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COMPENSATION FOR “MEASURES TANTAMOUNT TO EXPROPRIATION” UNDER NAFTA: WHAT IT MEANS AND WHY IT MATTERS

*Jeffrey Turk**

I. INTRODUCTION

The U.S. implementing legislation pursuant to the North American Free Trade Agreement (NAFTA) was signed into law on December 8, 1993 by President William J. Clinton amidst a swarm of controversy.¹ The agreement created a free trade zone between Mexico, Canada, and the United States. Much of the initial discussion in the United States involving NAFTA centered on its constitutionality and the benefits of free trade between the three signatories in general.² In recent years, the debate has largely shifted to the investment rights provisions detailed in Chapter 11. This chapter has been described as “the biggest threat to United States judicial independence that no one has heard of and even fewer people understand.”³ Senator John Kerry, expressing his disapproval of the provision, stated, “not a single word was uttered in discussing Chapter 11. Why?”

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¹ See JEFFREY DUNOFF ET AL., *INTERNATIONAL LAW: NORMS, ACTORS, PROCESS* 289 (Aspen Pubs. 2002).

² See, e.g., *Made in the USA Found. v. United States*, 242 F.3d 1300 (11th Cir. 2001); see also 139 CONG. REC. E3128-02 (1993) (statement of Rep. Frank).

³ Adam Liptak, *Review of U.S. Rulings by Nafta Tribunals Stirs Worries*, N.Y. TIMES, Apr. 18, 2004, at A20.

Because we didn't know how this provision would play out. No one really knew just how high the stakes would get."⁴ Abner Mikva, a former congressman, and a member of a tribunal established under Chapter 11 opined that "[i]f Congress had known that there was anything like this in NAFTA they would never have voted for it."⁵

The clause generating this discussion enables investors from member countries to bring personal claims against NAFTA governments for expropriating property and provides for the recovery of damages.⁶ Due to a lack of clarity in NAFTA's express language, and the paucity of final arbitral decisions interpreting Chapter 11, the extent of this right is still unclear.

Although NAFTA is relatively new, the debate over the international law standard governing expropriation has been rooted in North American politics since at least the beginning of the twentieth century. In 1915, Mexico began nationalizing private property belonging to U.S. citizens.⁷ Mexico maintained that they had a right under international law to deny compensation for "expropriations of a general and impersonal character."⁸ The United States however, supported the Hull Doctrine, named after Secretary of State Cordell Hull, which asserts: "no government is entitled to expropriate private property; for whatever

⁴ *Id.*

⁵ *Id.*

⁶ See Ray C. Jones, *NAFTA Chapter 11 Investor-to-State Dispute Resolution: A Shield to Be Embraced or a Sword to be Feared*, 2002 B.Y.U. L. Rev. 527 (2002); see also Mary Bottari, *NAFTA's Investor "Rights": A Corporate Dream, A Citizen Nightmare*, MULTINATIONAL MONITOR, Apr. 1, 2001, at 9.

⁷ See DUNOFF, *supra* note 1, at 71.

⁸ *Id.*

purpose, without provision for prompt, adequate, and effective payment therefor.”⁹ While NAFTA seems to have codified the U.S. position in most cases, some believe that exceptions to this rule still exist.

This paper attempts to delineate the scope of the right to recover for the expropriation of property under NAFTA, and address the implications of this right. It also discusses and rejects the arguments for broad exceptions to the general rule of compensation for regulatory expropriations enacted for environmental or social purposes. Part II provides a basic overview of the relevant portions of Chapter 11, Part III surveys some of the major claims that have been submitted for arbitration, and Part IV offers a framework for deciding which “expropriations” are compensable.

II. OVERVIEW OF CHAPTER 11

NAFTA’s expropriation provision is contained in Article 1110, which states:

No Party shall 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 non-discriminatory basis;
- (c) in accordance with due process of law and the general principles of treatment provided in Article 1105; and
- (d) upon payment of compensation¹⁰

Additionally, Chapter 11 creates a unique remedial mechanism for the enforcement of this provision. Unlike traditional dispute resolution proceedings, such as

⁹ Letter from Cordell Hull, Secretary of State, United States, to the Mexican Ambassador 1 (Aug. 22, 1938) reprinted in DUNOFF, *supra* note 1, at 71.

¹⁰ See North American Free Trade Agreement, Dec. 17, 1992, Can.-Mex.-U.S., 107 Stat. 2057, 32 I.L.M. 605 [hereinafter NAFTA].

that employed by the World Trade Organization (WTO), that grant jurisdiction only when a government asserts a claim, NAFTA gives individual investors the ability to bring claims on their own behalf.¹¹ The stated purpose for the procedure is to provide “a mechanism for the settlement of investment disputes that assures both equal treatment among investors of the Parties in accordance with the principle of international reciprocity and due process before an impartial tribunal.”¹²

In addition to the fulfillment of these goals, the NAFTA Chapter 11 procedure increases the potential for a large number of claims. Individual investors usually only consider their own economic interests when deciding whether to initiate dispute resolution proceedings, whereas national governments are inclined to take other factors into consideration.¹³ Such factors frequently dampen enthusiasm for international litigation, and may have foreclosed many claims. Commentators disagree about the merits of bypassing the restraining influence of government discretion and allowing investors to bring claims on their own behalf. Supporters assert that Chapter 11 forces host states to abide by their commitments, while opponents claim that the procedure gives investors an “unencumbered stick” to use against member states with policies adverse to their interests.¹⁴

¹¹ *Id.* art. 1116(1).

¹² *Id.* art. 1115.

¹³ Joseph A. Strazzeri, *A Lucas Analysis of Regulatory Expropriations Under NAFTA Chapter Eleven*, 14 GEO. INT'L ENVTL. L. REV. 837, 845 (2002).

¹⁴ See Jason L. Gudofsky, *Shedding Light on Article 1110 of the North American Free Trade Agreement Concerning Expropriations: An Environmental Case Study*, 21 NW. J. INT'L L. & BUS. 243, 249 (2000).

Foreign investors may file a claim six months after a NAFTA party has allegedly violated Chapter 11, and up to three years after the investor knew or should have known of the breach.¹⁵ Disputes can be submitted to a tribunal convened by either the International Center for Settlement of Investment Disputes (ICSID) or the United Nations Commission on International Trade Laws (UNCITRAL).¹⁶ Additionally, the arbitrators are instructed to “decide the issues in dispute in accordance with [NAFTA] and applicable rules of international law.”¹⁷ Arbitral awards have no binding precedential value, and rulings are limited to the particular facts of each case.¹⁸

Remedies for breach of Article 1110 include monetary damages with interest and the restitution of property, but remedies may never include punitive damages.¹⁹ Investors who prevail at arbitration can enforce the award under the New York Convention, which provides for collection of arbitral awards.²⁰ Review of the award is possible, however, and disappointed parties can appeal the ruling in a domestic court of the country where the arbitration took place.²¹

III. CASES SUBMITTED UNDER CHAPTER 11

Since Chapter 11 came into effect, International Tribunals have issued decisions addressing investor rights to compensation for expropriation in eleven

¹⁵ NAFTA arts. 1117(2), 1120(1).

¹⁶ *Id.* art. 1120.

¹⁷ *Id.* art. 1130.

¹⁸ *Id.* art. 1135(1).

¹⁹ *Id.* art. 1134.

²⁰ *Id.* art. 1135(7).

²¹ *See* Jones, *supra* note 6, at 536.

cases.²² This section provides a brief sketch of two noteworthy examples. These cases show the practical ways in which international investors have invoked Chapter 11, and the ways in which Tribunals have confronted the issues. The cases also offer a glimpse of how similar cases may be handled in the future. Although these decisions do not carry precedential weight, tribunals typically look to earlier cases for direction in making awards, and have historically accorded such decisions some weight.²³

A. Metalclad Corp.

COTERIN, a Mexican corporation, operated a hazardous waste transfer station in the Municipality of Guadalcázar, Mexico beginning in 1990.²⁴ On September 26, 1991, the Federal Government of Mexico closed the site, and COTERIN applied to the municipality for a permit to construct a hazardous waste landfill at the site. This application was rejected.²⁵ In April 1993, Metalclad Corp., a California based company, entered into an option agreement to purchase COTERIN. Metalclad continued construction at the site, which was officially completed in March 1995. Through negotiations with the federal government,

²² These cases include *Loewen Group, Inc. v. United States*; *Methanex Corp. v. United States*; *Mondev International Ltd. v. United States*; *Ethyl Corp. v. Canada*; *S.D. Myers, Inc. v. Canada*; *Pope & Talbot, Inc. v. Canada*; *Azinian v. United Mexican States*; *GAMI Investments Inc. v. United Mexican States*; *Feldman v. United Mexican States*; *Metalclad Corp. v. United Mexican States*; and *Waste Management, Inc. v. United Mexican States*. For a complete list of cases submitted under Chapter 11, see U.S. DEPT. OF STATE, NAFTA INVESTOR STATE ARBITRATIONS, at <http://www.state.gov/s/l/c3439.htm> (last visited Fe. 2, 2005).

²³ See, e.g., *Feldman v. United Mexican States*, ICSID Case No. ARB (A/F)/99/1 para. 143 (Dec. 16, 2002) (award) (discussing previously decided Chapter 11 claims and asserting that its conclusions are consistent with those reached in the earlier cases).

²⁴ *United Mexican States v. Metalclad Corp.*, 2001 BCSC 664 paras. 2, 3, 4 (2001).

²⁵ *Id.* paras. 6-7.

Metalclad obtained permission in 1995 to operate the landfill for five years.²⁶ Shortly thereafter, the local municipality denied Metalclad's application for a construction permit. Following fruitless attempts to resolve the matter in Mexican courts, Metalclad filed a notice of claim with ICSID alleging violation of Chapter 11.²⁷ Prior to the hearing, the governor of the state in which the site was located issued a decree creating an ecological preserve in the area containing the site, making use of the facility virtually impossible.²⁸

The tribunal found that by tolerating the conduct of the municipality, Mexico took a measure tantamount to expropriation within the meaning of Chapter 11. The tribunal further held that the ecological decree amounted to an independent expropriation.²⁹ The court reasoned that Chapter 11 required compensation for "covert or incidental interference with the use of property."³⁰

Mexico petitioned the award to the Supreme Court of British Columbia. The court set aside the first part of the award by ruling that the tribunal had incorrectly read a transparency requirement into NAFTA.³¹ The court, however, upheld the tribunal's ruling that the ecological decree was an act tantamount to expropriation.³²

Metalclad is noteworthy as the first instance in which NAFTA justified compensation to an investor for an act tantamount to expropriation. It also

²⁶ *Id.* para. 13.

²⁷ *Id.* paras. 15-16.

²⁸ *Id.* para. 17.

²⁹ *Id.* para. 35.

³⁰ *Id.* para. 103.

³¹ *Id.* para. 79.

³² *Id.* para. 91.

provides a stark example of the effect Chapter 11 can have on legislation in general, particularly environmental regulation. In this case, Mexico was effectively ordered to pay private damages for converting a hazardous waste landfill into an ecological preserve. Had Mexico known that it would be forced to pay for this decision, it might have been less likely to take this action. Chapter 11's ability to chill socially beneficial legislation, and the concomitant restriction on state sovereignty, is the major objection for those opposed to investment rights provisions.

Substantial political fallout would result from interpreting Chapter 11 in a way that would frequently cause member nations to pay foreign investors for legislation. Perhaps understanding this, other tribunals have read this section much more narrowly and denied compensation. One example of this is *S.D. Myers v. Canada*.

B. S.D. Myers

The investor in this case was an Ohio-based corporation, whose business included the disposal of a highly toxic chemical substance called polychlorinated biphenyl (PCBs).³³ Since 1980, U.S. law had prohibited the cross-border transport of PCBs except in rare circumstances.³⁴ In October 1995, the U.S. granted S.D. Myers (SDMI) "enforcement discretion" to begin importing Canadian PCBs.³⁵ SDMI would have profited greatly from this authorization,

³³ *S.D. Myers Inc. v. Canada*, NAFTA/UNCITRAL Trib. paras. 89, 90 (2003) (partial award).

³⁴ *Id.* para. 101.

³⁵ *Id.* para. 118.

since it would have been able to treat the materials more efficiently than any Canadian facility, in part because the Ohio plant was substantially closer to the majority of the Canadian waste than its nearest Canadian competitor.³⁶ The Canadian disposal industry responded by lobbying the Canadian government to close the border to the export of PCBs.³⁷ The Canadian government enacted legislation effectively preventing SDMI from importing PCBs for approximately eighteen months, after which Canada agreed to maintain an open border to PCB export.³⁸

SDMI claimed that the Canadian government's actions were tantamount to an expropriation, but the tribunal disagreed. The tribunal explained:

“[a]n expropriation usually amounts to a lasting removal of the ability of an owner to make use of its economic rights although it may be in some contexts and circumstances, it would be appropriate to view a deprivation as amounting to an expropriation, even if it were partial or temporary.”³⁹

The tribunal found that the phrase ‘tantamount to expropriation’ was included “to embrace the concept of so-called creeping expropriation rather than to expand the internationally accepted scope of the term expropriation.”⁴⁰ Although the tribunal agreed with SDMI that there might be some cases in which state regulatory conduct could breach Chapter 11, they asserted that in most cases, regulations are

³⁶ *Id.* para. 112.

³⁷ *Id.* para. 122.

³⁸ *Id.* para. 127.

³⁹ *Id.* para. 283.

⁴⁰ *Id.* para. 286.

“a lesser interference,” that do not “involve the deprivation of ownership rights.”⁴¹

While Metalclad and SDMI used different reasoning to come to different results in their respective cases, both tribunals considered similar issues in making their rulings. The following section discusses those issues in greater detail.

IV. CONSIDERATIONS FOR DETERMINING WHETHER AN ACT IS “TANTAMOUNT TO EXPROPRIATION”

Three major questions arise in cases submitted under Chapter 11: (1) is there a government actor; (2) how much of the investment has been expropriated; and (3) why has the investment been expropriated. This section explains the importance of these three questions, explains how each must be answered before compensation is available, and discusses why finding the answers to these questions has been contentious.

A. Is There a Government Actor?

As a threshold matter, a government actor must cause economic harm for an act to be characterized as an expropriation. The most obvious example arises when the federal government of one of the NAFTA parties has caused the harm. *S.D. Myers* is an example of this type of occurrence, because the investor claimed that the Canadian government expropriated its property by prohibiting the exportation of PCBs. However, claims under Chapter 11 are not restricted to actions taken by a central government. NAFTA Article 201(1) defines “measure”

⁴¹ *Id.* para. 282.

as “any law, regulation, procedure, requirement, or practice.”⁴² This definition encompasses an expansive range of activity that can conceivably cover activities taken by many governmental entities.

Indeed, many Chapter 11 cases have involved measures taken by actors outside of the respective central governments. For instance, *Methanex Corp. v. United States* involved a claim by a Canadian company alleging that a California executive order, and the regulations issued in accordance with that order, resulted in a compensable expropriation under NAFTA.⁴³ In *Methanex*, the governor of California directed the California Air Resources Board to ban the use of MTBE, a gasoline additive, in Californian gasoline.⁴⁴ The ban was allegedly instituted as a result of a study that had found the additive to be environmentally harmful.⁴⁵ Methanex, a Canadian company that produces methanol, an essential ingredient in MTBE, disputed the rationale for the ban, and theorized that the actual intent was to favor the domestic ethanol industry by eliminating the competition.⁴⁶ The investor alleged that the executive order was tantamount to expropriation as it had decreased Methanex’s market share by eliminating the primary use for the company’s product in California.⁴⁷ Similarly, *Metalclad Corp.*, in another arbitra-

⁴² NAFTA, *supra* note 10, art. 201(1).

⁴³ *Methanex Corp. v. United States*, NAFTA/UNCITRAL Trib. paras. 20, 22 (2002) (second amended statement of claim), available at <http://www.state.gov/documents/organization/15035.pdf> (last visited Jan 24, 2004).

⁴⁴ *Id.* para. 20.

⁴⁵ *Id.* para. 21.

⁴⁶ *Id.* para. 158.

⁴⁷ *Id.* para. 317.

tion ruling, was awarded damages stemming from a decree issued by the governor of a Mexican state.⁴⁸

Moreover, claims are not limited solely to measures taken by executive or legislative bodies. Courts have likewise been found to have ordered measures tantamount to expropriation. For example, a Canadian conglomerate called the Loewen Group filed a Chapter 11 claim challenging a \$500 million jury verdict rendered in a Mississippi state court.⁴⁹ The seeds of that claim were sown when a local businessman brought suit against Loewen in state court asserting a relatively minor dispute seeking \$5 million in damages.⁵⁰

Throughout the subsequent trial, the plaintiff's attorney stressed the fact that Loewen was a rich Canadian corporation attempting to profit at the expense of the poor citizens of Mississippi.⁵¹ The attorney flagrantly stroked the jurors' passions on the issues of nationality, race, and social status.⁵² The jury responded by awarding \$100 million in compensatory damages and \$400 million in punitive damages, the largest award in Mississippi history.⁵³ Loewen filed a NAFTA Chapter 11 claim based on the unfair tactics allowed at trial and a tribunal held that NAFTA conferred jurisdiction to hear cases based on judicial "takings."⁵⁴ The tribunal reasoned that "the conduct of an organ of the State shall be considered as an act of the State under International law whether the organ be legisla-

⁴⁸ See *United Mexican States v. Metalelad Corp.*, 2001 BCSC 664 paras. 15, 16 (2001).

⁴⁹ *Loewen Group v. United States*, ICSID Case No. ARB (AF)/98/3 para. 117 (Oct. 30, 1998) (notice of claim).

⁵⁰ *Loewen*, ICSID Case No. ARB (AF)/98/3 para. 37 (June 26, 2003) (award).

⁵¹ *Id.* paras. 54-70.

⁵² *Id.*

⁵³ *Id.* para. 104.

⁵⁴ *Loewen*, ICSID Case No. ARB (AF)/98/3 para. 70 (Jan. 5, 2001) (award on jurisdiction).

tive, executive or judicial, whatever position it holds in the organization of the State.”⁵⁵ In its subsequent award, the *Loewen* tribunal clarified its position on this issue by emphasizing that only final, non-appealable judicial rulings can serve as the basis for Chapter 11 jurisdiction. For jurisdiction to attach, an investor must “exhaust remedies which are effective and adequate and are reasonably available to the complainant in the circumstances in which it is situated.”⁵⁶ In *Loewen*, the tribunal denied the investors’ claim in part because of Loewen’s failure to fully utilize the United States appellate process before pursuing Chapter 11 remedies.⁵⁷

In drafting Chapter 11, the NAFTA signatories sought to include activities taken by a wide range of government actors. This is shown by the inclusion of the word “practice” in the definition of the word “measure” in Article 201(1).⁵⁸ The Canadian government espoused this view in an official statement by asserting that “[t]he term ‘measure’ is a non-exhaustive definition of the ways in which governments impose discipline in their respective jurisdictions.”⁵⁹ It will be interesting to see whether actions taken by other governmental actors are challenged as tribunal case law develops further.

B. How Much Has Been Taken?

While it is generally agreed that the term “measure” has an expansive definition for Chapter 11 purposes, defining the phrase “tantamount to expropri-

⁵⁵ *Id.*

⁵⁶ *Loewen*, ICSID Case No. ARB (AF)/98/3 para. 168 (June 26, 2003) (award).

⁵⁷ *Id.* para. 217.

⁵⁸ NAFTA, *supra* note 10, art. 201(1).

⁵⁹ North American Free Trade Agreement, Canadian Statement on Implementation, C. GAZ. 1994.I.68 (Jan. 1, 1994), available at http://www.dfait-macsi.gc.ca/tna-nae/documents/N11_JAN1994.pdf (last visited Jan. 26, 2005).

ation” has been contentious.⁶⁰ The Vienna Convention, the authoritative guide to treaty interpretation, states: “[a] treaty shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in light of its objects and purpose.”⁶¹ Specifically defining the expropriation clause in NAFTA, however, has been difficult, since the treaty itself does not offer a definition. Consequently, this topic has been the subject of much dispute in international law.⁶²

Clearly, tribunals must view alleged governmental takings from the point of view of the investor, rather than the state. It does not matter whether or not the government has received a benefit from the act. The Metalclad tribunal stressed this point by stating that an expropriation can occur even when there is no “obvious benefit [to] the host state.”⁶³ The significant issue is to what extent has state action caused the investor to lose his investment.⁶⁴

Two separate yet related issues are embodied by the second question regarding how much was taken: the extent of the tangible scope of the taking, and the temporal nature of the taking. This section deals with each of these issues in turn.

⁶⁰ See David A. Gantz, *Some Comments on NAFTA's Chapter II*, 42 S. TEX. L. REV. 1285, 1294 (2001).

⁶¹ Vienna Convention on the Law of Treaties, *opened for signature* May 23, 1969, art. 31, 1195 U.N.T.S. 331, 8 I.L.M. 679 [hereinafter Vienna Convention].

⁶² See, e.g., *Banco Nacional de Cuba v. Sabbatino*, 376 U.S. 398 (1964) (“There are few if any issues in international law today in which opinion seems to be so divided as the limitations on a state’s power to expropriate the property of aliens.”).

⁶³ *Metalclad Corp. v. United Mexican States*, ICSID Case No. ARB(AF)/97/1 para. 103 (Aug. 30, 2000) (award).

⁶⁴ This approach was also used by the Iran-U.S. Claims Tribunal. See George H. Aldrich, *What Constitutes a Compensable Taking of Property? The Decisions of the Iran-United States Claims Tribunal*, 88 AM. J. INT’L L. 585, 609 (1994).

1. Tangible scope of the taking

Perhaps the most critical issue in deciding whether an act rises to the level of expropriation, is the scope of the effect on the investment. It has been argued that even acts that have a relatively small effect can amount to a compensable expropriation. An example of this can be found in the notice of arbitration in *Ethyl*, which involved a Canadian ban on the use of a gasoline additive not manufactured in Canada.⁶⁵ The investor claimed that expropriation exists “whenever there is a substantial and unreasonable interference with the enjoyment of a property right.”⁶⁶ This statement reflects two ideas, the first being that compensation is owed for *substantial interference*. Although this phrase is subject to interpretation, a substantial interference means something less than a total loss. The second idea relates to the investor’s use of the term “unreasonable interference,” which is discussed below.

Asserting an even more expansive definition of expropriation, the Loewen Group, in its claim protesting the actions of the Mississippi state court, argued that: “under international law an expropriation occurs where government action interferes with an alien’s use and enjoyment of property.”⁶⁷ This is the broadest definition possible, since it calls for compensation for even minimal government interference.

Some commentators argue that while minimal governmental interference is not compensable, “taking most of an owner’s property is likely sufficient to

⁶⁵ *Ethyl Corp. v. Canada*, NAFTA/UNCITRAL Trib. para. 11 (Oct. 2, 1997) (statement of claim).

⁶⁶ *Ethyl Corp. v. Canada*, NAFTA/UNCITRAL Trib. para. 32 (Apr. 14, 1997) (notice of arbitration).

⁶⁷ *Loewen Group v. United States*, ICSID Case No. ARB (AF)/98/3 para. 164 (1998) (notice of claim).

establish an expropriation.”⁶⁸ This standard would also require compensation for something less than a total imposition on an investor’s property rights.

Claimants who argue for an expansive definition point to Article 1110’s express language. They say that the inclusion of the phrase “tantamount to expropriation,” in addition to the inclusion of both direct and indirect expropriations, implies that the drafters of NAFTA sought to give investors rights greater than those found under international law.⁶⁹

Other commentators have argued for a more exacting standard. For instance, J. Martin Wagner stated: “[B]efore measures restricting the rights of owners to use and dispose of their property will be considered to amount to expropriation, it must be apparent that the governmental actions have so completely deprived the owners of their property rights that the rights are rendered nugatory.”⁷⁰ Obviously, this standard is far more difficult to meet than that supported by investors.

The first NAFTA tribunal to address this issue was the tribunal hearing *Pope & Talbot v. Canada*.⁷¹ That case involved a Canadian regulation limiting the free export of softwood lumber manufactured in certain parts of Canada.⁷² In finding that Canada did not violate Article 1110, the tribunal stated that NAFTA’s

⁶⁸ Gudofsky, *supra* note 14, at 255.

⁶⁹ See, e.g., Ana Tschén, *Chapter 11: The Efforts to Define Expropriation*, 8 CURRENTS: INT’L TRADE L.J. 50, 54 (1999).

⁷⁰ J. Martin Wagner, *International Investment, Expropriation and Environmental Protection*, 29 GOLDEN GATE U. L. REV. 465, 522 (1999).

⁷¹ *Pope & Talbot Inc. v. Canada*, NAFTA/UNCITRAL Trib. para. 96 (June 26, 2000) (interim merits award).

⁷² *Pope*, NAFTA/UNCITRAL Trib. para. 15 (Mar. 25, 1999) (statement of claim).

language does not broaden “the ordinary concept of expropriation under international law . . . without regard to the magnitude or severity of that effect.”⁷³ The tribunal further explained that

[w]hile it may sometimes be uncertain whether a particular interference with business activities amounts to an expropriation, the test is whether that interference is sufficiently restrictive to support a conclusion that the property has been ‘taken’ from the owner. Thus the Harvard Draft defines the standard as requiring interference that would justify an inference that the owner will not be able to use, enjoy, or dispose of the property.⁷⁴

This definition implies that the investor must face a total loss before an award of compensation becomes appropriate. In this case, because the investor still earned substantial profits from its investments, and maintained control of its business operations, the tribunal determined that no expropriation had taken place.⁷⁵

The investors in *Metalclad*, on the other hand, substantially lost their investment, which was rendered effectively worthless by the governor’s ecological decree.⁷⁶ In that case, the tribunal offered a more expansive definition of expropriation, defining it as “the open, deliberate and acknowledged taking of property, as well as covert or 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.”⁷⁷ The inclusion

⁷³ *Pope*, NAFTA/UNCITRAL Trib. para. 96 (interim merits award).

⁷⁴ *Id.* para. 102.

⁷⁵ *Id.* paras. 100, 105.

⁷⁶ *Metalclad Corp. v. United Mexican States*, ICSID Case No. ARB(AF)/97/1 para. 113 (Aug. 30, 2000) (award), available at http://www.economia-snci.gob.mx/sphp_pages/importa/sol contro/consultoria/Casos_Mexico/Metalclad/laudo/laudo_ingles.pdf. (last visited Jan. 26, 2005) (holding that “Metalclad has completely lost its investment”).

⁷⁷ *United Mexican States v. Metalclad Corp.*, 2001 BCSC 664 para. 99 (2001).

of the phrase “or in significant part” reflects the idea that even partial takings may require compensation. Significantly, the British Columbia court upheld this definition as a ruling of law.⁷⁸

However, both *Pope & Talbot* and *S.D. Myers* refused to accept the proposition that the phrase “tantamount to expropriation” extends an investor’s rights under international law. Instead, they held that this phrase was included to encompass creeping expropriation.⁷⁹ This refers to a succession of smaller takings, which has the cumulative effect of constituting a total expropriation.⁸⁰ This reading of Chapter 11 greatly diminishes the utility of the phrase “tantamount to expropriation” for investors. In effect, it incorporates the international law standard for expropriations, while only admitting a duty to look at the effect of a number of regulations on an investment to determine whether there has been a sufficient impact.⁸¹

In making its ruling, the *Pope & Talbot* tribunal declined to use the decisions of the Iran-U.S. Claims Tribunal as precedent.⁸² That tribunal was established to adjudicate claims brought by U.S. citizens, whose property had

⁷⁸ *Id.*

⁷⁹ *Pope*, NAFTA/UNCITRAL Trib. paras. 99, 104 (interim merits award); *S.D. Myers v. Canada*, NAFTA/UNCITRAL Trib. para. 286 (2003) (partial award).

⁸⁰ See Joel C. Beauvais, *Regulatory Expropriations Under NAFTA: Emerging Principles and Lingering Doubts*, 10 N.Y.U. ENVTL. L.J. 245, 259 (2002).

⁸¹ The use of the phrase “tantamount to expropriation” in other contexts discussing the international law standard for expropriation supports the idea that the inclusion of this phrase in NAFTA does not expand on rights accorded under international law. For instance, the Inter-American Juridical Committee, in its discussion of the legality of the Helms-Burton act stated: “Any State that expropriates, nationalizes or *takes measures tantamount to expropriation or nationalization* of property owned by foreign nationals must . . . [pay] adequate and effective compensation.” 35 I.L.M. 1322, 1331 (1996) (emphasis added).

⁸² *Pope*, NAFTA/UNCITRAL Trib. para. 104 (interim merits award).

been expropriated by the Iranian government following the revolution in that country.⁸³ *Pope & Talbot* did not consider the Iran-U.S. Claims Tribunal (IUSCT) to be an appropriate source of precedence because “that Tribunal’s mandate expressly extends beyond expropriation to include other measures affecting property rights.”⁸⁴

This reasoning is dubious. At the very least, decisions by the IUSCT should be considered an outer limit for determining which expropriations are compensable.⁸⁵ Since that tribunal’s mandate is arguably broader than that provided for by NAFTA, claims which the IUSCT rejected as non-compensable should be analogized with similar NAFTA disputes. Furthermore, even though the IUSCT’s mandate may have been broader, most of their claims were decided under customary international law,⁸⁶ the same standard applied by NAFTA tribunals. Significantly, in some cases, such as *Foremost Tehran Inc.*,⁸⁷ the IUSCT specified whether it was granting compensation based on international law theories, or based on its expansive mandate.⁸⁸ These discussions can be used to determine which cases are directly applicable and which should be treated as an outer limit for NAFTA jurisprudence. Consequently, NAFTA tribunals should consider many IUSCT decisions to be valid persuasive authority. That tribunal

⁸³ See DUNOFF, *supra* note 1, at 164.

⁸⁴ *Pope*, NAFTA/UNCITRAL Trib. para. 104 (interim merits award).

⁸⁵ See Kevin Banks, *NAFTA’s Article 1110 – Can Regulation be Expropriation?*, 5 NAFTA: L. & BUS. REV. AM. 499, 515 (1999).

⁸⁶ See Maurizio Brunetti, *NAFTA Chapter 11: The Iran-United States Claims Tribunal, NAFTA Chapter 11, and the Doctrine of Indirect Expropriation*, 2 CHI. J. INT’L L. 203, 205 (2001).

⁸⁷ *Foremost Tehran Inc.*, 17 Iran-U.S.C.T.R. 153 (1986).

⁸⁸ Aldrich, *supra* note 64, at 590.

rendered final decisions in a large number of cases,⁸⁹ many of which include facts that could be analogized to potential NAFTA disputes. Failure to consider the experiences of that tribunal only results in increased uncertainty for both investors and states under the relatively new NAFTA scheme.

The IUSCT discussed the scope of expropriation necessary to entail compensation in *Starrett Housing Corporation v. Iran*.⁹⁰ In that case, the Iranian government took a number of adverse actions against the claimant, culminating in the appointment of managers to direct all of Starrett Housing's activities.⁹¹ By doing so, the Iranian government deprived the claimants of "the effective use, control, and benefits of their property rights."⁹² In awarding damages, the tribunal explained that:

[I]t is recognized in international law that measures taken by a state can interfere with property rights to such an extent that these rights are rendered so useless that they must be deemed to have been expropriated, even though the State does not purport to have expropriated them and the legal title to the property formally remains with the original owner.⁹³

The phrase "so useless that they must be deemed to have been expropriated" is strikingly similar to the *Pope & Talbot* holding that compensation is appropriate for "an interference [that] is sufficiently restrictive to support a conclusion that the property has been 'taken' from the owner."⁹⁴ The IUSCT expanded on their

⁸⁹ For a full list of awards and decisions given by the tribunal, see its website at <http://www.iusct.org/lists-eng.html> (last visited Apr. 5, 2005).

⁹⁰ *Starrett Housing Corp.* 4 Iran-U.S.C.T.R. 122 (1983).

⁹¹ *Id.* § IV(b).

⁹² *Id.*

⁹³ *Id.*

⁹⁴ *Pope & Talbot Inc. v. Canada*, NAFTA/UNCITRAL Trib. para. 96 (June 26, 2000) (interim merits award).

definition in *Tippets v. Iran*, by saying that compensation is appropriate “whenever events demonstrate that the owner was deprived of fundamental rights of ownership.”⁹⁵ This idea comports with the Harvard draft’s view that only acts that remove an owner’s ability to “use, enjoy and dispose of” property are compensable.⁹⁶ The similarity of these holdings demonstrates that the IUSCT rulings employed a remarkably similar standard to that articulated by Chapter 11 tribunals. Thus, those decisions should be analyzed in deciding future cases under NAFTA.

It is widely recognized in both international and domestic law that governments have the right to regulate within their domain without compensating those who are negatively affected by the regulation.⁹⁷ One justification for this concept is that investors must pay to operate within a sovereign territory, and submission to regulation constitutes such payment.⁹⁸ However, governments

⁹⁵ *Tippets*, 6 Iran-U.S. Cl. Trib. Rep. 219, 225 (1984).

⁹⁶ *Pope*, NAFTA/UNCITRAL Trib. para. 96 (interim merits award).

⁹⁷ See Chris Tollefson, *Games Without Frontiers: Investor Claims and Citizen Submissions Under the NAFTA Regime*, 27 YALE J. INT’L L. 141, 159 (2002) (“It has traditionally been assumed that governments are entitled to take regulatory action that adversely affects the value of a property without paying compensation as long as the action is taken in good faith.”). Under American domestic law, expropriations are governed by the Takings Clause of the U.S. Constitution which states: “[N]or shall private property be taken for public use, without just compensation.” U.S. CONST. amend. V. In *Lucas v. S.C. Coastal Council*, the Supreme Court ruled that a regulation must deny an owner all economically beneficial use of his property to be considered a regulatory taking. 505 U.S. 1003 (1992). Mexican takings law derives from Article 27 of the Mexican Constitution which states in part: “Private property shall not be expropriated except for reasons of public use and subject to payment of indemnity. The Nation shall at all times have the right to impose on private property rights the limitations dictated by the public interest, as well as to regulate, for the collective good, the use of natural resources susceptible to expropriation.” MEX. CONST. art. 27. Courts have interpreted this to mean that compensation is only required when a taking is directed at a specific property, and ownership of the property is transferred to the State. See *Wagner*, *supra* note 70, at 517. Under Canadian law, the right to compensation for expropriation is not required even for direct takings, but is only considered a matter of statutory interpretation. See *R. v. Appleby*, 15 N.B.R.2d 650, 659 (1977).

⁹⁸ See, e.g., *Ruckelhaus v. Monsanto*, 467 U.S. 986, 1007 (1984) (“[S]uch restrictions are the burdens we all must bear in exchange for the advantage of living and doing business in a civilized community.”) (internal quotation omitted).

violate this arrangement by enacting regulation that substantially deprives investors of the value of their property. In determining whether regulation has crossed this line, tribunals should evaluate the expectations of investors. Rarely, if ever, does regulation render property utterly valueless. Even the ecological decree in *Metalclad* did not entirely deprive the company of all of the investment's economic value. The investor in that case still owned an ecologic preserve. However, *Metalclad*'s expectation was to own a waste treatment center, something that was no longer possible.⁹⁹ As a result, its expectation value was essentially worthless, and therefore compensable under Chapter 11. The claimant in *Pope & Talbot* on the other hand, was still able to operate its business of choice at a profit, albeit a diminished one. Therefore, the claimant still realized part of the expectation value of its investment, and no expropriation occurred.

2. Temporal scope of the taking

In determining whether the action is substantial enough to warrant compensation, tribunals must address the temporal nature of the taking as well as the tangible scope of the imposition on the investment. The IUSCT acknowledged this in *Tippets*, by saying that an expropriation has occurred whenever "it appears that this deprivation is not merely ephemeral."¹⁰⁰ This arguably gives an investor greater protection than that afforded to claimants by NAFTA tribunals to date. George Aldrich, a member of the IUSCT, has asserted that the "ephemeral" standard means that compensation is appropriate whenever "the terms of the

⁹⁹ See *Metalclad Corp. v. United Mexican States*, ICSID Case No. ARB(AF)/97/1 para. 113 (Aug. 30, 2000) (award) (noting that *Metalclad* faced "the complete frustration of the operation of the landfill").

¹⁰⁰ *Tippets*, 6 Iran-U.S.C.T.R. 219, 225.

deprivation denied compensation for any losses that might be incurred while the deprivation continued or when the deprivation continued for several years.”¹⁰¹ Aldrich’s first assertion is unlikely to be accepted by NAFTA tribunals because it essentially states that an expropriation for any amount of time is compensable. However, his second standard, that the harmful act continue for several years, may offer helpful guidance.

The Third Restatement of Foreign Relations also recognizes that a temporary taking may constitute an expropriation. It states: “[a] state is responsible as for an expropriation of property . . . that . . . unduly delays, effective enjoyment of an alien’s property.”¹⁰² This illustrates that expropriations, even if temporary, are compensable.

NAFTA tribunals have in some instances focused on the ephemeral quality of a taking. For instance, in *S.D. Myers*, no compensation was due because the offending regulation was only in effect for eighteen months. The tribunal stated that this amounted to the mere delaying of an opportunity as opposed to an expropriation.¹⁰³ In making this determination the tribunal acknowledged that “in some contexts and circumstances it would be appropriate to view a deprivation as amounting to an expropriation, even if it were partial or temporary.”¹⁰⁴

¹⁰¹ Aldrich, *supra* note 64, at 593.

¹⁰² RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW § 712 cmt. g (1987).

¹⁰³ *S.D. Myers Inc. v. Canada*, NAFTA/UNCITRAL Trib. para. 287 (2003) (partial award).

¹⁰⁴ *Id.* para. 283.

An analysis of both the NAFTA and Iranian tribunals decisions shows that arbitrators have focused on an interplay of factors in determining whether a taking amounts to an expropriation under international law. One factor involves the degree to which the government's actions interfered with the investor's business or investment. Another factor involves a consideration of the period over which that interference took place. It is apparent that under both arbitral schemes, compensation is appropriate only when the government action renders the investment practically useless. This standard is contrary to that espoused by some NAFTA Chapter 11 claimants.

The temporal aspect however, should not be rigidly defined. Courts must look to the circumstances of each case to determine whether an action is continued long enough to constitute an expropriation. Different industries in different regions assign varying importance to restrictions in time. Eighteen months may constitute an ephemeral amount of time in some industries, but a virtual eternity in others. The Third Restatement gives support to this view by stating: "[a] temporary deprivation of an alien's control over his property may in some cases cause significant injury and give rise to a claim for damage."¹⁰⁵ Thus, a factual inquiry into the investor's injury is appropriate when determining whether non-permanent takings are compensable. NAFTA tribunals can develop these factors through case law but should look to the Iranian Claims Tribunal as a good starting point for addressing these issues.

¹⁰⁵ RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW § 712 n. 6 (1987).

C. Why Has the Government Taken the Action?: Compensation for Regulatory Takings

The third and most controversial question NAFTA tribunals are asked to determine is whether compensation is owed to investors who are deprived of property as a result of regulation enacted for environmental, safety, public health, or other such policy considerations. This section deals with that question and concludes that the regulatory character of an expropriation does not disqualify an investor from receiving compensation. It then addresses some potential problems with a regime in which such compensation is available, and introduces proposals for mitigating some of these difficulties.

Metalelad provides a good example of a case in which an investor was awarded compensation for a regulatory decree that was purportedly implemented for environmental reasons. Many commentators were appalled at this result and feared that states would refrain from enacting environmental legislation for fear that they would be forced to pay for doing so.¹⁰⁶ Others, however, saw compensation as a necessary component of investor protection.¹⁰⁷ The Pope & Talbot tribunal reasoned that, “a blanket exemption for regulatory measures would create a gaping loophole in international protections against expropriation.”¹⁰⁸ S.D. Myers also dealt with this issue and the tribunal stated: “Regulatory conduct

¹⁰⁶ See, e.g., Samrat Ganguly, *The Investor-State Dispute Mechanism (ISDM) and a Sovereign's Power to Protect Public Health*, 38 COLUM. J. TRANSN'L L. 113, 119 (1999).

¹⁰⁷ See Strazzeri, *supra* note 13, at 856-57.

¹⁰⁸ Pope & Talbot Inc. v. Canada, NAFTA/UNCITRAL Trib. para. 99 (June 26, 2000) (interim merits award).

by public authorities is unlikely to be the subject of legitimate complaint under Article 1110 of the NAFTA, although the Tribunal does not rule out that possibility.”¹⁰⁹ Both tribunals recognized that regulations tend to impact rights to a degree not amounting to expropriation under the scope test. However, in cases where they do, both tribunals were willing to concede that compensation would be appropriate.

The IUSCT provides guidance in addressing this question as well. Cases decided by that tribunal are especially relevant because most of the claims have involved governmental actions that did not amount to direct expropriations.¹¹⁰ Interestingly, the Iranian tribunal’s opinion on this issue evolved over time. Originally, the tribunal articulated a test in *Sea Land Services Inc. v. Iran*, in which a “finding of expropriation would require, at the very least, that the tribunal be satisfied that there was deliberate governmental interference with the conduct of Sea Land’s operation.”¹¹¹

This standard would inquire into the motives of the governmental actors as opposed to the effect of the actions on the investment. However, in subsequent cases, starting with *Tippets*, the tribunal changed its view by stating that “[t]he intent of the government is less important than the effects of the measures on the owner, and the form of the measures of control or interference is less important than the reality of their impact.”¹¹² The tribunal explained their reasoning for

¹⁰⁹ *S.D. Myers*, NAFTA/UNCITRAL Trib. para. 283 (partial award).

¹¹⁰ See Brunetti, *supra* note 86, at 205.

¹¹¹ *Sea-Land Services Inc.*, 6 Iran-U.S. Cl. Trib. Rep. 166 (1984).

¹¹² *Tippets*, 6 Iran-U.S. Cl. Trib. Rep. 225-26.

employing the new test in *Phelps Dodge v. Iran*¹¹³ by stating: “the Tribunal understands the economic and social concerns that inspired the law pursuant to which it acted, but those reasons and concerns cannot relieve the Respondent of the obligation to compensate [the investor] for its loss.”¹¹⁴ By enacting this test, the tribunal rejected the idea that expropriations in the form of bona fide regulations are not compensable.

Traditionally, under international law, states have a right to enact legislation consistent with their police power, without paying compensation.¹¹⁵ The Restatement endorses this view, stipulating: “A state is not responsible for loss of property or for other economic disadvantage resulting from bona fide general taxation, regulation, forfeiture for crime, or other action of the kind that is commonly accepted as within the police power of states, if it is not discriminatory.”¹¹⁶

Some international cases also advance this theory. For instance, in *Hauer v. Land Rheinland-Pfalz*, the European Court of Justice upheld a regulation

¹¹³ *Phelps Dodge*, 10 Iran-U.S. Cl. Trib. Rep. 121 (1986).

¹¹⁴ *Id.*

¹¹⁵ Black’s Law Dictionary defines police power as:

1. The inherent and plenary power of a sovereign to make all laws necessary and proper to preserve the public security, order, health, morality, and justice. It is a fundamental power essential to government, and it cannot be surrendered by the legislature or irrevocably transferred away from government 3. Loosely, the power of the government to intervene in the use of privately owned property.

BLACK’S LAW DICTIONARY 1178 (7th ed. 1999). Similarly, Ballentine’s Law Dictionary defines police power in part as:

An attribute of sovereignty, comprehending the power to make and enforce all wholesome and reasonable laws and regulations necessary to the maintenance, upbuilding, and advancement of public weal and protection of public interests. That power in government which restrains individuals from transgressing the rights of others, and restrains them in their conduct so far as is necessary to protect the rights of all.

BALLENTINE’S LAW DICTIONARY 958 (3d ed. 1969) (citations omitted). Both definitions offer an expansive view of police power, which could arguably include all regulation.

¹¹⁶ RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW § 712 cmt. g (1987).

prohibiting the planting of a certain type of grape vine as non-compensable.¹¹⁷ However, that case was decided under the European Convention of Human Rights (ECHR) which provides that the right to personal property will not impair the right of the state to enact laws necessary to control property use in the general interest.¹¹⁸ Another frequently cited example is the *Oscar Chinn* (UK v. Belgium) case, in which the Permanent Court of International Justice ruled that states may regulate to stimulate an economy in times of severe recession, even when doing so bankrupts some enterprises.¹¹⁹

Some commentators have sought to extend police powers to bona fide environmental measures, which, they argue, are non-compensable under NAFTA.¹²⁰ The agreement itself supports this argument by stressing the importance of environmental concerns. NAFTA's preamble states the desire of the signatories to "undertake [the agreement] in a manner consistent with environmental protection and conservation; preserve their flexibility to safeguard the public welfare; promote sustainable development; [and] strengthen the development and enforcement of environmental laws and regulations."¹²¹ Chapter 11 itself emphasizes the importance of domestic environmental regulation and states: "1. Nothing in this Chapter shall be construed to prevent a Party

¹¹⁷ *Hauer v. Land Rheinland-Pfalz*, 1979 E.C.R. 3727, [1980] C.M.L.R. 42 (1980).

¹¹⁸ See European Convention for the Protection of Human Rights and Fundamental Freedoms, Nov. 4, 1950, 213 U.N.T.S. 222.

¹¹⁹ *Oscar Chinn* (U.K. v. Belg.), 1934 P.C.I.J. (ser. A/B) No. 63 (Dec. 12).

¹²⁰ See Wagner, *supra* note 70, at 527; see also Howard Mann & Konrad von Moltke, *NAFTA's Chapter 11 and the Environment: Addressing the Impacts of the Investor State Process on the Environment*, 1999 INT'L INST. SUSTAINABLE DEV. 40, available at <http://www.iisd.org/pdf/naftasummary.pdf> (last visited Jan. 31, 2005).

¹²¹ NAFTA, *supra* note 10, pmb1.

from adopting, maintaining, or enforcing any measure, otherwise consistent with this Chapter, that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental concerns.”¹²²

However, the plain language of Article 1110 undercuts the argument that such regulatory expropriations are non-compensable. The article allows takings to occur for a public purpose and in a non-discriminatory way, but only if accompanied by compensation. In other words, the black letter of Chapter 11 demonstrates that Article 1110 is a “no fault provision.”¹²³ Even if there were a limited exception for certain traditional police measures such as actions taken during time of war, and currency regulation,¹²⁴ that exception should not be extended to environmental, and other similar regulations. NAFTA stresses the importance of environmental regulation, but not at the expense of the investor. Extending police power status to environmental legislation causes the exception to swallow the rule, and almost any regulation would be justifiable as a police power and therefore non-compensable. This concern is recognized in the *Pope & Talbot* tribunal’s language concerning creeping expropriation, and the broad language of Chapter 11 certainly does not justify creating such a broad exception.

¹²² *Id.* art. 1114(1).

¹²³ Ian A. Laird, *NAFTA Chapter 11: NAFTA Chapter 11 Meets Chicken Little*, 2 CHI. J. INT’L L. 223, 226 (2001).

¹²⁴ These circumstances, as well as agrarian land reform, may be considered large-scale nationalizations, which may not require full compensation under international law. Judge Lagergren argues that in cases of fundamental national upheaval, full compensation would not be appropriate if it would result in significant economic hardship for the expropriating government. Judge Holtzmann rejects this view claiming that International Law requires full compensation in all cases. See *INA Corp. v. Iran*, 8 Iran-U.S.C.T.R. 373 (Aug. 12, 1985).

A comparison between the language used in the ECHR and that used in NAFTA demonstrates the difference between the two regimes. The European system emphasizes the primacy of regulation by stressing that its personal property protection shall not “in any way impair” a state’s regulatory power. Compensation for regulation could certainly impair such power. NAFTA however, only encourages environmental legislation that is “otherwise consistent with” the investment section. Accordingly, regulation that deprives an investor of his property is only appropriate when investors are compensated.

One potentially negative side effect of a regime based on compensation for regulatory expropriations is that it may give corporations a perverse incentive to act irresponsibly. For instance, companies may be more willing to market products that entail potential health and safety concerns under NAFTA, knowing that if a state bans their product, they will be compensated. Conversely, refusing compensation for investments lost as a result of valid environmental legislation may encourage companies to internalize social and environmental concerns and costs. This argument is an extension of the “polluter pays principle.”¹²⁵ In other words, corporations that harm the environment must pay society for the harm they cause, and society should not have to pay corporations to refrain from harming the environment.¹²⁶

¹²⁵ See Mann and von Moltke, *supra* note 120, at 46 (“Under the polluter pays principle, the community effectively ‘owns’ the environment, and forces users to pay for damage they impose.”) (quoting John Moffet and Francois Bregha).

¹²⁶ The first international formulation of the polluter pays principle (PPP) is contained in the 1972 Organization for Economic Cooperation and Development (OECD) Council Recommendation on Guiding Principles concerning International Economic Aspects of Environmental Policies. As stated in that report, the PPP means that polluters should bear the expense of public measures taken to restore the environment to an acceptable state. Underlying the PPP is the sense that prices paid for goods “should accurately reflect the full

The polluter pays principle, however, is only useful as a remedial device. It does not prohibit investors from harming the environment per se. Rather, it simply states that if they do so, they must bear the cost. Since the financial benefits of an investment may exceed the costs to the environment, regulation that makes an investment useless should entail compensation equal to the value of the investment minus the cost of the harm averted.

An example may be useful to clarify this point. Suppose a factory is constructed at a cost of \$25 million. The factory emits air pollution that will cost the government \$20 million to clean up. According to the polluter pays principle, the factory owner would have to pay for the cost of the clean-up.¹²⁷ However, suppose that instead of requiring the factory owner to pay for the pollution it has caused, the government enacts a law prohibiting the operation of the factory. In such a case the government should compensate the investor \$5 million—the difference between the cost of his investment and the harm averted.

Another potential concern with Chapter 11 is that social activists will try to use NAFTA as an effective tool to shape policy.¹²⁸ This is especially true in areas of emerging technology, which expand faster than governments can regulate. Take, for example, the hypothetical case of an American lobbyist convincing a group of Mexican investors to open a human cloning, partial birth

cost of [the items'] production and/or consumption." See *The Polluter Pays Principle as it Relates to International Trade*, Joint Working Party on Trade and the Environment, COM/ENV/TD(2001) 44/FINAL (Dec. 2002), available at <http://www.oalis.oecd.org/olis/2001doc.nsf> (last visited Jan. 31, 2005). Although the precise status of the PPP is currently uncertain, it has become increasingly accepted and has even been termed a "general principle of international environmental law" by some international agreements. *Id.*

¹²⁷ The total financial cost of the factory would therefore be \$45 million.

¹²⁸ While such a case has not yet occurred, it is well within the realm of possibility.

abortion, and stem cell research clinic using equipment that is so specialized that if these practices are banned the clinic would be worthless and the entire investment lost. Banning these practices would engender enormous damages since constructing such a clinic would entail a large investment, and there is great demand for the services it would provide, even though many people view them as morally abhorrent. Therefore, under NAFTA, it would seem that if the American government (state or federal) wished to ban these activities, it would have to pay to do so, perhaps chilling such regulation.

In such an extreme situation, however, it is unlikely that a NAFTA tribunal would grant compensation. It may point to the Vienna Treaty that provides that treaties be interpreted “in the light of its object and purpose.”¹²⁹ Some of NAFTA’s stated objectives are to: “(a) eliminate barriers to trade in, and facilitate the cross border movement of goods and services between the territories of the Parties; (b) promote conditions of fair competition in the free trade area; (c) increase substantially investment opportunities in their territories.”¹³⁰ A tribunal may say that NAFTA was not meant to be used as a means for social legislation lobbying and therefore refuse compensation. However, should the investors in the above hypothetical have purely economic motives, this argument is not available.¹³¹ In such a case, a tribunal may say that when the plain meaning

¹²⁹ Vienna Convention, *supra* note 61, art. 31(1).

¹³⁰ *Id.* art. 32(a).

¹³¹ In a borderline case, the issue of motivation may be left to the tribunal as the trier of fact. At least one tribunal has already been asked to evaluate the subjective intent of a party. In *Methanex*, the investor asked the tribunal to find that the State of California banned its product for the purpose of bolstering the domestic ethanol industry, and not out of environmental concern. See *Methanex Corp. v. United States*, NAFTA/UNCITRAL Trib. para. 24 (2002) (second amended statement of claim).

of a statute leads to a result, which is “manifestly absurd or unreasonable,” they must look to “supplementary means of interpretation.”¹³² Accordingly, they may find that Chapter 11 was not meant to cover such situations.¹³³ However, the tribunal may say that this is analogous to any other NAFTA claim in which property has been rendered valueless due to regulation. Compensation may even be more intellectually defensible in such a case than in *Metalclad*. In that case, the government asserted an ecologically viable reason for the expropriation, whereas here, justification is based on a less tangible moral choice.

Finally, a tribunal may apply equitable principles in rejecting the claim. Some have opined that the IUSCT often did this, instead of strictly construing its mandate.¹³⁴ However, it may not be desirable to have international arbitral bodies engaging in judicial activism. The *Loewen* tribunal explicitly addressed this issue in the closing paragraphs of its award. Based on the circumstances detailed above, the tribunal found that the Mississippi state court trial upon which the claim arose “was so flawed that it constituted a miscarriage of justice amounting to a manifest injustice as that expression is understood under

¹³² NAFTA, *supra* note 10, art. 102.

¹³³ Bill Merkin, former U.S. negotiator stated: “I would say NAFTA negotiators did not expect this provision would be used as much as it has been by private companies.” Gudofsky, *supra* note 14, at 301; see also Todd Weiler, *Arbitral and Judicial Decision: The Ethyl Arbitration. First of its Kind and a Harbinger of Things to Come*, 11 AM. REV. INT’L ARB. 187, 192 (2000) (“[C]urrent and former Canadian officials have commonly claimed that they seriously believed that the NAFTA’s investor-state provisions would only be used by Canadians and Americans against measures imposed by Mexico.”); David R. Haigh, *The Management and Resolution of Cross Border Disputes as Canada/U.S. Enter the 21st Century: Chapter 11 - Private Party vs. Governments, Investor-State Dispute Settlement: Frankenstein or Safety Valve?*, 26 CAN.-U.S. L.J. 115, 125 (2000) (“[T]here is some substance to the argument that the NAFTA parties have *inadvertently* created a destructive agency which they now cannot control and which might, in some ways, arguably bring about their ruin.”) (emphasis added). *But see* Strazzeri, *supra* note 13, at 841 (“The inclusion of Article 1110 was not accidental. The architects of the agreement fully knew what they were creating.”).

¹³⁴ See Aldrich, *supra* note 64, at 591.

international law.”¹³⁵ The tribunal also acknowledged that the human reaction would be to apply principles of equity, and redress the wrong suffered by the investor.¹³⁶ The court, however, held that without express international agreement, the tribunal had no power to “step from outside into the domestic arena.”¹³⁷ They argued that exceeding their mandate would damage “the viability of NAFTA itself.”¹³⁸

Some commentators have argued for a balancing test in which the importance of the regulation, the means chosen, and the extent of the act would all be weighed against investors’ property rights.¹³⁹ The *Ethyl* claim, discussed above, seems to argue for a similar test by interpreting NAFTA as requiring compensation for “unreasonable interference.” The Third Restatement lends credence to this idea by including an “action that . . . unreasonably interferes with . . . an alien’s property” in its definition of expropriation.¹⁴⁰ A balancing approach could be used to discern between reasonable and unreasonable acts. Additionally, the European Court of Justice has successfully employed a similar approach.¹⁴¹ However, the text of NAFTA does not support this option. As noted above, Chapter 11 has a no fault provision that allows governments to expropriate, but requires compensation when they do so. Furthermore, it is inappropriate to

¹³⁵ *Loewen Group v. United States*, ICSID Case No. ARB (AF)/98/3 para. 54 (June 26, 2003) (award).

¹³⁶ *Id.* paras. 241-42.

¹³⁷ *Id.* para. 242.

¹³⁸ *Id.*

¹³⁹ *See Banks*, *supra* note 85, at 506.

¹⁴⁰ RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW § 712 cmt. g (1987).

¹⁴¹ *See Banks*, *supra* note 85, at 506.

require a non-national body to weigh social, cultural, and other intrastate interests. For example, it would be impossible to apply a balancing test in the case of the human cloning, partial birth abortion and stem cell research clinic discussed above. Citizens of Mexico and Canada may reach widely divergent opinions on these sensitive issues, as may citizens in different regions of the United States. An international, un-elected body should not be the final arbiter of the relative merits to the arguments underlying these important debates.

Should tribunals attempt to assume this role, The *Loewen* tribunal's concerns¹⁴² over exceeding its mandate would be greatly magnified. In *Loewen*, the tribunal had been asked to rectify an irrefutable injustice, and the only question was whether the tribunal should broaden its mandate to redress the wrong. The use of a balancing test would require tribunals to go far beyond this point and evaluate the merits of regulations enacted in countries to which tribunal members do not belong. Chapter 11 does not empower tribunals to engage in such debates, and they have no right to do so.

Perhaps a better option would be to take realistic investor expectations into account when evaluating the right to compensation. Investments in activities that are likely to be highly regulated, or completely banned, would not be compensated for, if they are "expropriated." Such a result could be justified by the fact that the investor should have known that the property would likely never be viable, and therefore had no value.

¹⁴² *Loewen Group v. United States*, ICSID Case No. ARB (AF)/98/3 (June 26, 2003) (award).

V. CONCLUSIONS

To determine the costs and benefits of Chapter 11, the scope of the right to compensation granted by the phrase “tantamount to expropriation,” must be understood. A review of tribunal decisions under NAFTA and international law brings us to the following summary of where the international law currently stands. Compensation is required when a government actor deprives a foreign investor of his fundamental ownership rights, i.e., the rights to use, enjoy and dispose of his property, for a substantial period of time, regardless of the means, or reasons for the expropriation. Of course, this does not apply to the enforcement of laws enacted before the investment was made.¹⁴³ In such a case, the investor has no right to engage in an illegal investment, and all loss is borne solely by the individual.¹⁴⁴ This definition is substantially similar to the ideas expressed in the Hull Doctrine. However, one difference may arise in the context of investments in emerging industries that are likely to be heavily regulated, or banned completely. Unlike in other situations, investors in these industries realize that their investments will be regulated, and the value of their investment is adjusted accordingly.

It is understood that this definition of Chapter 11 forecloses the possibility of heavy regulation for established goods such as tobacco products¹⁴⁵

¹⁴³ It is consequently unlikely that court decisions will be the subject of much successful arbitration.

¹⁴⁴ See generally Strazzeri, *supra* note 13 (arguing that compensation is not required for rights that an investor never had).

¹⁴⁵ A case has recently been filed by a Canadian tobacco company protesting a 1998 settlement agreement between states attorney generals and the tobacco industry, requiring tobacco companies wishing to do business in the United States to contribute money to an escrow account to compensate future plaintiffs in suits against the tobacco industry. See *Grand River Enters. v. United States*, Notice of Arbitration, available at <http://www.state.gov/documents/organization/30961.pdf> (last visited Jan. 31, 2005).

and sports utility vehicles. Banning such goods would entail prohibitively costly compensation. However, it is unlikely that such regulation would be enacted even absent NAFTA.

While NAFTA is generally considered to be a great economic success,¹⁴⁶ some worry that the investor rights provisions contained in Chapter 11 impede the ability of member states to regulate for the common good.¹⁴⁷ Such concerns may even cause other states to rethink the benefits of free trade agreements.¹⁴⁸

Nevertheless, compensation in such instances is socially desirable for three reasons. First, requiring compensation forces governments to internalize the costs of regulation as well as the benefits, and take a wider range of interests into consideration when making decisions. This is especially true in an international context since alien investors have no formal democratic voice.

Second, requiring those who are adversely impacted by regulation to pay for the regulation's benefit to the state, is inequitable. This cost should be spread across society.¹⁴⁹ Historically, compensation has been required when "a given person has been required to give up property rights beyond his just share of the

¹⁴⁶ See Haigh, *supra* note 133, at 115.

¹⁴⁷ See, e.g., Liptak, *supra* note 3.

¹⁴⁸ See, e.g., Michael Ewing-Chow, *Investor Protection in Free Trade Agreements: Lessons From North America*, 5 SING. J. INT'L. & COMP. L. 748 ("The recent jurisprudence regarding Chapter 11 and expropriation should therefore be a concern to Singapore as it negotiates the investment protection clauses of the FTAs."). *Id.*

¹⁴⁹ See Kathleen Ryan, *Should the RMA Include a Takings Regime?*, 2 N.Z. J. OF ENVTL. L. 63-91 (1998), cited in Kevin Guerin, *Protection Against Government Takings: Compensation for Regulation?*, New Zealand Treasury Working Paper 02/18 at 5.2 (2002) available at <http://www.treasury.govt.nz/workingpapers/2002/twp02-18.pdf> (last visited Jan. 31, 2005) (noting that compensation provisions should be drafted to encourage regulators to "spread costs widely").

cost of government.”¹⁵⁰ Accordingly, compensation is not required for governmental actions that spread both the burdens and the benefits across society.¹⁵¹ However, compensation is appropriate when a substantial cost is borne by a small group of people for the general benefit of the rest of the population.¹⁵²

Finally, compensation gives individuals an incentive to invest, leading to great economic advantage.¹⁵³ Investment by foreigners provides capital infusion for domestic economies, while creating jobs in local markets. A binding agreement to compensate in the event of expropriation attracts foreign investment leading to these benefits.

To be sure, the standard advanced in this paper is most similar to that found in American takings law, and Mexico and Canada face more institutional change than does the United States as a result of Chapter 11.¹⁵⁴ Nevertheless, the benefits of adhering to this standard far outweigh the potential cost for all three countries.

¹⁵⁰ William Stoebuck, *A General Theory of Eminent Domain*, 47 WASH. L. REV. 553, 608 (1972), quoted by Guerin, *supra* note 149, at 3.1.

¹⁵¹ See Guerin, *supra* note 149, at 4.1.

¹⁵² This has been recognized as the guiding principle behind the Takings Clause of the United States Constitution. The U.S. Supreme Court has stated that “The Fifth Amendment’s guarantee that private property shall not be taken for a public use without just compensation was designed to bar Government from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole.” *Armstrong v. United States*, 64 U.S. 40, 49 (1960).

¹⁵³ See Beauvais, *supra* note 80, at 256-57.

¹⁵⁴ See *supra* part IV.B.1; see also David Schneiderman, *NAFTA’s Taking Rule: American Constitutionalism Comes to Canada*, 46 U. TORONTO L. J. 499 (1996); see also Debra F. Guajardo, *Redefining the Expropriation of a Foreign Direct Investment in Mexico*, 42 S. TEX. L. REV. 1309 (2001).