gress approved new trade legislation which, in response to the growing criticism of Chapter 11, included a mandate that foreign investors be accorded "no greater substantive rights" under investment agreements than U.S. investors possess under U.S. law. In the words of then Senate Finance Committee Chair Max Baucus (D-Montana), the sponsor of the amendment adding this language, "The rights of U.S. investors define the ceiling. Negotiators must not enter agreements that grant foreign investors rights that breach that ceiling." This provision responds both to the apparently broad scope of the United

The litigation process accords third parties none of the intervention rights, either by right or as a matter of court discretion, that exist under U.S. court rules

States' potential liability to foreign investors under Chapter 11 and to the perceived unfairness of granting foreign investors greater legal rights than U.S. citizens possess in their own country.

As the preceding discussion has hopefully made clear, altering the approach taken in Chapter 11 to comply with this new mandate will be a major challenge. Chapter 11 is expressly based on the premise that the law governing its proceedings is entirely distinct from U.S. law. Moreover, every feature of the litigation process, from the appointment of non-U.S. lawyers to sit on the panels to the virtual exclusion of the Department of Justice, reinforces the point that Chapter 11 is designed to, and will in fact, produce legal rules that diverge from U.S. legal norms.

Compliance with both the letter and the spirit of the 2002 trade law should lead to a quite different approach. One straight-forward option would be to abandon the investor-state litigation process altogether, on the theory that creating an independent litigation process for the benefit of foreign investors cannot be squared with Congress's express desire to ensure that foreign investors not be accorded greater rights than U.S. citizens. Another alternative would be to revise the Chapter 11 litigation process to provide for appellate review of panel decisions by U.S. federal courts and to authorize U.S. courts to review panel decisions to ensure that the legal standards they apply do not depart from U.S. law. This proposal would inevitably encounter the objection that preserving U.S. sovereignty in this fashion would undermine U.S. efforts to use the investor-state litigation process to protect the interests of U.S. investors operating in other countries. But this objection simply reflects the fact that the United States may not be able to have it both ways: it cannot reasonably seek to preserve its sovereignty and also establish a litigation process designed to override the sovereignty of other nations. The 2002 trade law apparently reflects Congress's judgment to make preservation of U.S. sovereignty the higher priority.

A radically different approach would be to embrace the need for, and perhaps the in-

evitability of, a comprehensive system of international dispute resolution, to address not only investment issues but a whole host of other issues as well. But to be consistent with democratic ideals, this approach would require rethinking the entire international law-making process. Following the relatively successful U.S. constitutional model, the international community could create a world legislative body, both to prescribe substantive law and to review and pass on judicial appointments. Judges on world courts could be granted lifetime tenure and salary protection,

ensuring that, as our society becomes more international, we preserve the benefits of an Article III-type judiciary. To complete the picture, perhaps a popularly elected world executive officer would be required.

Needless to say, the political viability of this suggestion appears to be nil, at least for the foreseeable future. On the other hand, the approach exemplified by Chapter 11 of selectively embracing internationalism in a fashion which benefits investors but undermines U.S. con-

stitutional institutions also seems untenable. If the United States remains committed to preserving the values underlying the U.S. constitutional system, it must shape its policies on trade and investments in a fashion which respects those values. If the United States remains true to preserving the values of its constitutional ideals, Chapter 11 and similar measures must be rejected.

The Contract with America's short life essentially ended with the close of the 104th Congress in January 1997. But Congress, apparently in profound ignorance of what it was unleashing, embraced the Chapter 11 model of a "takings" provision in NAFTA in 1994, so this provision actually began with and has outlived the Gingrich Revolution. Accordingly, the effort to defeat the real Contract on America, the expanding international version, will inevitably be more complicated and time-consuming. However, at the end of day, I suspect, the outcome will be the same, as Americans realize that their constitutional values and environmental quality are at stake. •

It undermines separation of powers: judges are in the executive branch, which also interprets the meaning of Chapter 11 provisions