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915 EAST FIRST STREET, LOS ANGELES, CA 90012 (213) 229-5300

Focus

Treaty Trials

'Metalclad' Illustrates Lack of Environmental Protection in NAFTA

By Gideon Kracov and Joseph F. C. DiMento

Recognizing the growth of global trade and economic interdependence, the United States, Mexico and Canada signed the North American Free Trade Agreement, 32 I.L.M. 605 (1993). NAFTA contains rules designed to ensure predictability in foreign investment and resolve investment disputes. Since NAFTA came into force, observers have witnessed the potency of these rules but also have learned that global relationships cannot be defined by investment alone.

Take the *Metalclad* case, for example, where an investment relationship with Mexico generated a dispute over environmental protection. In October 1996, Metalclad Corp., a Newport Beach-based waste-disposal company, filed a notice of claim against Mexico under NAFTA's dispute-resolution rules. Metalclad alleged that a municipality in the Mexican state of San Luis Potosi prevented it from opening a waste-disposal facility. Citing environmental concerns, the municipality refused to issue permits for the facility, which later was declared part of a 600,000-acre ecological zone.

Metalclad's case was the first brought to arbitration under NAFTA Chapter 11, titled "Investments," which contains substantive legal standards and procedures for resolving investment disputes. Chapter 11 establishes rules for binding arbitration to resolve a dispute between an investor from one NAFTA country and the government of another NAFTA country, so-called investor-state arbitration.

Pursuant to this procedure, Metalclad filed the case with the International Center for the Settlement of Investment Disputes, an international arbitral body linked to the World Bank, seeking $90 million in damages. In August 2000, a three-member panel sitting in Vancouver, Canada, unanimously ruled for Metalclad, awarding $16.6 million in damages. Specifically, the panel found that Mexico violated Sections 1105 and 1110 of Chapter 11. Section 1105 requires that investors be treated "in accordance with international law, including fair and equitable treatment and full protection and security." Section 1110 prevents expropriation, interpreted as covert or incidental interference that has the effect of depriving the owner in whole or in part of the reasonably expected use of the property.

Under NAFTA rules, Mexico appealed to the Supreme Court of British Columbia, which, in May 2001, substantially upheld the panel's earlier finding in favor of Metalclad. *United Mexican States v. Metalclad Corp.*, [2001] B.C.S.C. 664 (Sup. Ct. of British Columbia, May 2, 2001). In a scholarly opinion applying British Columbia law on enforcement of arbitration awards, the court found that the decree that placed the facility in the ecological zone had the effect of forever barring Metalclad's operation, an act tantamount to expropriation.

Commentators such as Public Citizen and Friends of the Earth sharply criticized the ruling for disregarding environmental protection. They argued that Chapter 11 undermines democratic decision-making. Others lamented the weak NAFTA Environmental Side Agreement, 32 I.L.M. 1480 (1993). Although full of potential and good intentions, the side agreement does not afford the environment the robust protection that Chapter 11 gives to investors.

Despite these concerns, citing its "international obligations," the Mexican government paid Metalclad $16 million in October 2001 to resolve the case. On the other hand, Metalclad's president stated that he was happy to end a "harsh personal and corporate inducement" but regretted that the facility "could have been the first step in addressing one of the most serious environmental problems in our hemisphere."

Metalclad is not the only politically sensitive NAFTA claim. A pending dispute that affects Californians involves Methanex Corp., a Canadian company that filed a Chapter 11 claim against the United States relating to California's ban on the gasoline additive methyl tertiary-butyl ether. Methanex alleges that the MTBE ban, ordered by Gov. Gray Davis in 2000 for environmental-protection reasons, violates the NAFTA prohibition on expropriation. Methanex seeks $970 million in damages.

Canada's environmental laws also have been the subject of Chapter 11 challenges. In the summer of 1998, Canada settled a Chapter 11 dispute brought by Virginia-based Ethyl Corp. concerning Canada's ban of cross-border transport of the gasoline additive methylcyclopentadienyl manganese tricarbonyl. Ethyl claimed that Canada's regulation treated Ethyl differently from Canadian businesses and therefore violated Section 1110. After a preliminary decision from a Chapter 11 panel, Canada paid Ethyl $13 million and publicly declared that there was no scientific basis for the ban.

Metalclad and the other Chapter 11 cases are excellent examples of the increasing importance of international treaty-making and the strong protection afforded to investors under trade agreements such as NAFTA. The cases also evidence the well-established reliance on arbitration to resolve international disagreements. Like it or not, these dispute-resolution rules are working and here to stay. The rule of law prevails, which is better than the alternative. Legal practitioners should learn how these rules affect their clients' interests and seize the opportunities presented.

More fundamentally, the NAFTA cases illustrate that our international relationships involve many substantive policy areas, not all of which are reflected appropriately in existing agreements. Metalclad may have invoked NAFTA Chapter 11 to resolve the dispute over its waste-treatment facility, but most commentators agree that NAFTA's drafters did not anticipate the use of Chapter 11 in the environmental context. Its limited focus is investors' rights, not the environment.

Policy-makers should not ignore NAFTA's shortcomings or the "green" critique of Chapter 11. The rule of law depends on fair and balanced laws. This means that Congress, currently considering fast-track trade-promotion authority, should go beyond the existing provisions of the NAFTA Environmental Side Agreement in future agreements to add a real bite, like in Chapter 11.

This approach is the way of the future. The just-completed World Trade Organization ministerial meeting in Doha, Qatar reached a deal to negotiate and clarify the relationship between World Trade Organization rules and international environmental agreements. Harmonization of environmental and other laws is a hallmark accomplishment of the European Union, soon to include several Central European countries.

The strong provisions of the Basel Convention on the Control of Hazardous Waste Movement, 28 I.L.M. 657 (1989), have nearly 150 signatory nations. Moreover, the United States' Free Trade Agreement with the Kingdom of Jordan approved in November 2001 includes a clause that prohibits either country from relaxing environmental standards to foster trade.

This balanced approach recognizes that international agreements have been, and will remain, critical policy instruments, while better accounting for the full dimensions of our global relationships.

Gideon Kracov is an associate at Rose, Klein & Marias in Los Angeles. **Joseph DiMento** is a professor of law and society at U.C. Irvine.