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Skirting the Law;
Under NAFTA, foreign companies can avoid American courts

By Mike McKee

Ten months ago, then-Gov. Gray Davis signed legislation that essentially stopped work at a Canadian-owned gold mine at the foot of the Chocolate Mountains in the deserts of Imperial County.

The bill, which requires the complete restoration of metallic mines, was applicable to all companies. In truth, it was directly aimed at shutting down a Glamis Gold Ltd. mine by making it too expensive to operate, and effectively safeguarding the "Trail of Dreams" - a nearby 130-mile-long sacred site of the Quechan Indian Tribe.

"This measure," Davis said, "sends a message that California's sacred sites are more precious than gold."

Glamis, a British Columbia company that has owned the Imperial Mine for 17 years, struck back in December - not against California, but against the federal government in an arbitration before the United Nations. Glamis alleges that California violated the North American Free Trade Agreement by shutting the mine, and demands damages of more than $50 million.

Using NAFTA to avoid litigation in U.S. courts is a strategy that's catching on quickly. Companies in Canada, Mexico and the United States are filing complaints under the trade agreement's Chapter 11 provision, which lets them appear before three-member international arbitration panels - rather than the nations' individual courts - to attack state, provincial and federal laws they believe are illegal or discriminate against foreign businesses.

The practice has segments of this country's legal community in an uproar.

"It's easy to see that this system could become enormously significant and supplant the jurisdiction of the nation's courts," said John Echeverria, executive director of the Georgetown Environmental Law and Policy Institute. "It's a completely parallel set of legal institutions."

The panels meet in secret, are not bound by precedent and issue rulings that cannot be appealed - and some say they have unprecedented power to overrule American courts, even the U.S. Supreme Court. Echeverria says there's real concern that a "revolutionary change" is under way in the structure and organization of the American judicial system. Even U.S. Supreme Court Justice Sandra Day O'Connor has written a paper stating that handing over authority to international tribunals "presents a very significant constitutional question."

A report by consumer advocacy group Public Citizen warns that these so-called "investor-to-state dispute resolutions" would let private investors and corporations seek monetary damages for "any government policies or actions" they believe violate their rights under NAFTA.

"If a corporation wins its case," the report states, "it can be awarded unlimited amounts of taxpayer dollars from the treasury of the offending nation even though it has gone around the country's domestic court system and domestic laws to obtain such an award."

Proponents of the NAFTA rules, however, believe the legal community's worries are mostly overblown.

"The fact of the matter is that the protections provided under Chapter 11 are the same kinds of protections U.S. investors are seeking overseas," says Alan Gourley, a partner in Washington's Crowell & Moring who represents Glamis in its fight with California. "And these protections are the minimum you would expect a nation to provide to ensure the free flow of capital into the country."

But groups such as the National Association of Attorneys General, the Conference of Chief Justices and the National Conference of State Legislatures have taken stands against NAFTA's rules, and petitioned Congress to protect

the American judicial system. Several states' AGs have also contacted congressional representatives. The AGs are troubled by the fact that they aren't even allowed to defend their own laws: That's the State Department's job.

In the Glamis case, Davis' action came six months after Gale Norton, Bush's interior secretary, rescinded a Clinton-era decision that had kept the mine inoperative under federal law.

"That raises the question," California Attorney General Bill Lockyer says, "How aggressively does the U.S. State Department defend our position when a sister agency, the Department of Interior, is on the other side of the issue? I don't know the answer to that."

U.S. UNDEFEATED, SO FAR

To date, only eight complaints, two involving California, have been filed against the United States, but they have taken aim at a broad range of American laws, and have sought billions of dollars in damages.

Among them, a Quebec forest products company has challenged federal rules on the importation of lumber. An Ontario business, which manufactures industrial products from hemp, has attacked U.S. drug laws that bar the sale of products containing THC, the main ingredient of cannabis. And a Quebec engineering company unsuccessfully took on a "Buy America" law that allowed only U.S. steel to be used in state highway projects.

The arbitration panels haven't ruled against the United States yet. But Canada and Mexico, also subject to the rules, haven't been as lucky.

Out of four complaints, Canada has been ordered to pay about $462,000 to an Oregon wood products company, while Mexico, served with eight complaints, was told to pay $16.7 million to a Minnesota waste disposal corporation.

The closest the United States has come to losing a case involved a Mississippi lawsuit, and it unnerved American judges and lawyers because an arbitration panel comprised of an American, an Australian and a Briton almost overruled the Mississippi Supreme Court. The panel denied a Canadian firm's claim in a $175 million case without reaching the merits, but still stated that it felt the Mississippi ruling was unconstitutional.

"But for a small legal technicality," Georgetown's Echeverria says, "they would have declared the rulings of the Mississippi courts a violation of law."

Lockyer says there's the possibility that could happen to any state or U.S. Supreme Court ruling. "And that loss of sovereignty and finality troubles the justices," Lockyer adds.

It also bothers many that NAFTA seems to give foreign parties more rights than native-born Americans by letting them demand payment for any government action that affects the value of their property or enterprise.

According to the Public Citizen report, "Such a notion of 'regulatory takings' does not exist for U.S. citizens or companies because it has been rejected by Congress and the courts. In short, these NAFTA cases are giving foreign investors greater rights and remedies on U.S. soil than are available to U.S. companies here at home."

If American judges and lawyers want someone to blame for NAFTA's conditions, they need only point the finger at their own federal government.

The United States, in its dealings with less developed countries, has always insisted on trade agreements that include neutral forums where American companies can arbitrate disputes independently of those nations' courts, experts on both sides say. The tables are now turned.

"When developed countries, such as the U.S., started exporting capital to other countries, it was considered necessary that bilateral investment treaties have an independent dispute resolution mechanism built into them," says J. Brian Casey, a partner in the Toronto office of Chicago's Baker & McKenzie. "The idea was to remove the possibility of a local court or government treating a foreign investor unfairly or in a manner not consistent with internationally recognized rules of law."

Casey represents Methanex Corp., a British Columbia company that's seeking $1 billion in damages from the United States because of California's ban on MBTE, a gasoline additive and suspected carcinogen. The company makes methanol, a prime ingredient of MTBE, and argues that California essentially has expropriated its investments.

As Georgetown's Echeverria puts it: "The chickens have come home to roost." He says the United States is just now confronting the "pitfalls" of a system it has pushed on less developed countries over the years.

Defenders of the process, he says, say that opening up the United States for foreign claims under NAFTA is the "necessary quid pro quo" that will let American corporations continue to sue countries in neutral forums, "rather than in the domestic courts of those nations, which often are alleged to be incompetent and, at worst, corrupt."

Some are worried about what would happen if NAFTA's arbitration provisions are incorporated into other trade agreements.

"Our recent experience under NAFTA demonstrates how drastically such provisions in international trade agreements can depart from American constitutional standards," Lockyer wrote in a letter to California senators Barbara Boxer and Dianne Feinstein. "Although NAFTA applies only to Canada, the United States and Mexico, pending trade legislation could potentially subject the United States to liability to foreign investors from any nation."

A RANGE OF POLICY AT STAKE

Most of the cases against the United States to date have alleged illegal takings, but Echeverria points out that there are no limits. Suits could cover "everything from domestic tax administration to restrictions on cigarette advertising to drinking-water protection measures."

Indeed, while the two California cases are basically takings suits, both attack state environmental laws.

Some officials find that disturbing. While foreign investors can only seek monetary damages under NAFTA, there are concerns that the federal government might pressure for revisions in state laws if pummeled with large judgments.

"If an arbiter imposed huge financial sanctions, that might change California law as a practical matter," Lockyer says. "Depending on the view of your own government, you could be changing [your laws], or your government might be abrogating or overriding state law."

He points to Department of Transportation's decision, in a non-NAFTA case, to permit Mexican trucks full access to United States highways. Responding to a suit by the Teamsters and the California Trucking Association - to which California supplied an amicus curiae brief - the Ninth Circuit U.S. Court of Appeals put a stop to the plan last year, and demanded that the feds conduct environmental impact studies.

"That's one where the U.S. government is trying to pre-empt California laws," Lockyer says. "[The Mexican] fleet is very dirty compared to California standards."

Casey, the Baker & McKenzie lawyer, says a foreign party still has to show that it has been treated unfairly or that its property was taken without compensation - "something which has not yet been demonstrated to be easy.

"International panels have not rewritten generally understood law in this area, nor have they demonstrated a desire to go beyond generally accepted views of basic international law," Casey says. "The fears vocalized by some have, to date, proved to be ill-founded."

Casey says there have been some rumblings about the process in Mexico and Canada, but nothing to the extent of the discussion in America. Even so, Congress has taken no steps to change the system.

Some lawyers and judges question whether the international arbitration panels would survive constitutional scrutiny. After all, they say, Article III of the U.S. Constitution gives only the federal courts the power to decide cases and controversies, and says Congress cannot delegate the "essential attributes of judicial power" to any other body.

Georgetown's Echeverria says that issue is slowly bubbling to the surface.

"How can the United States be approving these arrangements?" he says. "Sooner or later, probably sooner than later, the courts themselves are going to have to confront the question of whether these arbitration panels violate the U.S. Constitution."

Meanwhile, the California AG's office can only hope and pray that the State Department does its best at defending California's laws.

"It's no secret," says Oakland-based Deputy AG Marc Melnick, a state expert on NAFTA issues, "that the Bush administration is not really a friend of California."

Associate Editor Mike McKee's e-mail address is mailto:mmckee@therecorder.com .