FAIR AND EQUITABLE TREATMENT: *METHANEX V. UNITED STATES* AND THE NARROWING SCOPE OF NAFTA ARTICLE 1105

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I. INTRODUCTION

The North American Free Trade Agreement (NAFTA) between the United States, Canada, and Mexico, which became effective on January 1, 1994,[1] followed in the footsteps of the Treaties of Friendship, Commerce, and Navigation and bilateral investment treaties (BITs) in providing protection to foreign investment.[2] The NAFTA's trilateral arrangement guarantees comprehensive protection to the investments of one NAFTA Party's investors in the territory of another.[3] Investment is defined broadly in Article 1139 of the NAFTA and includes ownership and other interests in an enterprise, equity or debt securities, real estate, and tangible and intangible property, including intellectual property.[4] Chapter 11 of the NAFTA addresses investment protection and sets out three objectives: "(1) to establish a secure investment environment through the elaboration of clear rules of fair treatment of foreign investment and investors; (2) to remove barriers to investment by eliminating or liberalizing existing restrictions; and (3) to provide an effective means for the resolution of disputes between an investor and the host government."[5] Article 1105(1) provides that "[e]ach Party shall accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treat-

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1. North American Free Trade Agreement, Dec. 17, 1992, U.S.-Can.-Mex., 32 I.L.M. 289 (1993) [hereinafter NAFTA].

2. *See* K. Scott Gudgeon, *United States Bilateral Investment Treaties: Comments on Their Origin, Purposes, and General Treatment Standards*, 4 INT'L TAX & BUS. LAW 105, 107-12 (1986).

3. *See* David A. Gantz, *Potential Conflicts Between Investor Rights and Environmental Regulation Under NAFTA's Chapter 11*, 33 GEO. WASH. INT'L L. REV. 651, 652 (2001).

4. *See* JON R. JOHNSON, THE NORTH AMERICAN FREE TRADE AGREEMENT: A COMPREHENSIVE GUIDE § 7.7 (1994); Daniel M. Price & P. Bryan Christy, III, *An Overview of the NAFTA Investment Chapter: Substantive Rules and Investor-State Dispute Settlement*, *in* THE NORTH AMERICAN FREE TRADE AGREEMENT: A NEW FRONTIER IN INTERNATIONAL TRADE AND INVESTMENT IN THE AMERICAS 165, 173 (Judith H. Bello et al. eds., 1994).

5. Price & Christy, *supra* note 4, at 172.

ment and full protection and security."[6]

The scope of Article 1105's investment protections is presently subject to great debate. Disputes recently arbitrated under the Chapter 11 dispute resolution mechanism have highlighted the tension between protections provided to investments and the power of governments, including state or provincial governments, to regulate.[7] Many of these disputes have involved environmental regulation.[8] The tension between investment protection and government regulation, combined with the broad definitions employed in the text of the NAFTA, has brought to the fore debate about the scope of these protections. The scope of fair and equitable treatment has been addressed by several Chapter 11 arbitral tribunals and is presently being addressed in *Methanex v. United States.*[9]

This Note will first consider "fair and equitable treatment" generally, as defined in BITs and customary international law. Second,

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6. NAFTA, *supra* note 1, art. 1105(1), 32 I.L.M. at 639. The protections of Article 1105 extend to the investment and not to the investor. The distinction was made based on concern that extension to investors as well as investments would allow personal injury claims against the Parties. Price & Christy, *supra* note 4, at 174.

7. *See* Gantz, *supra* note 3, at 654-55.

8. *See* David A. Gantz, *Reconciling Environmental Protection and Investor Rights Under Chapter 11 of NAFTA*, 31 Envtl. L. Rep. (Envtl. L. Inst.) 10646, 10653-56 (June 2001). Chapter 11 arbitrations involving environmental issues include *Methanex Corp. v. United States*; *Metalclad Corp. v. United Mexican States*; *Pope & Talbot Inc. v. Canada*; *Ethyl Corporation v. Canada*; and *S.D. Myers, Inc. v. Canada*. The best places to find documents in these cases are the website of the Office of the Legal Adviser of the U.S. Department of State, http://www.state.gov/s/l/c3439.htm, and the website of Canadian attorney Todd Weiler, http://www.naftaclaims.com. *See* Gantz, *supra* note 3, at 659 n.32, 659-70. *See generally* William T. Waren, *Paying to Regulate: A Guide to Methanex v. United States and NAFTA Investor Rights*, 31 Envtl. L. Rep. (Envtl. L. Inst.) 10,986 (Aug. 2001); Lucien J. Dhooge, *The Revenge of the Trail Smelter: Environmental Regulation as Expropriation Pursuant to the North American Free Trade Agreement*, 38 AM. BUS. L.J. 475 (2001); Jason L. Gudofsky, *Shedding Light on Article 1110 of the North American Free Trade Agreement (NAFTA) Concerning Expropriations: An Environmental Case Study*, 21 NW. J. INT'L L. & BUS. 243 (2000); Julia Ferguson, *California's MTBE Contaminated Water: An Illustration of the Need for an Environmental Interpretive Note on Article 1110 of NAFTA*, 11 COLO. J. INT'L ENVTL. L. & POL'Y 499 (2000).

9. Methanex Corporation filed its original Notice of Intent to Submit a Claim on July 2, 1999. The arbitration is conducted following the Arbitration Rules of the United Nations Commission on International Trade Law (UNCITRAL). The three arbitrators initially appointed were V.V. Veeder, QC, Warren Christopher, Esq., and J. William Rowley, QC. Methanex Notice of Change of Counsel and Amended Notice of Intent at 9, 12, Methanex Corp. v. United States (Nov. 30, 2000), *available at* http://www.state.gov/documents/organization/3973.pdf. In response to a challenge by Methanex, Warren Christopher resigned on September 20, 2002. *See* Response of Arbitrator Warren Christopher to Notice of Challenge (Sept. 20, 2002), *available at* http://www.naftaclaims.com. Professor W. Michael Reisman of Yale University has joined the Tribunal as the third arbitrator.

this Note will review NAFTA Chapter 11 jurisprudence regarding the scope of fair and equitable treatment. Third, I will examine the *Methanex* proceeding in which the scope of fair and equitable treatment is presently being considered. Fourth, I will evaluate the effects of the Free Trade Commission's (FTC) Interpretation of Certain Chapter 11 Provisions of July 31, 2001 (the "Interpretation"), in which the FTC clarified the scope of Article 1105's fair and equitable treatment provision. Finally, I will suggest a logical interpretation of fair and equitable treatment in light of Article 1105's text and purpose.

A. *Fair and Equitable Treatment Generally*

"Fair and equitable treatment," like many terms in the text of the NAFTA, is not defined. Traditional rules of treaty interpretation mandate that the terms of a treaty be interpreted in accordance with their plain meaning in light of the object and purpose of the treaty.[10] If the terms are ambiguous or the plain reading would lead to an unreasonable result, resorting to the *travaux préparatoires*, or negotiating history, is appropriate.[11] The *travaux préparatoires* for Chapter 11, however, are limited.[12] Critics of the NAFTA argue for a narrow interpretation of fair and equitable treatment, whereas proponents argue for a more expansive reading.

"Fair and equitable treatment" is a term of international law that appears in BITs that the United States has entered into with other states, as well as in BITs between other states. "Nearly all recent BITs require that investments and investors covered under the treaty receive 'fair and equitable treatment,' in spite of the fact that there is no general agreement on the precise meaning of this phrase."[13] BITs were originally designed to protect foreign investment because customary international law provided aliens with only limited rights.[14] U.S. BITs were "intended to protect United States investments in foreign countries, while creating a body of state practice consistent with the United States' position regarding the protection owed by states to alien-owned

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10. *See* Vienna Convention on the Law of Treaties, May 23, 1969, art. 31(1), 1155 U.N.T.S. 331, 8 I.L.M. 679, 691-92.

11. *See id.* art. 32, 8 I.L.M. at 692.

12. *See* Clyde C. Pearce & Jack Coe, Jr., *Arbitration Under NAFTA Chapter Eleven: Some Pragmatic Reflections Upon the First Case Filed Against Mexico*, 23 HASTINGS INT'L & COMP. L. REV. 311, 314 (2000).

13. RUDOLF DOLZER & MARGRETE STEVENS, BILATERAL INVESTMENT TREATIES 58 (1995).

14. *See id.* at 10-11.

property under customary international law."[15] U.S. BITs were initially entered into primarily with developing nations, and consequently, the agreements contained strong protections for investors in order to encourage foreign investment.[16]

The scope of fair and equitable treatment, however, generally is not clearly defined in the BITs. The principal debate among scholars and practitioners is whether fair and equitable treatment is limited to the international minimum standard in international law, whether it is an independent and objective standard based on the plain meaning approach of statutory interpretation, or whether it has evolved into an independent norm of customary international law.[17] One scholar adopted the restrictive view, finding that the fair and equitable treatment provision provided a "baseline of protection which will be useful principally in situations where other substantive provisions of international law and national law provide no protection. It provides a basic principle of equitable treatment to guide interpretation of other BIT provisions."[18] A more expansive view of its scope highlights its independence as a standard. "The terms 'fair and equitable treatment' envisage conduct which goes far beyond the minimum standard and afford protection to a greater extent and according to a much more objective standard than any previously employed form of words."[19] Investors generally argue for the more expansive view, seeking greater investment protection, whereas states generally argue for the more restrictive view, seeking to limit their liability to foreign investors.

II. NAFTA JURISPRUDENCE

Since the NAFTA became effective on January 1, 1994, several Chapter 11 tribunals have considered the scope of the fair and equitable treatment provision in Article 1105.

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15. KENNETH J. VANDEVELDE, UNITED STATES INVESTMENT TREATIES: POLICY AND PRACTICE 1 (1992).

16. *See id.* at 19-20.

17. *See* DOLZER & STEVENS, *supra* note 13, at 58-60; Stephen Vasciannie, *The Fair and Equitable Treatment Standard in International Investment Law and Practice*, 70 BRIT. Y.B. INT'L L. 99, 102-05 (2000).

18. VANDEVELDE, *supra* note 15, at 76-77.

19. DOLZER & STEVENS, *supra* note 13, at 59 (quoting F.A. Mann, *British Treaties for the Promotion and Protection of Investments*, 52 BRIT. Y.B. INT'L L. 242, 244 (1981)).

A. *Metalclad Corporation v. United Mexican States*

Metalclad Corporation ("Metalclad"), an American company, claimed that a Mexican municipality's denial of a Municipal Construction License to its indirectly wholly-owned subsidiary Confinamiento Tecnico de Residuos Industriales, S.A. de CV (COTERIN) based on environmental grounds was a violation of NAFTA Articles 1105 (fair and equitable treatment) and 1110 (expropriation).[20] COTERIN purchased a hazardous waste landfill site in the La Pedrera Valley, located in the municipality of Guadalcazar, in the State of San Luis Potosi.[21] The site had previously stored untreated toxic waste.[22] The National Ecological Institute (INE), a sub-agency of the federal Secretariat of the Mexican Environment, National Resources and Fishing, granted COTERIN a federal permit in January 1993 to construct a hazardous waste landfill, and COTERIN began construction on the site thereafter.[23]

In April 1993, Metalclad entered into an option agreement to purchase COTERIN and its permits in order to construct the landfill.[24] The state government granted COTERIN a state land use permit conditioned on the project meeting certain specifications.[25] In June 1993, Metalclad met with various officials, including the Governor of San Luis Potosi, the President of the INE, and the General Director of the Mexican Secretariat of Urban Development and Ecology, who indicated that, except for the federal permit for operation of the landfill, all the necessary permits had been issued.[26] In August 1993, the INE granted COTERIN the federal permit for operation of the

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20. *See* Máximo Romero Jiménez, *Considerations of NAFTA Chapter 11*, 2 CHI. J. INT'L L. 243, 246-47 (2001) (citing Metalclad v. United Mexican States, ICSID Case No. ARB(AF)/97/1 Final Award (Aug. 30, 2000), *available at* http://www.state.gov/s/l/c3752.htm). Metalclad delivered its Notice of Intent to Submit a Claim to Arbitration under Article 1119 of the NAFTA to Mexico in October 1996. United Mexican States v. Metalclad Corp., 2001 BCSC 664 (May 2, 2001), *available at* http://www.naftaclaims.com [hereinafter Metalclad BCSC]. Metalclad filed its Notice of Claim with the International Centre for Settlement of Investment Disputes (ICSID) on January 2, 1997. Metalclad v. United Mexican States, ICSID Case No. ARB(AF)/97/1 Notice of Claim (Jan. 2, 1997), *available at* http://www.naftaclaims.com.

21. Metalclad BCSC, *supra* note 20, ¶ 3.

22. *See* Jiménez, *supra* note 20, at 246.

23. Metalclad v. United Mexican States, ICSID Case No. ARB(AF)/97/1 Final Award, ¶ 29 (Aug. 30, 2000), *available at* http://www.state.gov/s/l/c3752.htm [hereinafter *Metalclad*].

24. *Id.* ¶ 30.

25. *Id.* ¶ 31.

26. *Id.* ¶¶ 32-33.

site.[27] In September 1993, Metalclad exercised its option and purchased COTERIN.[28] Metalclad claimed that shortly thereafter, the Governor of San Luis Potosi began a public campaign in opposition to the operation of the landfill.[29] In October 1994, after several months of construction and inspections by federal and state officials, the Municipality of Guadalcazar ordered construction to stop, citing Metalclad's lack of a municipal permit.[30] Metalclad applied for a permit and claimed that it was assured by federal officials that it already had all of the authorization needed and that the municipal permit would be granted.[31] Metalclad completed construction of the site in March 1995.[32] Metalclad argued that immediately upon completion, demonstrations in opposition to the site began and state troopers assisted in blocking traffic to and from the site, effectively preventing Metalclad from opening the site.[33] Metalclad's application for a municipal permit was denied after public debate at a Town Meeting, of which Metalclad was not notified.[34] After Metalclad initiated Chapter 11 proceedings, the Governor of San Luis Potosi issued an Ecological Decree declaring a "Natural Area" for the protection of rare cactus, which encompassed the site.[35] The Governor of San Luis Potosi stated that this action "definitely cancelled any possibility that exists of opening the industrial waste landfill of La Pedrera."[36]

The Tribunal found that Mexico failed to provide Metalclad's investment fair and equitable treatment in accordance with international law, as required by Article 1105(1).[37] The Tribunal decided that even if a municipal permit were necessary, the municipality exceeded its powers when it denied the permit on environmental grounds because environmental regulation is a power of the federal government and the municipality's authority extends only to construction considerations.[38] The Tribunal linked Mexico's lack of transparency in contravention of Article 102(1) and fair and equitable treatment and found that the lack

27. *Id.* ¶ 35.
28. *Id.*
29. *Metalclad, supra* note 23, ¶ 36.
30. *Id.* ¶¶ 39-40.
31. *Id.* ¶ 41.
32. *Id.* ¶ 45.
33. *Id.* ¶ 46.
34. *Id.* ¶¶ 50, 54.
35. *Metalclad, supra* note 23, ¶ 59.
36. *Id.* ¶ 60.
37. *Id.* ¶ 74.
38. *Id.* ¶ 86.

of transparency was a violation of Article 1105.[39] Metalclad had relied on the representations of the federal government, which failed to make clear the actual requirements and procedures.[40] "Mexico failed to ensure a transparent and predictable framework for Metalclad's business planning and investment. The totality of these circumstances demonstrates a lack of orderly process and timely disposition in relation to an investor of a Party acting in the expectation that it would be treated fairly and justly in accordance with the NAFTA."[41]

Metalclad's jurisprudential importance arguably has been reduced by the British Columbia Supreme Court's (BCSC) review and effective reversal of parts of the award.[42] Under a British Columbia statute, the International Commercial Arbitration Act (ICAA), a court in British Columbia has jurisdiction to review an award by an arbitral tribunal when the seat of the arbitration was in British Columbia.[43] The seat of the *Metalclad* arbitration was Vancouver, British Columbia, allowing the ICAA judicial review.[44] Mexico sought to have the entire award set aside[45] on the ground that the Tribunal exceeded its jurisdiction in finding that a breach of the NAFTA's transparency provisions constituted a breach of Article 1105(1)'s fair and equitable treatment provision.[46]

In a May 2, 2001 decision, the BCSC decided that the Tribunal erred by linking transparency and fair and equitable treatment.[47] Article 102(1)'s transparency principle is not an actionable obligation under Chapter 11, and therefore the Tribunal exceeded the scope of the submission to arbitration.[48] The BCSC referred to the separate opinion in the *S.D. Myers, Inc. v. Government of Canada* proceeding and stated that although it disagreed with the arbitrator's position that Article 1105's fair and equitable treatment provision encompassed transparency and regulatory fairness, this argument would have been within the proper scope of a Chapter 11 arbitration, and therefore a British Columbia court would not have had the authority to set aside the award

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39. *See* Jiménez, *supra* note 20, at 247.

40. *See Metalclad*, *supra* note 23, ¶¶ 87-88.

41. *Id.* ¶ 99.

42. *See* Gantz, *supra* note 3, at 707.

43. United Mexican States v. Metalclad Corp., 2001 BCSC 664, ¶ 39 (May 2, 2001), *available at* http://www.naftaclaims.com.

44. *See id.*

45. *Id.* ¶ 1.

46. *See id.* ¶ 66.

47. *See id.* ¶¶ 70-71.

48. *Id.* ¶ 72.

under the ICAA.[49] The BCSC also referred disapprovingly to the *Pope & Talbot, Inc. v. Canada* decision that fair and equitable treatment had an "additive element," stating that the *Pope & Talbot* Tribunal "has interpreted the word 'including' in Article 1105 to mean 'plus', which has a virtually opposite meaning."[50] The BCSC's reversal of the *Metalclad* Tribunal's decision with respect to Article 1105's fair and equitable treatment provision effectively narrows the scope of fair and equitable treatment.[51]

However, future Chapter 11 tribunals must keep in mind that the BCSC's decision was based on the its finding that the *Metalclad* Tribunal exceeded its authority. On October 31, 2001, the BCSC issued a subsequent opinion in which it clarified its earlier decision.[52] Justice Tysoe stated,

> Although I have concluded that the Tribunal made decisions on matters outside the scope of the submission to arbitration when it found the first two breaches of Articles 1105 and 1110, I should not be taken as holding that there was no breach of Article 1105 and no breach of Article 1110 until the issuance of the Ecological Decree .... If Metalclad wishes to pursue the portion of the interest contained in the Award which I have set aside, by establishing a breach of Article 1105 or Article 1110

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49. *See* Metalclad BCSC, *supra* note 20, ¶¶ 68-69.

50. *Id.* ¶ 65.

51. In *Methanex v. United States*, both Methanex and the United States considered the effect of the BCSC's decision on the arbitral award in *Metalclad*. Methanex asserted that the BCSC "erred in concluding that transparency is not an important procedural objective of NAFTA." Claimant Methanex Corporation's Rejoinder to United States' Reply Memorial on Jurisdiction, Admissibility and the Proposed Amendment, 53-54 n.21 (May 25, 2001) [hereinafter Methanex Rejoinder on Jurisdiction], *available at* http://www.state.gov/documents/organization/6043.pdf. As an "important procedural objective," transparency is "encompassed within the requirement of 'fair and equitable treatment' regardless." *Id.* "[M]ost fundamentally, the municipal court reviewing *Metalclad* is not an international tribunal at all, and it plainly overstepped its authority in substituting its judgment on issues of international law for that of the international arbitral tribunal assigned express adjudicatory authority pursuant to NAFTA." *Id.* The United States responded that although transparency is required by Chapter 18, lack of transparency is not actionable under Chapter 11 because it is not included in Articles 1116(1) or 1117(1), which set forth actionable bases under Chapter 11, and it is not part of customary international law. *See* Rejoinder Memorial of Respondent United States of America on Jurisdiction, Admissibility and the Proposed Amendment, 31-33 (June 27, 2001) [hereinafter U.S. Rejoinder on Jurisdiction], *available at* http://www.state.gov/documents/organization/6040.pdf.

52. United Mexican States v. Metalclad Corp., 2001 BCSC 1529 (Oct. 31, 2001), *available at* http://www.courts.gov.bc.ca/jdb-txt/sc/01/15/2001bcsc1529.htm.

> prior to the issuance of the [Ecological] Decree without regard to the concept of transparency, the matter is remitted to the Tribunal.[53]

Therefore, the BCSC's decision of May 2, 2001, cannot be interpreted to mean that Mexico provided Metalclad with fair and equitable treatment; instead, it means that Article 102's transparency requirement is not an element to be considered in determining a breach of Article 1105.

B. *Ethyl Corporation v. Government of Canada*

Ethyl Corporation, an American company, claimed that Canada's enactment of the Manganese-based Fuel Additives Act, which banned the import into Canada and the interprovincial sale of a gasoline-enhancing product, methylcyclopentadienyl manganese tricarbonyl (MMT), effectively prevented the sale of foreign-produced MMT.[54] Canada enacted the import and interprovincial sale ban on MMT because it was unable to effect a total ban on MMT as a toxic substance under the Canadian Environmental Protection Act.[55] Although Canada agreed to settle before the Tribunal addressed the merits, Canada's discriminatory and non-uniform legislative ban likely would have been assessed under Article 1105's fair and equitable treatment standard.[56]

C. *S.D. Myers, Inc. v. Government of Canada*

S.D. Myers, Inc. ("S.D. Myers"), an American company, claimed that Canada's enactment of an export ban on polychlorinated biphenyl (PCB) waste effectively prevented its competition in the Canadian PCB waste market[57] and denied it fair and equitable treatment under Article 1105.[58] S.D. Myers had a PCB treatment facility in Ohio but did not have one in Canada.[59] Canada's ban on PCB waste exports shut S.D.

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53. *Id.* ¶ 4.

54. *See* Gantz, *supra* note 3, at 665.

55. *See id.*

56. *See id.* at 666.

57. *See* Todd Weiler, *A First Look at the Interim Merits Award in S.D. Myers, Inc. v. Canada: It Is Possible to Balance Legitimate Environmental Concerns with Investment Protection*, 24 HASTINGS INT'L & COMP. L. REV. 173, 175 (2001).

58. *See* S.D. Myers, Inc. v. Canada Partial Award, ¶ 136 (Nov. 13, 2000), *available at* http://www.naftaclaims.com.

59. *Id.*

Myers out of the Canadian PCB waste treatment market. S.D. Myers argued that the PCB ban was enacted in order to benefit Chem-Securities, Canada's only PCB treatment facility.[60] Canada counter-argued that it was obligated to enact the ban in order to comply with various international environmental agreements.[61] The Tribunal applied reasoning similar to the recent *Metalclad* decision and found that intentional discrimination on the basis of nationality is a breach of international law and consequently a breach of Article 1105.[62]

D. *Pope & Talbot, Inc. v. Canada*

Pope & Talbot, Inc. ("Pope & Talbot"), a U.S. corporation, brought a Chapter 11 claim in March 1999 against Canada based on Canada's enactment of export quotas and other measures in its implementation of the 1996 United States-Canada Softwood Lumber Agreement.[63] Pope & Talbot's claim was based on Canada's implementation measures and not on the Softwood Lumber Agreement itself.[64] Canada imposed a fee-free export quota system, which reallocated quotas among British Columbia, Quebec, Ontario, and Alberta.[65] Pope & Talbot brought a complaint against Canada, claiming that the export quotas and other measures discriminated against Pope & Talbot's Canadian subsidiary in British Columbia in violation of Canada's Chapter 11 obligations.[66] Pope & Talbot claimed that Canada's measures were in violation of several Chapter 11 obligations, including Article 1102 (national treatment), Article 1105 (minimum standard of treatment), and Article 1110 (expropriation).[67]

The Tribunal rendered a Merits Award on April 10, 2001, in favor of

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60. *Id.* at 667.

61. Canada argued that the PCB export ban was necessary in order to comply with the Basel Convention on the Control of Transboundary Movements of Hazardous Waste and their Disposal and under the Agreement of the Government of Canada and the Government of the United States Concerning the Transboundary Movement of Hazardous Waste. *Id.*

62. Weiler, *supra* note 57, at 184.

63. Robert K. Paterson, *A New Pandora's Box? Private Remedies for Foreign Investors Under the North American Free Trade Agreement*, 8 WILLAMETTE J. INT'L L. & DISP. RESOL. 77, 100 (2000).

64. Appleton & Associates, Backgrounder: NAFTA Award, Pope & Talbot, Inc. and Canada, *available at* http://www.appletonlaw.com/4b3P&T.htm (last visited Sept. 19, 2002).

65. Press Release by Pope & Talbot, Pope & Talbot, Inc. Files Claim Against Government of Canada for Damages Under NAFTA, ¶ 4 (Mar. 25, 1999), *at* http://www.appletonlaw.com/4b3P&T.htm.

66. *See* Gantz, *supra* note 3, at 694.

67. *Id.* at 695.

Pope & Talbot on the Article 1105 claim.[68] The Tribunal found that Canada's Softwood Lumber Division of the Department of Foreign Affairs and International Trade (SLD) failed to provide Pope & Talbot's investment, here its subsidiary, fair and equitable treatment.[69]

> [T]he end result for the Investment was being subjected to threats, denied its reasonable requests for pertinent information, required to incur unnecessary expense and disruption in meeting SLD's requests for information, forced to expend legal fees and probably suffer a loss of reputation in government circles. . . . In its totality, the SLD's treatment of the Investment during 1999 in relation to the verification review process is nothing less than a denial of the fair treatment required by NAFTA Article 1105, and the Tribunal finds Canada liable to the Investor for the resultant damages.[70]

Canada had argued for a narrow interpretation of Article 1105's fair and equitable treatment provision.[71] Canada asserted that Article 1105's minimum treatment standard required "egregious" conduct in order to have a violation.[72] Canada argued that Article 1105's scope of fairness was consistent with traditional customary law principles of fairness and did not extend further than the customary international minimum standard of treatment of aliens.[73] The Tribunal acknowledged the possibility of a broader interpretation, encompassing fairness in addition to the international law minimum.[74] The Tribunal considered U.S. and other states' BITs and determined that they demonstrate an evolution of investor rights to include fairness elements beyond customary international law.[75] It also rejected the United States' textual argument that the language of Article 1105 ("in accordance with international law, including fair and equitable treatment") shows that the "drafters of NAFTA Chapter 11 'excluded any possible conclusion that the parties were diverging from the customary interna-

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68. Pope & Talbot Inc. v. Canada Award on the Merits of Phase 2, ¶ 195 (Apr. 10, 2001), *available at* http://www.appletonlaw.com/cases/P&T-Merits%20Award-April%2010,%202001.pdf [hereinafter *Pope & Talbot Inc.*].

69. *See* Appleton & Associates, Backgrounder, *supra* note 64, at 2.

70. *Id.*

71. Gantz, *supra* note 3, at 698; *see Pope & Talbot Inc.*, *supra* note 68, ¶ 108.

72. *Pope & Talbot Inc.*, *supra* note 68, ¶ 108; Gantz, *supra* note 3, at 698.

73. *See Pope & Talbot Inc.*, *supra* note 68, ¶¶ 108-09; Gantz, *supra* note 3, at 698.

74. *Pope & Talbot Inc.*, *supra* note 68, ¶ 110.

75. *See Pope & Talbot Inc.*, *supra* note 68, ¶ 111; Gantz, *supra* note 3, at 699.

tional law concept of fair and equitable treatment.' "[76]

The Tribunal reasoned that the protections in the NAFTA would not be less than those in BITs.[77]

> [T]here is the basic unlikelihood that the Parties to NAFTA would have intended to curb the scope of Article 1105 *vis-à-vis* one another when they (at least Canada and the United States) had granted broader rights to other countries that cannot be considered to share the close relationships with the NAFTA parties that those Parties share with one another. NAFTA begins by stressing "the special bonds of friendship and cooperation among their nations."[78]

The Tribunal also pointed out that a narrow interpretation of fair and equitable treatment would allow the NAFTA Parties to treat foreign investors less favorably than they treat domestic investors, which would be contrary to other Chapter 11 protections.[79] The Tribunal "interpret[ed] Article 1105 to require that covered investors and investments receive the benefits of the fairness elements under ordinary standards applied in the NAFTA countries, without any threshold limitation that the conduct complained of be 'egregious,' 'outrageous,' or 'shocking', or otherwise extraordinary."[80]

Applying this broad interpretation of fair and equitable treatment to the case, the Tribunal concluded that only one action by SLD constituted a violation of Article 1105.[81] Interestingly, the action occurred on March 25, 1999, shortly after Pope & Talbot had filed its Notice of Arbitration on December 24, 1998.[82] SLD conducted an audit of Pope & Talbot's records, including questionnaires submitted in response to requirements for the quota allocation system, and required a verification of documents, which necessitated several truckloads of documents to be shipped from Pope & Talbot's headquarters in Portland, Oregon,

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76. Gantz, *supra* note 3, at 699; *see Pope & Talbot Inc., supra* note 68, ¶¶ 112-15.

77. The Tribunal rejected the argument that the NAFTA Parties intended "to provide each other's investment more limited protections than those granted to other countries not involved jointly in a continent-wide endeavor aimed, among other things, at 'increas[ing] substantially investment opportunities in the territories of the Parties.' " *Pope & Talbot Inc., supra* note 68, ¶ 115. *See* Gantz, *supra* note 3, at 699.

78. *Pope & Talbot Inc., supra* note 68, ¶ 115.

79. *Id.* ¶ 116; Gantz, *supra* note 3, at 699-700.

80. *Pope & Talbot Inc., supra* note 68, ¶ 118.

81. *See id.* ¶ 171; Gantz, *supra* note 3, at 700.

82. *See Pope & Talbot Inc., supra* note 68, ¶ 156; Gantz, *supra* note 3, at 700.

to SLD in Canada.[83] The Tribunal decided that the manner in which the audit was carried out violated Article 1105, and characterized it as a "naked assertion[] of authority."[84] The Tribunal did not conclude that Pope & Talbot actually suffered injury under the quota system or was otherwise penalized as a result of the audit.[85]

The result of *Pope & Talbot* was a broad interpretation of the scope of fair and equitable treatment in Article 1105. The Tribunal interpreted fair and equitable treatment as encompassing more than the traditional customary law notion of fair and equitable treatment. This interpretation of Article 1105 subjects the NAFTA Parties to greater liability while providing a greater degree of protection for investments.

E. *Azinian v. United Mexican States*

The *Azinian* Tribunal's Award issued on November 1, 1999, was the first Chapter 11 arbitral decision on the merits.[86] Mr. Robert Azinian, Mr. Kenneth Davitian, and Ms. Ellen Baca were U.S. citizens and shareholders of Desechos Solidos de Naucalpan S.A. de C.V. (DESONA), a Mexican waste collection corporation.[87] DESONA entered into a concession contract related to waste collection and disposal on November 15, 1993, with the city of Naucalpan de Juarez, Mexico.[88] Claimants had held themselves out as principals in Global Waste with forty years of experience in the waste collection industry.[89] However, only Mr. Davitian had any experience in the field.[90] Mr. Azinian had no relevant experience, had a history of unsuccessful commercial litigation, and had declared bankruptcy.[91] After becoming dissatisfied with DESONA's poor performance and failure to fulfill its contractual obligations, the Naucalpan Ayuntamiento, or city council, annulled the contract on the grounds that it was either void because of the Claimants' misrepresentations or it was rescindable for non-performance.[92] The Ayuntamiento

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83. *See Pope & Talbot Inc., supra* note 68, ¶ 172; Gantz, *supra* note 3, at 700.

84. *See Pope & Talbot Inc., supra* note 68, ¶ 174.

85. Gantz, *supra* note 3, at 700.

86. Paterson, *supra* note 63, at 125.

87. Azinian v. United Mexican States, ICSID Case No. ARB(AF)/97/21 (Nov. 1, 1999), ¶ 1, *in* 39 I.L.M. 537 (2000) [hereinafter *Azinian*].

88. *Id.* ¶ 1.

89. *Id.* ¶ 29.

90. *Id.* ¶¶ 29-30.

91. *Id.* ¶ 30.

92. *See id.* ¶ 35.

found twenty-seven grounds for termination of the contract.[93] DESONA challenged this decision in Mexican courts and lost.[94]

After failing in Mexican courts, claimants brought NAFTA Chapter 11 claims under Articles 1110 (expropriation) and 1105 (fair and equitable treatment).[95] It is well established that international arbitral tribunals are not bound by the decisions of national courts.[96] Claimants argued that the annulment of the contract was an expropriation, which violated Article 1110, and that their investment did not receive fair and equitable treatment by Mexico, which violated Article 1105.[97] The Tribunal found that claimants failed to put forth an Article 1105 claim.[98] "The only conceivably relevant substantive principle of Article 1105 is that a NAFTA investor should not be dealt with in a manner that contravenes international law. There has not been a claim of such a violation of international law other than the one more specifically covered by Article 1110. . . . [U]nder the circumstances of this case, if there was no violation of Article 1110, there was none of Article 1105 either."[99] Because the only claim advanced by claimants was that the annulment of the contract constituted expropriation in violation of Article 1110, and claimants did not advance a claim of an independent failure to accord fair and equitable treatment, the Tribunal in this instance correctly linked Articles 1110 and 1105.

The Tribunal emphasized that a national court's incorrect decision alone does not constitute a violation of the NAFTA.[100] "More is required; the claimants must show either a denial of justice, or a pretence of form to achieve an internationally unlawful end."[101] In this instance, claimants argued not that the Mexican judiciary's actions deprived them of justice, but that the Naucalpan authorities harmed their investment.[102] Claimants' failure to raise a complaint against the Mexican judiciary defeats their claim. "For if there is no complaint against a determination by a competent court that a contract governed

93. *Azinian, supra* note 87, ¶ 34.

94. DESONA first challenged the annulment before the State Administrative Tribunal and its Superior Chamber and then in a Mexican federal circuit court. The courts upheld the Ayuntamiento's annulment of the contract. *See id.* ¶ 78.

95. *See id.* ¶ 75.

96. *See id.* ¶ 86 (citing Amco v. Indonesia (ICSID)).

97. *See id.* ¶¶ 91-92.

98. *Id.* ¶ 92.

99. *See Azinian, supra* note 87, ¶ 92.

100. *See id.* ¶ 99.

101. *Id.* ¶ 99.

102. *See id.* ¶ 100.

by Mexican law was invalid under Mexican law, there is by definition no contract to be expropriated."[103] If claimants had advanced arguments that the Mexican courts refused to hear their case, subjected them to undue delay, seriously failed to administer justice, or clearly and maliciously misapplied the law, then a denial of justice claim could have been substantiated.[104] The Tribunal concluded that the Naucalpan Ayuntamiento's annulment of the concession contract did not violate Mexico's Chapter 11 obligations to provide claimants' investment fair and equitable treatment under Article 1105.[105]

F. *The Loewen Group, Inc. v. United States*

The Loewen Group, Inc. v. United States is the first NAFTA arbitration in which the foreign corporation investor claimed that the host state's judicial process violated the Chapter 11 investment protections.[106] The Loewen Group ("Loewen"), a Canadian funeral home conglomerate, was sued in Mississippi state court[107] for breach of contract and related claims.[108] The suit was brought by O'Keefe, owner of several funeral homes and Gulf National Funeral Insurance Company.[109] O'Keefe initially sought $4 million in damages, but later increased the amount to $105 million.[110] O'Keefe's attorney, Willie Gary, played upon the jury's racial and nationalistic biases by emphasizing that Loewen was a foreign company making money in a predominantly black community.[111] O'Keefe's lawyers frequently brought up race, nationality, and Loewen's personal wealth.[112] The jury found for O'Keefe and initially awarded $100 million for compensatory damages and $160 million for punitive damages.[113]

Loewen moved for a mistrial on the grounds that Mississippi law requires a separate hearing to determine punitive damages, which it

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103. *Id.* ¶ 100.

104. *Id.* ¶¶ 102-03.

105. *See Azinian*, *supra* note 87, ¶ 124.

106. Michael I. Krauss, *NAFTA Meets the American Torts Process: O'Keefe v. Loewen*, 9 GEO. MASON L. REV. 69, 87 (2000).

107. O'Keefe v. Loewen Group, Inc., 91-67-423 (Cir. Ct., Hinds Co., Miss. 1995).

108. Krauss, *supra* note 106, at 74-75.

109. *Id.* at 74.

110. *Id.* at 77, 80.

111. *Id.* at 77-78.

112. *See* Rene Lettow Lerner, *International Pressure to Harmonize: The U.S. Civil Justice System in an Era of Global Trade*, 2001 BYU L. REV. 229, 237-38.

113. Krauss, *supra* note 106, at 80.

did not receive in the Mississippi state court.[114] The judge initially denied the motion and offered to let the verdict stand if both parties agreed not to file an appeal based on the jury's error.[115] Loewen insisted on arguing the issue of punitive damages before the jury.[116] O'Keefe asked for $1 billion in punitive damages, and the jury awarded $400 million.[117] This was the largest punitive damages award in Mississippi's history.[118]

In order to appeal, Mississippi law requires that the appellant post a bond in the amount of 125% of the judgment.[119] Loewen moved to have the amount of the bond reduced pursuant to Mississippi's Appellate Rule of Procedure 8(b), which provides that the trial court may reduce or eliminate the bond upon a showing of good cause.[120] The judge denied the motion, as well as Loewen's motions for a new trial, for judgment notwithstanding the verdict, and for remittiturs.[121] In order to post a bond, Loewen would have had to provide a $625 million letter of credit, and it would have cost $200 million in non-recoverable fees.[122] Paying the judgment would have bankrupted the company.[123] The Mississippi Supreme Court denied Loewen's petition for review of the trial court's refusal to reduce the bond requirement.[124] O'Keefe likely recognized the high risk of reversal on appeal and settled with Loewen for $175 million.[125]

Loewen brought a NAFTA Chapter 11 claim against the United States[126] based on Articles 1102 (national treatment), 1105 (fair and

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114. *Id.*

115. *Id.*

116. *Id.*

117. *Id.* at 83 (citing O'Keefe v. The Loewen Group Inc., 91-67-423 (Cir. Ct., Hinds Co., Miss. 1995)).

118. Paterson, *supra* note 63, at 96.

119. Krauss, *supra* note 106, at 84.

120. *Id.*

121. *Id.* at 85.

122. *Id.*

123. *Id.*

124. *Id.*

125. *See* Krauss, *supra* note 106, at 86.

126. The United States is responsible for the acts of its judiciary. "Although independent of the Government, the judiciary is not independent of the State: the judgment given by a judicial authority emanates from an organ of the State in just the same way as a law promulgated by the legislature or a decision taken by the executive." Azinian v. United Mexican States, ICSID Case No. ARB(AF)/97/21 Final Award (Nov. 1, 1999), ¶ 98, *in* 39 I.L.M. 537 (2000). A state is responsible for acts of its judiciary in three situations: (1) where the decision of a municipal court is "clearly incompatible with a rule of international law"; (2) where there is a "denial of justice"; and (3)

equitable treatment), and 1110 (expropriation).[127] In its Article 1105 claim, Loewen argued that in its litigation with O'Keefe, the United States failed to give Loewen fair and equitable treatment.[128] Loewen claimed that the Mississippi trial court failed to provide Loewen with fair and equitable treatment "by allowing O'Keefe's lawyers to repeatedly elicit irrelevant and highly prejudicial testimony, and to make irrelevant and highly prejudicial comments, about the nationality, race, and class of the principal parties in the litigation."[129] Loewen also claimed that the "grossly excessive verdict" and Mississippi's application of the bond requirement were denials of fair and equitable treatment.[130]

The Tribunal has not yet issued an award on the merits in this case. Loewen may prevail in its claim, however, in light of the *Azinian* Tribunal's finding that a denial of justice by a Party's judiciary may constitute a violation of that Party's Chapter 11 obligations. Critics of Chapter 11 may find this possibility troubling for several reasons. First, some argue that it is highly unlikely that the NAFTA negotiators intended for the Parties' legal systems to be within the realm of actionable claims. Second, the United States has a highly developed legal system that guarantees certain protections, including due process and right of appeal. Although courts err, the appellate process is designed to review and correct any errors of law of lower courts. Third, many American lawyers and citizens would likely find it troubling that the decision of a U.S. trial court could be challenged by a foreign investor and that this challenge would be reviewed by a panel of three arbitrators, some of whom will not be U.S.-trained lawyers. Fourth, some critics argue that allowing foreign investors to challenge judicial decisions under Chapter 11 gives them another bite at the apple. This gives foreign investors greater rights than domestic investors, whose only recourse is the domestic legal system. However, a judicial decision remains an act of the government that is subject to the obligations

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where the decision is contrary to municipal law. *See id.* The distinction between seeking appellate review of a domestic court decision and bringing a NAFTA claim for denial of justice deserves emphasis. "The possibility of holding a State internationally liable for judicial decisions does not, however, entitle a claimant to seek international review of the national court decisions as though the international jurisdiction seised has plenary appellate jurisdiction. This is not true generally, and it is not true for NAFTA. *What must be shown is that the court decision itself constitutes a violation of the treaty.*" *Id.* ¶ 99.

127. Krauss, *supra* note 106, at 87.

128. *Id.* at 88-89.

129. Lerner, *supra* note 112, at 241.

130. *Id.*

imposed by the NAFTA, including Article 1105. Exempting the judiciary from actions under Chapter 11 would allow the Parties to circumvent the investor protections of the NAFTA by achieving through the judiciary what would otherwise be impermissible actions by the legislature. Unless the NAFTA is amended to exclude judicial actions from the definition of "measure" under Article 201, judicial decisions will remain actionable under Chapter 11 and denials of justice may be deemed a denial of fair and equitable treatment.

III. METHANEX CORP. V. UNITED STATES AND THE FTC INTERPRETATION OF FAIR AND EQUITABLE TREATMENT

A. *Factual Background*

1. The Parties

Methanex Corporation ("Methanex"), a Canadian producer and marketer of methanol, brought a claim against the United States in July 1999 alleging violations of NAFTA Articles 1105 (fair and equitable treatment) and 1110 (expropriation).[131] Methanex is the world's largest producer and marketer of methanol, having a market share of about 24%.[132] Methanex Methanol Company ("Methanex U.S.") is a Texas general partnership indirectly wholly-owned by Methanex.[133] The partnership is made up of Methanex, Inc. and Methanex Gulf Coast, Inc., both incorporated in Delaware.[134] Methanex Fortier, Inc. is incorporated in Delaware and indirectly wholly-owned by Methanex.[135] "Methanex U.S., Methanex Fortier, and their respective operations, goodwill, and market share, as well as Methanex's own goodwill and market share, are investments in the United States as defined by NAFTA."[136] Methanex originally sought damages in the amount of

131. Notice of Intent to Submit a Claim to Arbitration Under Article 1119, Section B, Chapter 11 of the North American Free Trade Agreement at 1, Methanex Corp. v. United States (July 2, 1999) , *available at* http://www.state.gov/s/l/c5819.htm [hereinafter Methanex Notice of Intent]. Methanex was originally incorporated under the laws of Alberta, Canada and is now a continuing corporation under the Canadian Business Corporations Act. Claimant Methanex Corporation's Draft Amended Claim at 3, Methanex Corp. v. United States (Feb. 12, 2001), *available at* http://www.state.gov/documents/organization/7379.doc [hereinafter Methanex Amended Claim].

132. Methanex Amended Claim, *supra* note 131, at 3-4.

133. Methanex Notice of Intent, *supra* note 131, at 2.

134. Methanex Amended Claim, *supra* note 131, at 4.

135. *Id.*

136. *Id.* at 5.

$970 million[137] but amended its claim and increased the amount of damages sought to $1 billion.[138]

2. MTBE

Methanol is a key ingredient in methyl tertiary-butyl ether (MTBE).[139] Forty percent of Methanex U.S.'s sales of methanol in the United States is to third parties who use methanol to produce MTBE.[140] MTBE is used as a source of octane for gasoline and is an oxygenate, which increases the oxygen content of gasoline, thereby increasing fuel efficiency and decreasing vehicle emissions.[141] The use of oxygenates was required by the 1990 Clean Air Act Amendments for use in high smog areas and areas with high carbon monoxide during winter months.[142] MTBE was initially used to replace lead in gasoline[143] and was used in reformulated gasoline to reduce pollution.[144]

MTBE's negative effects on human health are debatable. The World Health Organization determined that MTBE is not a human carcinogen, and the National Toxicology Program did not list it as a carcinogen in its Ninth Report to Congress.[145] California does not classify it as a human carcinogen, developmental toxin, or reproductive toxin.[146] MTBE has actually been used as a medicine for humans.[147] The Environmental Protection Agency (EPA), however, has classified it as a possible human carcinogen.[148] MTBE is highly water soluble and highly resistant to biodegradation.[149] It has a turpentine-like taste and odor, both of which are detectable at even very low concentrations.[150]

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137. Methanex Notice of Intent, *supra* note 131, at 4.

138. Methanex Amended Claim, *supra* note 131, at 37.

139. *See* Methanex Notice of Intent, *supra* note 131, at 2.

140. *Id.*

141. Methanex Corp., *Q&A Background on Methanex's NAFTA Claims and MTBE* 2-3 (last updated Sept. 2000) (on file with Law and Policy in International Business).

142. *See* Waren, *supra* note 8, at 10,988.

143. *See* Ferguson, *supra* note 8, at 507.

144. Methanex Amended Claim, *supra* note 131, at 6.

145. Ferguson, *supra* note 8, at 509.

146. *Id.*

147. Methanex Amended Claim, *supra* note 131, at 7.

148. Statement of Defense of Respondent United States of America ¶ 51, Methanex Corp. v. United States (NAFTA Trib. Aug. 10, 2000), *available at* http://www.state.gov/documents/organization/7339.doc [hereinafter U.S. Statement of Defense].

149. *Id.* ¶¶ 53, 55.

150. *Id* ¶ 52.

3. The California Measures

In 1997, the California legislature passed the MTBE Public Health and Environmental Protection Act, which authorized a study of MTBE's effects and authorized its governor to initiate a phase-out if the study showed that MTBE had harmful effects.[151] The University of California at Davis conducted a study pursuant to this legislation and determined that although MTBE was not conclusively a human carcinogen, its costs outweighed its benefits.[152] The study revealed that MTBE had leaked into as many as 10,000 groundwater sites.[153] The research also showed that "substantial evidence from studies of chronic exposure demonstrate that MTBE is carcinogenic in rats and mice .... MTBE is an animal carcinogen with the potential to cause cancer in humans."[154]

Based on this study and growing public concern, on March 25, 1999, Governor Gray Davis issued an executive order for the phase-out of MTBE by December 31, 2002.[155] The California legislature enacted supporting legislation and required, among other things, that refiners report the amount of MTBE blended into gasoline.[156] California is not alone in implementing a phase-out of MTBE.[157] At least fourteen other states have adopted either phase-out or limiting legislations or have initiated their own studies on the environmental and health effects of MTBE.[158]

B. *Methanex's Claims of Unfair and Inequitable Treatment by California*

Methanex filed its Notice of Intent on July 2, 1999, claiming that California's phase-out plan was unfair and inequitable treatment and was tantamount to an expropriation.[159] Methanex made five claims in support of its assertion that it received unfair and inequitable treatment in violation of Article 1105.[160] First, Methanex claimed that the measures taken by Governor Gray Davis and the California State

151. Waren, *supra* note 8, at 10,988.
152. *Id.* at 10,988-89.
153. Ferguson, *supra* note 8, at 508.
154. Waren, *supra* note 8, at 10,989.
155. Methanex Notice of Intent, *supra* note 131, at 2.
156. Waren, *supra* note 8, at 10,989.
157. *Id.*
158. *Id.* at 10,989-90.
159. Methanex Notice of Intent, *supra* note 131, at 2-3.
160. *Id.*

Legislature "are not based on credible scientific evidence."[161] Second, Methanex argued that the measures "penalize and ban one component of gasoline solely because it provides evidence of the release of gasoline into the environment."[162] Third, Methanex asserted that California "failed to consider alternative effective measures to mitigate the effects of gasoline releases."[163] Fourth, Methanex argued that the measures "result from the failure or delay in enacting appropriate and/or enforcing legislation to reduce or eliminate gasoline releases into the environment."[164] Finally, Methanex insisted that California "failed to take proper consideration of the legitimate interests of Methanex and Methanex US."[165]

Additionally, Methanex argued that California's measures did and would end Methanex's sale of methanol for use in MTBE in California, and that this substantial interference in Methanex's business was directly and indirectly tantamount to an expropriation.[166] Methanex claimed that this expropriation was not compensated, in violation of Article 1110.[167]

Methanex argued that a reason for the MTBE ban was to protect the domestic production of ethanol, a fuel and oxygenate product that competes with MTBE.[168] Ethanol is a heavily subsidized and protected domestic product with a very powerful political lobby.[169] Despite not being the "cleanest of alternative fuels . . . [ethanol] does have the best-organized lobbying machine behind it."[170] The well-organized industry and its lobbyists make generous campaign contributions.[171] Ethanol also has definitively been declared a carcinogen, according to the World Health Organization, the State of California, and the National Toxics Program.[172]

The primary ethanol producer in the United States is Archer-Daniels-Midland (ADM), which holds a market share of more than seventy

161. *Id.* at 2.
162. *Id.*
163. *Id.* at 3.
164. *Id.*
165. Methanex Notice of Intent, *supra* note 131, at 3.
166. *Id.*
167. *See id.*
168. *See* Methanex Amended Claim, *supra* note 131, at 7-8.
169. *Id.* at 9.
170. *Id.* (quoting *You Say Ethanol, I Say Methanol*, WASH. TIMES, Dec. 16, 1993, at A20).
171. *See id.*
172. *Id.* at 11 (citing S. REP. NO. 106-426, at 92 (2000)).

percent.[173] Methanex claims that ADM would be the primary beneficiary of the MTBE ban and that ADM has been pushing for that outcome for some time.[174] Methanex also pointed out that ADM and other members of the ethanol industry have repeatedly emphasized the foreignness of methanol.[175] Emphasizing the foreign origin of methanol plays upon American fears of reliance on foreign sources of energy.[176] ADM's president remarked, "This is the Midwest versus the Middle East," and "It's corn farmers vs. the oil companies."[177] The emphasis on MTBE as a foreign competitor of the domestic product ethanol was also stressed by many members of Congress.[178]

In addition, Methanex claimed that alternative methods exist for preventing MTBE leaks into groundwater. The problem of MTBE leaks can be partially solved by repairing the underground storage tanks (UST) instead of banning MTBE.[179] The problem could be further reduced by banning two-stroke engines on jet-skis and other gasoline-powered boats, which are inefficient and can put out up to thirty percent of their fuel unburnt in their exhaust.[180] Methanex cited California's enactment of a ban instead of employment of the existing alternative measures as evidence of California's unfair and inequitable treatment. This is essentially a "least trade-restrictive" argument.

C. *Methanex's Article 1105 Legal Arguments Prior to the FTC Interpretation*

1. Article 1105 Should Be Interpreted Broadly to Include International Treaty Law as Well as Customary International Law

Methanex argued that the fair and equitable treatment provision of Article 1105 should be interpreted broadly in order to give effect to the NAFTA Parties' goals of encouraging and protecting foreign

173. *Id.* at 12.

174. *See* Methanex Amended Claim, *supra* note 131, at 12-13.

175. *Id.* at 13-14.

176. *See id.*

177. *Id.* at 13 (quoting John Bovard, *Corporate Welfare Fueled by Political Contributions*, BUS. & SOC'Y REV., June 22, 1995, at 22; David Greising & Peter Hong, *Big Stink on the Farm*, BUS. WK., July 20, 1992, at 31).

178. *See id.* at 15-18.

179. *Id.* at 24.

180. Methanex Amended Claim, *supra* note 131, at 27.

investment.[181] Methanex argued that several Chapter 11 tribunals determined that the NAFTA provisions must be broadly construed, including the *Loewen* Tribunal.[182] "NAFTA is to be interpreted in good faith in accordance with the ordinary meaning to be given to its terms in their context and in light of its object and purpose."[183] Methanex argued that fair and equitable treatment encompassed far more than a "mere prohibition on arbitrary and discriminatory measures,"[184] and was a heightened standard in order to provide investment protection.[185] Methanex argued that fair and equitable treatment should be interpreted in accordance with its plain meaning.[186] Additionally, Methanex argued that international law includes both customary international law and treaty law.[187]

2. Methanex's Bases for its Article 1105 Claim

Methanex initially put forth four bases for its Article 1105 claim of denial of fair and equitable treatment. First, Methanex argued that Article 1105 requires state officials to act without a financial or personal interest in their decision-making process.[188] Methanex claimed that Governor Davis' receipt of campaign contributions from ADM, a member of the protected domestic ethanol industry, although legal under U.S. law, violated international law because his actions were "unfair, inequitable, and not in accord with the duty of independence."[189]

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181. Claimant Methanex Corporation's Counter-Memorial on Jurisdiction at 2-3, Methanex Corp. v. United States (NAFTA Trib. Feb. 12, 2001)], *available at* http://www.state.gov/documents/organization/3939.doc [hereinafter Methanex Counter-Memorial].

182. *Id.* (citing The Loewen Group, Inc. v. United States, ICSID Case No. ARB(AF)/98/3, First Award on Jurisdiction ¶ 51 (Jan. 5, 2001) [hereinafter *Loewen*]). The *Loewen* Tribunal decided that certain provisions of the NAFTA required a liberal interpretation. "The text, context, and purpose of Chapter Eleven combine to support a *liberal* rather than a restricted interpretation of the words 'measures adopted or maintained by a Party,' that is, an interpretation which provides protection and security for the foreign investor and its investment." *Id.* at 3-4 (quoting *Loewen, supra*, ¶ 53).

183. *Id.* at 3 (quoting *Loewen, supra* note 182, ¶ 51).

184. Methanex Amended Claim, *supra* note 131, at 48.

185. Methanex Counter-Memorial, *supra* note 181, at 8.

186. *See* Methanex Amended Claim, *supra* note 131, at 48 (citing Metalclad v. United Mexican States, ICSID Case No. ARB(AF)/97/1 Final Award, ¶ 20 (Aug. 30, 2000), *available at* http://www.state.gov/s/l/c3752.htm).

187. *Id.*

188. *Id.* at 49.

189. *Id.* at 51.

Second, Methanex argued that Article 1105's fair and equitable treatment provision requires states to act reasonably and in good faith, both of which are equitable principles that Methanex claimed are incorporated into international law.[190] Methanex asserted that the California's MTBE ban was unreasonable because alternative methods existed to deal with the problem of MTBE pollution in the drinking water.[191] The existence of alternative methods and the evidence of Governor Davis' favoritism for ADM and the domestic ethanol industry suggest that the California measures were not made in good faith.[192]

Third, Methanex argued that discriminatory measures are by definition unfair and inequitable and that California's MTBE ban was discriminatory in both intent and effect.[193] Methanex argued that the California measures were intended to protect the domestic ethanol industry and resulted in Methanex's loss of market share in favor of domestic ethanol producers.[194]

Finally, Methanex argued that regulatory measures that are disguised restrictions on trade and investment and that are not the least trade-restrictive approach, following the World Trade Organization (WTO)/General Agreement on Tariffs and Trade (GATT) standard, violate Article 1105.[195] In support of this argument, Methanex asserted that the violation of an international principle for the protection of investment or trade was also a violation of the Article 1105 requirement that measures be fair, equitable, and in accordance with international law.[196] Methanex cited the result in *S.D. Myers v. Canada* for this proposition.[197]

> In some cases, the breach of a rule of international law by a host Party may not be decisive in determining that a foreign investor has been denied 'fair and equitable treatment,' but the fact that a host Party has breached a rule of international law that is

190. *Id.* at 53.

191. *Id.* at 55.

192. Methanex Amended Claim, *supra* note 131, at 56.

193. *Id.*

194. *Id.*

195. *Id.* at 58.

196. *Id.*

197. Methanex Amended Claim, *supra* note 131, at 58 (citing S.D. Myers, Inc. v. Canada (U.S.-Can.), NAFTA-UNCITRAL Tribunal, ¶ 234 (Nov. 13, 2000), *available at* http://www.appletonlaw.com/cases/Myers%20-%20Final%20Merits%20Award.pdf (separate opinion of Dr. Bryan Schwartz)).

specifically designed to protect investors will tend to weigh heavily in favour of finding a breach of Article 1105.[198]

Methanex claimed that Article 1105's definition of international law included both customary and treaty law, and therefore the United States' violations of obligations in WTO Agreements would constitute Article 1105 violations.[199] Methanex's four claims advocated a broad interpretation of both fair and equitable treatment and international law, viewing the latter as encompassing both customary international law and treaty law.

D. *The United States' Article 1105 Legal Arguments Prior to the FTC Interpretation*

1. Article 1105 Refers Only to Customary International Law

The United States' primary argument was that Article 1105's reference to international law is limited to customary international law and does not extend to independent treaty obligations.[200] The United States further argued that Methanex failed to identify any customary international law standard of treatment incorporated into Article 1105 that was applicable.[201] The United States argued that fair and equitable treatment is an example of the treatment in accordance with customary international law that Article 1105 provides.[202] Fair and equitable treatment is not an independent standard and cannot be applied without reference to customary international law.[203]

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198. *Id.* (citing S.D. Myers, Inc. v. Canada (U.S.-Can.), NAFTA-UNCITRAL Tribunal, ¶ 264 (Nov. 13, 2000), *available at* http://www.appletonlaw.com/cases/Myers%20-%20Final%20Merits%20Award.pdf).

199. *See id.* at 48-49. Methanex claimed that California's measures violated the WTO Agreement on Technical Barriers to Trade, which requires Members to employ the least trade-restrictive method possible. Methanex acknowledged that the WTO Agreement on Phytosanitary Measures does not apply because the California MTBE ban was enacted to protect the environment and not to protect health, but argued that if it did apply, then California would be in violation because the ban was arbitrary, unjustified, and discriminatory. *Id.* at 58-64.

200. *See* Reply Memorial of Respondent United States of America on Jurisdiction, Admissibility and the Proposed Amendment at 23, Methanex Corp. v. United States (Apr. 12, 2001), *available at* http://www.state.gov/s/l/c5822.htm [hereinafter U.S. Reply Memorial].

201. U.S. Statement of Defense, *supra* note 148, ¶ 139.

202. Memorial on Jurisdiction and Admissibility of Respondent United States of America at 39, Methanex Corp. v. United States (Nov. 13, 2000), *available at* http://www.state/gov/s/l/c5822.htm [hereinafter U.S. Memorial].

203. *See id.*

First, the United States argued that the plain language and structure of Article 1105 support its interpretation. According to the United States, "Article 1105(1)'s provision for 'treatment in accordance with international law, *including* fair and equitable treatment' clearly states the primacy of customary international law."[204] In addition, the heading of Article 1105 is "Minimum Standard of Treatment," which the United States viewed as confirming the customary international law minimum standard.[205]

Second, the United States argued that Methanex's broad interpretation of international law as encompassing independent treaty obligations in addition to customary international law was illogical in the context of Chapter 11.[206] The United States pointed to the provisions in Articles 1116(1) and 1117(1) that limit the scope of investor-state arbitration to specified NAFTA provisions as evidence of the Parties' intent to limit the subjects that a NAFTA tribunal could address.[207] Articles 1116(1) and 1117(1) provide for arbitration of claims based on a breach of only Section A of Chapter 11, Article 1503(2), or Article 1502(3)(a) under certain circumstances.[208] The United States argued that this limited arbitration provision in Chapter 11 could not logically or reasonably be extended to include independent treaty obligations.[209] According to Professor Vagts, Bemis Professor of Law at Harvard Law School and reporter for the *Restatement (Third) of Foreign Relations Law of the United States*, an expert witness for the United States in this proceeding:

> The question before the Tribunal, however, is not what "international law" means in the abstract, but rather what that term means in the specific context of Article 1105(1). As a preliminary matter, it is not apparent to me that it would be reasonable to read 'international law' in the context of a provision such as Article 1105(1) as referring to any source other than customary international law. It is difficult to reconcile the notion that 'international law' includes other provisions of the NAFTA or other conventional obligations with the carefully limited scope

204. *Id.* at 41-42 (emphasis in original).

205. *Id.* at 42.

206. *See* U.S. Rejoinder on Jurisdiction, *supra* note 51, at 20.

207. *Id.*

208. U.S. Reply Memorial, *supra* note 200, at 31.

209. *See id. at 32.*

of arbitral jurisdiction provided in NAFTA Articles 1116(1) and 1117(1).[210]

In further response to Methanex's claims that breaches of the WTO Technical Barriers and Sanitary and Phytosanitary Agreements constitute breaches of Article 1105, the United States pointed out that Articles 1116(1) and 1117(1) do not provide for arbitration based on NAFTA's similar provisions on technical barriers and sanitary and phytosanitary measures, which are found in Section B of Chapter 7, "Sanitary and Phytosanitary Measures," and in Chapter 9, "Standards-Related Measures."[211]

Third, the United States further supported its argument by reference to "the most direct antecedent to the usage of 'fair and equitable treatment' in international investment agreements," the OECD Draft Convention on the Protection of Foreign Property.[212] The Draft stated that fair and equitable treatment refers to "the standard set by international law for the treatment due by each State with regard to the property of foreign nationals."[213]

Fourth, the United States argued that each of the three NAFTA Parties formally expressed in NAFTA proceedings that fair and equitable treatment is limited to the minimum standard of customary international law.[214] They also argued that the expression of the same view by all three Parties constitutes an agreement on the issue and that applying Article 31(3)(b) of the Vienna Convention on the Law of Treaties, the agreement is authoritative.[215] "There shall be taken into account . . . any subsequent practice in the application of the treaty

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210. U.S. Rejoinder on Jurisdiction, *supra* note 51, at 20 (citing the Expert Report of Detlev F. Vagts).

211. U.S. Reply Memorial, *supra* note 200, at 32.

212. U.S. Memorial, *supra* note 202, at 39. The OECD Draft Convention on the Protection of Foreign Property, *reprinted in* 7 I.L.M. 117, 119 (1968), was first proposed in 1963 and revised in 1967. *Id.*

213. *Id.* at 39-40 (quoting OECD, 1967 Draft Convention on the Protection of Foreign Property, *supra* note 212, at 120).

214. U.S. Memorial, *supra* note 202, at 39-43. Mexico and Canada adopted this position in pleadings presented to the Supreme Court of British Columbia, which heard Mexico's application to set aside the award in United States v. Metalclad, Vancouver Registry No. L002904 (Brit. Colum. S. Ct.). U.S. Reply Memorial, *supra* note 200, at 23; *see* Post-Hearing Submission of Respondent United States of America at 2, Methanex Corp. v. United States (Jul. 20, 2001), *available at* http://www.state.gov/documents/organization/6050.pdf [hereinafter U.S. Post-Hearing Submission].

215. U.S. Reply Memorial, *supra* note 200, at 24.

which establishes the agreement of the parties regarding its interpretation."[216]

Fifth, the United States disagreed with the application of "fair and equitable treatment" in the arbitral awards in *Metalclad Corporation v. United Mexican States*[217] and *Pope & Talbot Inc. v. Canada.*[218] The United States argued that "[t]o the extent *Metalclad* can be read to suggest that 'fair and equitable' in Article 1105(1) articulates a standard other than the international minimal standard, it [was] wrongly reasoned and should not be followed here."[219] The United States objected that the *Metalclad* Tribunal applied a fair and equitable standard without reference to customary international law.[220] The United States found the *Pope & Talbot* Tribunal's decision "poorly reasoned and unpersuasive" because it determined that the fair and equitable standard was "additive to the requirements of international law."[221] The United States pointed out that the *Pope & Talbot* Tribunal actually acknowledged that its interpretation was contrary to the plain text reading of Article 1105.[222] The *Pope & Talbot* Tribunal also disregarded the Parties' agreement that Article 1105 refers only to the international minimum standard.[223] The United States disagreed with these Tribunals' expansive readings of the scope of fair and equitable treatment and argued that these expansive views are not controlling in the present proceeding.

2. Methanex Failed to Identify Any Customary International Law Standard of Treatment Incorporated into Article 1105 that is Implicated by California's Measures

First, in response to Methanex's argument that Article 1105 requires state officials to act without any pecuniary or personal interest in the decision-making process, the United States argued that there is no constraint in customary international law on the processes by which a state adopts executive or legislative mea-

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216. *Id.* (citing Vienna Convention on the Law of Treaties, *supra* note 10, art. 31(3)(b)).
217. U.S. Memorial, *supra* note 202, at 42.
218. U.S. Reply Memorial, *supra* note 200, at 26.
219. U.S. Memorial, *supra* note 202, at 42.
220. *See id.*
221. U.S. Reply Memorial, *supra* note 200, at 26.
222. *Id.*
223. *Id.*

sures.[224] The United States supported this position with its Expert Report of Detlev F. Vagts.[225] Professor Vagts asserted, "The variety of legislative and administrative procedures for laying down rules is so great—involving federal States and centralized States, parliamentary States and presidential States, democratic States and authoritarian States—that no general international consensus on what is a fair process has emerged or even been proposed."[226] The United States rejected as "misplaced" Methanex's complaints about the process by which the California measures were adopted.[227]

Second, the United States argued that Methanex failed to identify any substantive obligation implicated by California's measures. In response to Methanex's claim that the California measures were arbitrary, unreasonable, and lacking in good faith,[228] the United States argued that there is no general customary international law obligation for States to enact "good" or "reasonable" legislation and administrative rules.[229] The United States recognized that good faith and reasonableness can be required in certain circumstances. The United States pointed to Article 26 of the Vienna Convention on the Law of Treaties, which requires that treaty parties must fulfill their treaty obligations in good faith.[230] The United States also cited the International Court of Justice's (ICJ) decision in *Border and Transborder Armed Actions (Nicar. v. Hond.)* in which the ICJ held, "The principle of good faith is, as the Court has observed, 'one of the basic principles governing the creation and performance of legal obligations' . . . it is not in itself a source of obligation where none would otherwise exist."[231] In the absence of any specific obligation in international law implicated by California's measures, Methanex cannot rely solely on an obligation of good faith.[232]

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224. U.S. Memorial, *supra* note 202, at 45.

225. *Id.*

226. *Id.* (quoting the Expert Report of Detlev F. Vagts, ¶ 15).

227. *Id.*

228. Methanex Amended Claim, *supra* note 131, at 3.

229. U.S. Reply Memorial, *supra* note 200, at 27.

230. *Id.* (quoting the Vienna Convention on the Law of Treaties, *supra* note 10, art. 26).

231. U.S. Rejoinder on Jurisdiction, *supra* note 51, at 25 (citing Border and Transborder Armed Actions (Nicar. v. Hond.), 1988 I.C.J. 69, 105 (Dec. 20, 1988) (citations omitted). The ICJ reaffirmed this holding in Land and Maritime Boundary (Cameroon v. Nig.), 1998 I.C.J. 275 (June 11, 1998)).

232. *See id.* at 26.

E. *The FTC Interpretation of July 31, 2001*

Pursuant to Article 1131(2)[233] of the NAFTA, Trade Ministers from each Party, acting as the Free Trade Commission (FTC), issued an Interpretation of Certain Chapter 11 Provisions on July 31, 2001.[234] The Interpretation addressed both access to documents and the minimum standard of treatment in accordance with international law.[235] The text of the Interpretation addressing the Minimum Standard of Treatment in Accordance with International Law is as follows:

1. Article 1105(1) prescribes the customary international law minimum standard of treatment of aliens as the minimum standard of treatment to be afforded to investments of investors of another Party.
2. The concepts of "fair and equitable treatment" and "full protection and security" do not require treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens.
3. A determination that there has been a breach of another provision of the NAFTA, or of a separate international agreement, does not establish that there has been a breach of Article 1105(1).[236]

F. *Methanex's Response to the FTC Interpretation*

Methanex argued that the FTC Interpretation is binding on the Parties if and only if it is an interpretation and not an amendment of Article 1105(1).[237] Methanex recognized the power of the FTC to issue binding interpretations of NAFTA provisions.[238] Article 1131(2) provides, "An interpretation by the [FTC] of a provision of this Agreement

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233. NAFTA, *supra* note 1, art. 1131(2).

234. Notes of Interpretation of Certain Chapter 11 Provisions, NAFTA Free Trade Commission (July 31, 2001), *available at* http://www.dfait-maeci.gc.ca/tna-nac/NAFTA-Interpr-e.asp [hereinafter FTC Interpretation]. The FTC was comprised of Robert B. Zoellick, the Trade Representative of the United States, Luis Ernesto Derbez Bautista, the Secretary of Economy of Mexico, and Pierre S. Pettigrew, the Minister of International Trade of Canada. *Id.*

235. *Id.*

236. *Id.*

237. Claimant Methanex Corporation Reply to the Response of Respondent United States of America of October 26, 2001 to Methanex's Submission Concerning the NAFTA Free Trade Commission's July 31, 2001 Interpretation at 2, Methanex Corp. v. United States (Nov. 9, 2001), *available at* http://www.naftaclaims.com [hereinafter Methanex Reply Submission].

238. *Id.*

shall be binding on a Tribunal established under this section."[239] The FTC does not, however, have the power to amend the NAFTA.[240] Methanex found that the FTC Interpretation was "so ambiguous that it is subject to conflicting understandings," and must not be interpreted in such a way that it would be an amendment.[241] Methanex asserted that any interpretation limiting the scope of investment protection, such as the interpretation suggested by the United States, would be an impermissible amendment and the Tribunal would be exceeding its powers.[242]

First, Methanex argued that the Interpretation does not materially impact the proceeding because it does not affect the scope of investment protection.[243] The FTC Interpretation confirmed that fair and equitable treatment, as well as full protection and security, are part of customary international law.[244] Methanex also maintained that the Interpretation does not rule out that violations of independent treaty provisions may constitute a breach of Article 1105.[245]

Methanex argued that the Tribunal must interpret Article 1105's fair and equitable treatment provision in accordance with its ordinary meaning.[246] Methanex cited rules of treaty interpretation, NAFTA jurisprudence, the positions of the Parties, and international and domestic law in support of this proposition. First, the Vienna Convention on the Law of Treaties requires that treaty provisions be interpreted in good faith and that the ordinary meaning be given to the terms in their context and in light of the treaty's object and purpose.[247] Applying this canon of treaty interpretation, the words fair and equitable treatment should be interpreted by their plain meaning, particularly in light of the purpose of Chapter 11, which is to provide investment protection.

Second, the *Loewen* Tribunal previously ruled that Chapter 11 should

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239. NAFTA, *supra* note 1, art. 1131(2).

240. *See id.* arts. 2001(2)-(3). Any amendment of the NAFTA would be subject to the constitutional processes of the three Parties. *See* Methanex First Submission re: NAFTA FTC Statement on Article 1105 at 19, Methanex Corp. v. United States (Sept. 18, 2001), *available at* http://www.state.gov/s/l/c5823.htm [hereinafter Methanex First Submission].

241. Methanex Reply Submission, *supra* note 237, at 2-4.

242. *See id.* at 4-6.

243. Methanex First Submission, *supra* note 240, at 2.

244. *Id.*

245. *Id.*

246. *See id.* at 3.

247. Vienna Convention on the Law of Treaties, *supra* note 10, art. 31(1); Methanex First Submission, *supra* note 240, at 3.

be given a "liberal . . . interpretation" in order to effect the NAFTA's purpose of providing investment protection.[248] Third, Mexico previously maintained that fair and equitable treatment is to be interpreted by its ordinary meaning.[249] Methanex rejected the United States' argument that the definition of fair and equitable treatment is too "unknown" or "subjective" to be given its ordinary meaning.[250] Methanex asserted that the definition of fair and equitable treatment is well-known in both international and domestic law.[251] "While the fair and equitable standard may not be reducible to a single formulation applicable to every set of circumstances, the standard is routinely applied by international and U.S. judges in a variety of different contexts. There is no reason why this Tribunal cannot apply the same standard to the California measures."[252]

Methanex also argued that "international law" must be given its ordinary meaning, which includes both customary and treaty law.[253] In light of the treaty's purpose of investment protection, "international law" must be read expansively. Methanex cited negotiating history in support of its position.[254] According to Mr. Guillermo Aguilar Alvarez, one of Mexico's negotiators, the word "customary" was deleted from one of the drafts.[255] When Mexico objected to the inclusion of the word "customary," the U.S. negotiators responded that deletion of "customary" would broaden the scope of investment protection by incorporating independent treaty obligations.[256] According to Mr. Aguilar Alvarez, Mexico did not object to the broad scope, and the Parties eventually agreed on the exclusion of the word "customary."[257]

Under this broad reading of international law, the FTC Interpretation does not preclude a finding that the violation of an independent

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248. The Loewen Group, Inc. v. United States, ICSID Case No. ARB(AF)/98/3, ¶ 53 (Jan. 5, 2001); Methanex First Submission, *supra* note 240, at 3-4; Methanex Reply Submission, *supra* note 237, at 4.

249. *See* Azinian v. United Mexican States, ICSID Case No. ARB(AF)/97/21, ¶ 92 (Nov. 1, 1999); Methanex First Submission, *supra* note 240, at 4.

250. Methanex First Submission, *supra* note 240, at 4.

251. Methanex cites U.S. caselaw, the Restatement (Second) of Contracts, and sections of the United States Code which employ the term fair and equitable treatment in support of its position that the term is well-known. *Id.* at 4-5.

252. *Id.* at 5.

253. *Id.*

254. *Id.* at 6.

255. *Id.*

256. Methanex First Submission, *supra* note 240, at 6.

257. *Id.*

treaty obligation may constitute evidence of a breach of Article 1105's fair and equitable treatment provision where all of the other Chapter 11 requirements are met.[258] The Interpretation merely established that the breach of an independent treaty obligation is not a *per se* violation of Article 1105.[259]

Even if the Interpretation were construed as limiting applicable international law to customary international law, Methanex's investment would still be entitled to fair and equitable treatment because fair and equitable treatment is part of customary international law.[260] The Interpretation stated that fair and equitable treatment does not require "treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens."[261] Thus, the language itself of the Interpretation recognized that fair and equitable treatment is part of the customary international law minimum standard of treatment of aliens.

Methanex argued that strong evidence of the inclusion of fair and equitable treatment in customary international law is the prevalence of fair and equitable treatment provisions in BITs and multilateral investment treaties.[262] Methanex argued that there is "almost universal adoption" of the fair and equitable treatment standard.[263] "Nearly all recent BITs require that investments and investors covered under the treaty receive 'fair and equitable' treatment . . . ."[264] Additionally, many multilateral treaties adopted the fair and equitable treatment standard, including the Fourth ACP-EEC Convention (Lomé IV), the ASEAN Treaty, the Colonia Protocol of MERCOSUR (the Southern Common Market), COMESA (the Common Market for Eastern and Southern Africa), and the Energy Charter Treaty among European States.[265] The wide-spread inclusion of "fair and equitable treatment" in BITs and multilateral treaties is evidence of its existence as a principle of customary international law.

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258. Methanex Reply Submission, *supra* note 237, at 8.

259. *See id.*

260. *See* Methanex First Submission, *supra* note 240, at 7; Methanex Reply Submission, *supra* note 237, at 5.

261. FTC Interpretation, *supra* note 234.

262. *See* Methanex First Submission, *supra* note 240, at 9; Methanex Reply Submission, *supra* note 237, at 5.

263. Methanex Reply Submission, *supra* note 237, at 5. There are approximately 1,800 BITs in effect, employed by approximately 170 countries. Methanex First Submission, *supra* note 240, at 9-10.

264. Methanex First Submission, *supra* note 240, at 10 (quoting DOLZER & STEVENS, *supra* note 13, at 58).

265. *Id.*

Even if fair and equitable treatment is not viewed as sufficiently adopted by states to be part of customary international law, Methanex asserted that customary international law has always required certain equitable principles, including fairness.[266] In support of its position, Methanex cited several ICJ opinions, and in particular the opinion *Diversion of Water from the Meuse (Neth. v. Belg.).*[267] In that case, Judge Hudson, in a separate concurring opinion, stated that, "principles of equity have long been considered to constitute a part of international law, and as such they have often been applied by international tribunals."[268] Methanex also cited NAFTA jurisprudence, including the *S.D. Myers* decision.[269] In *S.D. Myers,* the Tribunal found that the fair and equitable requirement "imports into the NAFTA the international law requirements of due process, economic rights, obligations of good faith and natural justice."[270] Methanex also argued that the United States Supreme Court recognized that equitable principles are part of international law.[271]

Thus Methanex argued that its view is the only permissible reading of the Interpretation, for any reading that narrows the scope of the investment protection would be contrary to the purpose of the Treaty and would constitute an impermissible amendment of the Treaty. Under the reading proposed by the United States, fair and equitable treatment would "effectively be read out of NAFTA, to the detriment of foreign investments."[272]

G. *The United States' Response to the FTC Interpretation*

The United States argued that the FTC Interpretation is not an impermissible amendment but is instead a binding interpretation that conclusively establishes that Article 1105(1) prescribes no more than

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266. Methanex First Submission, *supra* note 240, at 11; Methanex Reply Submission, *supra* note 237, at 11.

267. Methanex First Submission, *supra* note 240, at 11.

268. Diversion of Water from the Meuse (Neth. v. Belg.), 1937 P.C.I.J. (ser. A/B) No. 70, at 76 (June 28).

269. Methanex First Submission, *supra* note 240, at 12.

270. S.D. Myers, Inc. v. Canada (U.S.-Can.), NAFTA-UNCITRAL Tribunal, ¶ 134 (Nov. 13, 2000), *available at* http://www.appletonlaw.com/cases/Myers%20-%20Final%20Merits%20Award.pdf.

271. Methanex First Submission, *supra* note 240, at 13 (stating that in *First Nat'l City Bank v. Banco Para El Comercio Exterior de Cuba,* 462 U.S. 611, 612-13 (1983), the Supreme Court applied "principles of equity common to international law").

272. Methanex Reply Submission, *supra* note 237, at 4.

the customary international law minimum standard of treatment.[273] Contrary to Methanex's assertion, the Interpretation is not a retroactive amendment, but an immediately applicable clarification with a retrospective effect.[274]

The United States supported its proposition that the FTC Interpretation is an interpretation and not an amendment by pointing out that the FTC itself considered it to be an interpretation.[275] Moreover, the NAFTA does not authorize Chapter 11 tribunals to question the FTC's decision.[276] The United States' argument is further supported by the language of Article 1105 and conventional rules of treaty interpretation.[277] The United States argued that "fair and equitable treatment" has substantive content no broader than the phrase preceding it, which is "in accordance with international law."[278] The United States pointed out that "in accordance with international law" is a general principle, followed by the word "including," which is then followed by "fair and equitable treatment."[279] "As is commonly understood, when a general principle is followed by the word 'including,' the terms or examples that ensue are encompassed within that general principle. Thus, it should come as no surprise that Article 1105(1)'s meaning would remain the same regardless of whether that Article required 'treatment in accordance with international law' or whether it required 'treatment in accordance with international law, including fair and equitable treatment and full protection and security.' "[280] In summary, the United States argued that the Interpretation does not change the meaning of Article 1105 but simply resolves the debate among academics as to whether fair and equitable treatment referred to the customary international law minimum standard of treatment of aliens or whether it incorporated a new standard based on subjective notions of what is

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273. Response of Respondent United States of America to Methanex's Submission Concerning the NAFTA Free Trade Commission's July 31, 2001 Interpretation at 5, Methanex Corp. v. United States (Oct. 26, 2001), *available at* http://www.state.gov/s/l/c5823.htm [hereinafter U.S. Response]; *see* Rejoinder of Respondent United States of America to Methanex's Reply Submission Concerning the NAFTA Free Trade Commission's July 31, 2001 Interpretation at 2, Methanex Corp. v. United States (Dec. 17, 2001), *available at* http://www.state.gov/s/l/c5823.htm [hereinafter U.S. Rejoinder].

274. *See* U.S. Rejoinder, *supra* note 273, at 10.

275. U.S. Response, *supra* note 273, at 4.

276. *Id.*

277. *See* U.S. Rejoinder, *supra* note 273, at 2.

278. *Id.*

279. *Id.*

280. *Id.*

fair and equitable.[281]

The United States also rejected Methanex's argument that the Interpretation limits investment protection, contrary to the intent of the NAFTA negotiators.[282] First, the United States argued that according to Article 32 of the Vienna Convention on the Law of Treaties, *travaux préparatoires* are only to be considered when treaty terms are "ambiguous or obscure" in light of the treaty's context, object, and purpose.[283] The United States claimed that the Interpretation clarified any ambiguity and that, therefore, resorting to the *travaux préparatoires* is unnecessary and inappropriate.[284]

Furthermore, the United States argued that even if resorting to the *travaux préparatoires* is necessary, the Declaration of Guillermo Aguilar Alvarez does not rise to the level of *travaux préparatoires.*[285] According to the United States, the Declaration is nothing but a "statement of a paid witness as to his recollection of what transpired in discussions that occurred over nine years ago – a recollection unsupported by any of the *travaux* that Mexico or counsel for the United States could locate after a diligent search."[286]

The United States also argued that customary international law does not encompass an independent fair and equitable treatment standard.[287] The fact that the phrase "fair and equitable treatment" appears in many BITs and multilateral treaties does not establish that there is a consensus on the meaning of that phrase.[288] Second, the United States asserted that the meaning of "fair and equitable" treatment is well understood to mean the customary international law minimum standard of treatment of aliens.[289]

The United States further argued that equitable notions of fairness and good faith are not independent obligations in international law.[290]

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281. U.S. Response, *supra* note 273, at 4.

282. U.S. Rejoinder, *supra* note 273, at 3.

283. *Id.*

284. *Id.*

285. *Id.* at 4.

286. *Id.* Mexico agreed that Mr. Aguilar Alvarez's Declaration should not be considered by the Tribunal. *See* Article 1128 Submission of the United Mexican States at 3, Methanex Corp. v. United States (Feb. 11, 2002), *available at* http://www.state.gov/s/l/c5823.htm [hereinafter Mexico Submission].

287. *See* U.S. Response, *supra* note 273, at 5; U.S. Rejoinder, *supra* note 273, at 6.

288. U.S. Response, *supra* note 273, at 5-6.

289. *Id.* at 6; U.S. Rejoinder, *supra* note 273, at 6.

290. *See* U.S. Response, *supra* note 273, at 6; U.S. Rejoinder, *supra* note 273, at 7.

General equitable principles serve as an interpretive guide only.[291] In the absence of independent treaty obligations, equitable principles are irrelevant and do not provide a basis for a claim.[292]

Although the United States recognized that a particular situation might constitute both a breach of NAFTA Article 1105 and a breach of an independent treaty obligation, the breach of the independent treaty obligation is legally irrelevant in the NAFTA proceeding.[293] The United States maintained that the Interpretation precludes Article 1105 claims based on violations of other treaty obligations.[294] Because the breach of an independent treaty obligation does not constitute a breach of Article 1105, NAFTA tribunals need not consider breaches of independent treaty obligations.[295]

H. *Canada's and Mexico's Responses to the FTC Interpretation*

Canada and Mexico agreed with the United States that the FTC Interpretation is not an amendment but is a valid, binding interpretation that is immediately applicable to all pending Chapter 11 proceedings.[296] Both Canada and Mexico recognized the authority of the FTC to issue interpretations.[297] Mexico emphasized that the interpretation process is specifically authorized by the constitutional processes of all three Parties.

> Mexico observes that the NAFTA, including Article 1131(2) and the power created thereby, was considered and approved by the legislatures of each of the States party to the Treaty. The members of the Commission have therefore been entrusted by their respective legislatures to safeguard the Agreement through the issuance of interpretations which then bind tribunals.[298]

Mexico and Canada also concurred that the Interpretation is not a retroactive amendment but a clarification of the meaning of the

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291. *See* U.S. Response, *supra* note 273, at 6; U.S. Rejoinder, *supra* note 273, at 7.

292. *See* U.S. Response, *supra* note 273, at 6-7; U.S. Rejoinder, *supra* note 273, at 7.

293. U.S. Rejoinder, *supra* note 273, at 8.

294. U.S. Response, *supra* note 273, at 7; U.S. Rejoinder, *supra* note 273, at 8.

295. U.S. Rejoinder, *supra* note 273, at 8.

296. *See* Third Submission of Canada Pursuant to NAFTA Article 1128 at 2, Methanex Corp. v. United States, *available at* http://www.state.gov/s/l/c5823.htm [hereinafter Canada Submission]; Mexico Submission, *supra* note 286, at 1.

297. Canada Submission, *supra* note 296, at 2; Mexico Submission, *supra* note 286, at 2.

298. Mexico Submission, *supra* note 286, at 3.

provision since the treaty came into effect.[299] According to Canada,

> It states not what the provisions of the NAFTA are to mean in the future, but what they have always meant. It identifies the legal standard established by the NAFTA Parties and applicable to Article 1105 since the NAFTA entered into force on 1 January 1994. There has been no removal of rights. The Commission's Interpretation is not an amendment to the provisions of the NAFTA.[300]

Thus both Canada and Mexico supported the United States' position that the FTC's Interpretation is authorized, valid, and binding.

Canada and Mexico also concurred with the United States that Article 1105 does not import independent treaty obligations.[301] Mexico emphasized that in light of Chapter 11's structure, it would be illogical to extend a Chapter 11 tribunal's jurisdiction to independent treaty obligations.[302] Chapter 11's provisions were constructed narrowly so that Articles 1116 and 1117 authorize jurisdiction only over obligations set out in section A of Chapter 11 and two parts of Chapter 15.[303] "If a Chapter Eleven tribunal cannot determine a breach of another chapter of the Agreement, it logically follows that it cannot have the jurisdiction to determine a breach of other international agreements such as the WTO Agreements."[304] Thus both Canada and Mexico agreed with the United States that breaches of independent treaty obligations are irrelevant for determining if there has been a breach of NAFTA Article 1105.

Canada and Mexico also agreed with the United States that the intent of the parties as determined by the *travaux préparatoires*, and the account of Mr. Aguilar Alvarez in particular, should not be considered.[305] The first step in treaty interpretation is an examination of the text.[306] Consideration of supplemental means of interpretation is only appropriate where treaty terms are ambiguous or unclear.[307] The FTC

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299. Canada Submission, *supra* note 296, at 2; Mexico Submission, *supra* note 286, at 7.

300. Canada Submission, *supra* note 296, at 2.

301. *Id.* at 3; *see* Mexico Submission, *supra* note 286, at 6-7.

302. *See* Mexico Submission, *supra* note 286, at 6.

303. *Id.*

304. *Id.*

305. Canada Submission, *supra* note 296, at 4-6; Mexico Submission, *supra* note 286, at 3-5.

306. Canada Submission ¶ 17, *supra* note 296, at 4 (citing the Vienna Convention on the Law of Treaties, *supra* note 10).

307. *Id.* at 5.

Interpretation clarified any ambiguity; therefore, it would be inappropriate to consider supplemental means of interpretation.[308] Moreover, even if the provisions of Article 1105 were not clear and it were necessary to consider supplemental means of interpretation, both Parties challenged the validity of the Declaration of Mr. Aguilar Alvarez.[309] Canada determined that the Declaration is "neither credible nor relevant."[310] Mexico agreed, finding that "the present recollection of one of many participants in the negotiations, especially when it is disavowed by his own State, does not even constitute *travaux préparatoires* that could eventually be relied upon by a tribunal."[311] Mexico also questioned Mr. Aguilar Alvarez's claim that the word "customary" had been deleted from one of the drafts and stated that it has not found any such drafts.[312]

In contrast, Mexico argued that if supplemental means were to be considered, then contemporaneous statements of the Parties support the Parties' assertion that "international law" referred only to "customary international law."[313] The Statement on Implementation published by the Government of Canada on January 1, 1994 (the date on which the NAFTA became effective), stated that Article 1105 "provides for a minimum absolute standard of treatment, based on long-standing principles of customary international law . . . ."[314] Although Mexico did not publish an official statement and the United States' Statement of Administrative Action does not address the issue, Mexico argued that neither the United States nor Mexico disputed Canada's position.[315] Thus, Canada and Mexico supported all of the United States' arguments.

IV. EFFECT OF THE FTC INTERPRETATION

A. *Effect of the FTC Interpretation on the Methanex Tribunal's Decision*

1. The *Methanex* Tribunal's Acceptance of the FTC Interpretation

The threshold question is whether the *Methanex* Tribunal, as a Chapter 11 tribunal, has the authority to assess the validity of the FTC

308. *Id.* at 6.
309. *Id.* at 4-6; Mexico Submission, *supra* note 286, at 3-4.
310. Canada Submission ¶ 20, *supra* note 296, at 6.
311. Mexico Submission, *supra* note 286, at 3.
312. *Id.* at 4.
313. *Id.* at 5.
314. *Id.*
315. *Id.*

Interpretation. Under one view, a Chapter 11 tribunal does not have the authority to review the FTC Interpretation because under section B of Chapter 11,[316] tribunals are only authorized to review the actions of the Parties in the context of an investor-Party dispute.[317] If a Chapter 11 tribunal were to review the FTC Interpretation, it would exceed its jurisdiction authorized by section B. This appears to be, however, a minority view.

If the *Methanex* Tribunal determines that it has the authority to review the FTC Interpretation, the question becomes whether the Tribunal will accept the Interpretation as an interpretation and follow it accordingly, or whether the Tribunal will reject it as an impermissible amendment exceeding the bounds of the FTC's authority under Article 1131. Under Article 1131, the FTC must interpret NAFTA provisions in accordance with international law.[318] The Vienna Convention on the Law of Treaties is part of international law and, therefore, governs the FTC's interpretation of Article 1105.[319] If the Tribunal determines that the FTC did not interpret Article 1105 in accordance with the Vienna Convention on the Law of Treaties and that its Interpretation fundamentally changes the scope of Article 1105 such that the Interpretation effectively amends Article 1105, the Tribunal may determine that the Interpretation is not binding. At least one practitioner and scholar has suggested that the latter is a possibility.[320]

> The ministers' change appears designed to lessen the substantive rights currently afforded to investors under NAFTA Article 1105. Normally under international law, treaty provisions whose application results in a diminution of substantive obligations must be construed narrowly. If this cannon [sic] of interpretation is applied to NAFTA Article 1131, tribunals may well conclude that the ministers used the wrong mechanism to make their change. What they needed to do was actually *amend* the NAFTA, not *interpret* it. Because the ministers have tried to amend by way of interpretation, their statement (at least in so

316. Section B of Chapter 11 provides the dispute resolution mechanism under which claims for violations of obligations under section A are brought. *See* JOHNSON, *supra* note 4, § 11.3.

317. *See* NAFTA, supra note 1, arts. 1115-38.

318. NAFTA, *supra* note 1, art. 1131.

319. *See id.*

320. Todd Weiler, Newsletter Commentary on July 31st Commission Statement, "Trade Ministers Say the Darndest Things" (Aug. 2001), *available at* http://www.naftaclaims.com.

> far as it applies to the substantive rights accorded under Article 1105) may not be determined to have any binding effect.[321]

At first blush, the FTC Interpretation appears to significantly change the scope of Article 1105's fair and equitable treatment provision. The "customary international law minimum standard of treatment of aliens" is far narrower than "international law," which also encompasses independent treaty obligations.

However, the Vienna Convention on the Law of Treaties also indicates that treaty terms should be interpreted in light of their context and the purpose of the treaty.[322] The purpose of the NAFTA was to provide specially negotiated investment protection for the Parties' investors.[323] This protection logically does not extend, however, to all treaty provisions that each of the Parties entered into with other non-party states. Extending Chapter 11's protections to all other treaty obligations would render ineffective the limiting provisions of Articles 1116 and 1117. This would violate the international law principle of effectiveness, which prohibits interpretation of treaty terms in such a way that would "make a provision meaningless, or ineffective."[324] Therefore, although at first blush the FTC Interpretation appears to alter the scope of Article 1105 in such a way that could be considered an amendment, further examination reveals that the reference to international law in Article 1105 could not originally have been intended to include independent treaty obligations and must have been limited to customary international law.

2. The *Methanex* Tribunal's Application of Customary International Law

Even if the *Methanex* Tribunal were to accept as valid the FTC's restrictive view of fair and equitable treatment as being in accordance with customary international law, the Tribunal would have to determine the present state of customary international law. The Tribunal would have to consider whether the prevalence of fair and equitable treatment provisions in BITs and multilateral agreements indicates that fair and equitable treatment has become part of customary international law.

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321. *Id.*

322. Vienna Convention on the Law of Treaties, *supra* note 10, art. 31.

323. *See* Price & Christy, *supra* note 4, at 172-76.

324. Methanex Reply Submission, *supra* note 237, at 4 (citing 1 OPPENHEIM'S INTERNATIONAL LAW 1280 (Jennings & Watts eds., 9th ed. 1996) (footnote omitted)).

Although the FTC Interpretation itself does not offer much guidance on the customary international law minimum standard of treatment of aliens, this standard is well-established.[325] The standard articulated by the U.S.-Mexico Claims Tribunal in *Neer* required that the state's behavior be egregious or shocking in order for an alien to have a course of action against the state.[326] This approach of tying fair and equitable treatment to the international minimum standard of treatment of aliens, however, is problematic in two respects.[327] First, if treaty parties intended the level of protection to be the international minimum standard of treatment of aliens, they should have employed that term instead of "fair and equitable" treatment, which is a term open to interpretation.[328] Second, the international minimum standard of treatment of aliens is accepted among many states but is challenged by several Latin American states.[329] Latin American states following the Calvo tradition would grant only national treatment to foreign investment and not fair and equitable treatment.[330] Although an investment receiving national treatment may receive fair and equitable treatment, that would not be the case where the state did not provide its own investors with fair and equitable treatment.[331] Latin American states following this tradition would be reluctant to equate fair and equitable treatment with the international minimum standard unless specifically negotiated.

A second inquiry is whether customary international law has evolved since the *Neer* standard was articulated in 1926. Methanex argued that the prevalence of the fair and equitable treatment provision in BITs and multilateral investment treaties indicated that it is a norm of customary international law.[332] The United States counter-argued that the sheer number of references to fair and equitable treatment in BITs

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325. Vasciannie, *supra* note 17, at 104-05 (citing arbitral decisions discussing the international minimum standard of treatment, including the *Neer* claim (United States v. Mexico, 1926), the *Roberts* claim (United States v. Morocco, 1926), and the *Chevreau* case (France v. Great Britain, 1931)).

326. *See* Neer (U.S. v. Mex.), 4 R.I.A.A. 60, 60 (1926) (describing treatment falling below the minimum standard as "an outrage or such a failure to reach international standard that would be conceded by every reasonable man").

327. *Id.* at 105.

328. *Id.*

329. *Id.*

330. *Id.* at 120-21.

331. *Id.* at 121.

332. Methanex First Submission, *supra* note 240, at 9; Methanex Reply Submission, *supra* note 237, at 5.

and multilateral investment treaties is meaningless because there is no consensus on the content of that phrase. The ICJ enunciated a rule in the *North Sea Continental Shelf* cases as to when a treaty rule has evolved into a norm of customary international law.[333] According to one scholar, the current use of the fair and equitable treatment provision does not appear to satisfy the *North Sea* test and has not yet evolved into an independent norm of customary international law.[334] First, although "fair and equitable treatment" appears in many multilateral agreements, several of these agreements were not ratified and did not achieve treaty status.[335] The World Bank Guidelines, the NAFTA, and the Multilateral Agreement on Investment[336] (not effective), are not sufficiently followed as to be considered representative of a broad consensus.[337]

Second, although the provision is included in a vast number of BITs, BITs were originally enacted primarily between a developed state and a developing state because of the developed state's concerns about the protection of its investment.[338] The developing states likely had political and economic motivations for accepting the fair and equitable treatment provision but may not have followed it out of an independent sense of legal obligation.[339] The unequal bargaining power between developed states and developing states results in developing states agreeing to treaty terms that they would not otherwise follow out of a sense of *opinio juris* but will follow in order to attract foreign investment.[340] In order for a practice to be considered a norm of customary international law, states must follow it out of a sense of legal obligation.

Thus although the proliferation of multilateral agreements and BITs including a fair and equitable treatment provision suggest an evolving and liberalizing standard of investment protection, the fair and equitable treatment standard has not yet reached the level of a norm of customary international law. "For the fair and equitable standard to be fully incorporated into customary law, there would need to be unequivocal evidence of the requisite *opinio juris* among a significant cross-section of countries, having special regard to the different perspectives

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333. Vasciannie, *supra* note 17, at 153-54.

334. *Id.* at 154.

335. *Id.* (citing the Havana Charter, the Abs-Shawcross Draft, and the OECD Draft).

336. The Multilateral Agreement on Investment is not yet a binding treaty. However, the Agreement is often referred to in debates about investment treaties because the negotiation history and language of the Agreement reflect current views on investment protection.

337. Vasciannie, *supra* note 17, at 156.

338. *Id.* at 157-58.

339. *Id.* at 158.

340. *Id.* at 158-59.

which have been traditionally presented by both capital-exporting and importing States, as well as the views of countries with economies in transition."[341]

An alternative view suggests that fair and equitable treatment is a standard that has become part of customary international law, as evidenced by the large and growing number of BITs and multilateral investment treaties that include fair and equitable treatment provisions. Proponents of this view argue that the amount of investment has increased considerably since the *Neer* standard was articulated, and the body of investment law has accordingly increased. This view is more flexible and takes into account the evolution of investment standards and practices.

3. The *Methanex* Tribunal's Application of the Fair and Equitable Treatment Standard

Applying the restrictive fair and equitable treatment standard articulated by the FTC to the proceeding, the *Methanex* Tribunal likely will determine that the United States did not violate its Article 1105 obligation to provide Methanex's investment in the United States with fair and equitable treatment. First, although earlier cases indicated an increasingly expansive view of the protection offered by Article 1105, the FTC Interpretation will have a narrowing effect on tribunals' future application of the fair and equitable treatment standard. Second, the link between Methanex and the California measures may be too attenuated. Methanex was not a producer of the banned product but a producer of one ingredient of the banned product. Allowing recovery under Chapter 11 for investors who produced a single ingredient of a banned product could potentially open the floodgates of investor claims wider than the Parties had intended. Absent evidence that California intended to discriminate against Methanex on the basis of nationality, the harm suffered by Methanex is too remote to constitute unfair or inequitable treatment.

Third, without more evidence that the California measures were intended to harm Methanex and benefit ADM, the measures should be upheld as a legitimate effort by the California legislature to regulate environmental dangers. The United States argued,

> Methanex's claim does not remotely resemble the type of grievance for which the States Parties to the NAFTA created the

341. *Id.* at 161.

> investor-State dispute resolution mechanism of Chapter 11. Methanex's case is founded on the proposition that, whenever a State takes action to protect the public health or environment, the State is responsible for damages to every business enterprise claiming a resultant setback in its fortunes . . . .[342]

There is increasing recognition that states should be given more discretion to enact legitimate public health and environmental regulations.[343] Governments should be able to enact measures to protect public health and the environment so long as the intent behind the measure is legitimate and is not disguised economic protectionism. If Methanex can prove that the California measures were motivated by economic protectionism instead of legitimate regulatory intent, then Methanex should prevail. However, absent a showing of discriminatory intent by California, the harm suffered by Methanex as the producer of one ingredient of a banned product was too remote to qualify as unfair or inequitable treatment.

In its Partial Award on Jurisdiction issued on August 7, 2002,[344] the Tribunal considered the United States' jurisdictional challenge based on Article 1101(1)'s "relating to" requirement.[345] Article 1101(1) provides that Chapter 11 applies to "measures adopted or maintained by a Party relating to" another Party's investors or their investments.[346] The United States argued that Article 1101(1)'s "relating to" phrase requires a "legally significant connection between the disputed measure and the investor."[347] The United States further argued that the California measures did not "relate to" Methanex because they were not expressly directed at methanol, methanol producers, or Methanex.[348] The Tribunal agreed that "relating to" means more than simply to affect. "We decide that the phrase 'relating to' in Article 1101(1) NAFTA signifies something more than the mere effect of a measure on an investor or an investment and that it requires a legally significant connection between them, as the USA contends."[349] The

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342. U.S. Statement of Defense, *supra* note 148, ¶ 2.

343. *See generally* Waren, *supra* note 8 (acknowledging that NAFTA claims pose a risk to states' abilities to regulate important issues including environmental and public health concerns).

344. Partial Award, Methanex Corp. v. United States (Aug. 7, 2002), *available at* http://www.naftaclaims.com [hereinafter Partial Award].

345. *See id.* ¶ 130.

346. *See* NAFTA, *supra* note 1, art. 1101(1), 32 I.L.M. at 639.

347. *See* Partial Award, *supra* note 344, ¶ 130.

348. *See id.* ¶ 128.

349. *Id.* ¶ 147.

Tribunal acknowledged that Methanex and the United States agreed that the "relating to" requirement may be satisfied if the purpose of the measure was the intent to harm a foreign investor or its investment on the basis of nationality.[350] However, the facts and inferences alleged by Methanex thus far likely were insufficient to prove the necessary intent.[351] The Tribunal decided that Methanex could submit a fresh pleading with additional evidence of intent in order to meet Article 1101(1)'s "relating to" requirement.[352] The Tribunal noted that it did not make a decision on the disputed interpretation of Article 1105.[353]

Methanex submitted a Second Amended Statement of Claim with evidential materials on November 5, 2002.[354] Methanex emphasized five points in its argument that the California measures were motivated by intent to discriminate against Methanex on the basis of nationality:

> California, in enacting the complained of measures, (1) intended to create a local ethanol industry (where no significant one had previously existed); (2) intended to benefit the U.S. ethanol industry; (3) intended to accomplish those goals by banning ethanol's competition – namely methanol and MTBE – from the California oxygenate marketplace; (4) were motivated to protect ethanol in part by political and financial inducements (not, however, bribes) provided by the U.S. ethanol industry; and (5) intended because of nationalistic biases, both inherent and overt, to discriminate against and thereby harm Methanex and all foreign methanol producers.[355]

If the Tribunal finds Methanex's evidence of California's intent to discriminate against it on the basis of nationality sufficient to overcome the jurisdictional hurdle of Article 1101(1)'s "relating to" requirement, the Tribunal will evaluate Methanex's claims under Article 1102 (national treatment), Article 1105 (fair and equitable treatment), and Article 1110 (expropriation). Methanex argued that the California measures discriminated against it in favor of domestic investors, which violated the United States' obligation under Article 1102 to provide

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350. *See id.* ¶¶ 151-52.

351. *See id.* ¶ 154.

352. *See id.* ¶ 161.

353. *See* Partial Award, *supra* note 344, ¶ 102.

354. *See* Claimant Methanex Corporation's Second Amended Statement of Claim, Methanex Corp. v. United States (Nov. 5, 2002), *available at* http://www.naftaclaims.com.

355. *Id.* ¶ 143.

foreign investors with the most favorable treatment accorded domestic investors.[356] Intentional discrimination is unfair and inequitable, which violates Article 1105.[357] Methanex further argued that California's discriminatory action was "tantamount . . . to expropriation" and was not compensated, in violation of Article 1110.[358]

B. *Effect of the FTC Interpretation on Future Investment and Investment Arbitration*

Prior to the issuance of the FTC Interpretation on July 31, 2001, NAFTA jurisprudence indicated a trend towards an expansive view of Article 1105's fair and equitable treatment provision, which suggested increasing protection for foreign investments. First, the *Metalclad* Tribunal held that lack of transparency in violation of Article 102(1) violated Article 1105.[359] Although the British Columbia Supreme Court reversed part of the *Metalclad* Tribunal's decision, including its Article 1105 determination, the Tribunal's initial decision demonstrates its willingness to give a broad reading to Article 1105's investment protections.[360] Second, the *S.D. Myers* Tribunal held that intentional discrimination on the basis of nationality was a breach of international law and, consequently, a violation of Article 1105.[361] Third, the *Pope & Talbot* Tribunal rendered perhaps the most expansive view of Article 1105 when it concluded that fair and equitable treatment encompassed fairness elements in addition to the international law minimum.[362]

The FTC Interpretation will effectively narrow the scope of Article 1105's investment protection if given effect by future Chapter 11 tribunals. Although the FTC, supported in its position by the United States, Canada, and Mexico, stated that the Interpretation was an interpretation of what Article 1105 had always meant and was not an amendment, the Chapter 11 jurisprudence indicates that investors, as

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356. *See id.* ¶ 296.

357. *See id.* ¶ 313.

358. *See id.* ¶¶ 317-20.

359. Jiménez, *supra* note 20, at 247.

360. The British Columbia Supreme Court decided that the *Metalclad* Tribunal erred in finding that lack of transparency constituted a violation of Article 1105 because lack of transparency is neither a violation of customary international law nor a violation of Chapter 11. Gantz, *supra* note 3, at 708.

361. Weiler, *supra* note 57, at 184.

362. Gantz, *supra* note 3, at 699 (citing Pope & Talbot Inc. v. Canada (Merits), ¶ 110 (Apr. 10, 2001), *available at* http://www.appletonlaw.com/cases/P&T-Merits%20Award-April%2010,%202001.pdf).

well as Chapter 11 tribunals, were uncertain as to the scope of Article 1105 and believed it broader than what the FTC has now clarified. In determining that fair and equitable treatment is limited to the customary international law minimum standard, the FTC effectively overruled *Pope & Talbot*'s determination that Article 1105 encompassed fairness elements in addition to the international law minimum.

The FTC Interpretation has not completely clarified the scope of Article 1105, however. In tying fair and equitable treatment to the international minimum standard, new debate has begun as to the meaning of the international minimum standard. Investors will certainly argue that it has evolved considerably since the U.S.-Mexico Claims Tribunal's decision in *Neer* in 1926, when a state's behavior had to be shocking, egregious, and outrageous in order for an alien to have a cause of action against a state for compensation. Investors will argue that fair and equitable treatment as an independent standard has evolved into a norm of customary international law. This modern view will provide Chapter 11 tribunals with more flexibility, which is arguably something that the NAFTA Parties had desired when they purposefully left "fair and equitable treatment" undefined in the text.[363] The alternative view is that an expansive reading of fair and equitable treatment as a norm of customary international law will result in unpredictability for the Parties.[364] This will certainly have an effect on future investment agreements that the United States negotiates, including the Free Trade Agreement of the Americas, the Central American Free Trade Agreement, the Free Trade Agreement with the five countries of the Southern African Customs Union, and the U.S.-Morocco Free Trade Agreement. Whereas an expansive reading of Article 1105's fair and equitable treatment provision would provide more investment protection for investments and therefore further economic growth in one respect, it will simultaneously influence the Parties' behavior to take affirmative steps to limit their liability in future agreements and actions.

V. CONCLUSION

Neither the broad reading of Article 1105 espoused by Methanex nor the narrow reading advocated by the United States should control. The

363. *See* Charles H. Brower, Remarks at the American Society of International Law 96th Annual Meeting (Mar. 14, 2002), *in Fair and Equitable Treatment Under NAFTA's Investment Chapter*, 96 AM. SOC'Y INT'L L. PROC. 11 [hereinafter ASIL Meeting].

364. J.C. Thomas, ASIL Meeting, *supra* note 363, at 16, 17.

logical approach to interpretation of Article 1105 is a modification of the United States' narrow reading of international law and customary international law, and Methanex's broad reading of "fair and equitable treatment," keeping in mind NAFTA's purpose of providing investment protection in order to encourage foreign investment.

The United States' position that "international law" refers only to "customary international law" is more persuasive than Methanex's argument that international law should be interpreted in the broadest sense possible. Methanex's expansive reading of "international law" as encompassing the Parties' obligations under other international agreements is illogical in light of the NAFTA's purpose, structure, and jurisprudence. The purpose of the investment chapter of the NAFTA is to provide certain enumerated protections for the Parties' investors' investments in the territory of the other Parties. The investment chapter's arbitration provision was not intended to be a dispute resolution mechanism for every other international agreement to which the Parties were signatories.

Methanex's broad reading of "international law" also fails a textual analysis. Even prior to the FTC Interpretation, the "international law" clause of Article 1105 could not have referred logically to the Parties' obligations under other treaties. It is illogical that the limited arbitration provision of Chapter 11, which excludes claims arising under other sections of the NAFTA, would encompass the Parties' obligations under other international agreements.

NAFTA jurisprudence also suggests that a narrower reading of international law is correct. Previous NAFTA arbitrations only went so far as to suggest that violations of other international agreements might be evidence of a violation of NAFTA; none went so far as to say that a violation of a treaty itself constitutes a violation of NAFTA actionable under Chapter 11. Therefore, the reference to "international law" prior to the FTC Interpretation and the reference to "customary international law" after the FTC Interpretation are consistent and do not constitute an impermissible amendment to the NAFTA.

Simply determining that the second clause of Article 1105 refers to customary international law, however, does not resolve what "fair and equitable treatment in accordance with customary international law" means. Although exactly what level of treatment is part of customary international law is a subject of great debate, customary international law undoubtedly has evolved since 1926 when the *Neer* standard was enunciated. Since 1926, foreign investment has become more sophisticated and the amount of foreign investment has increased. Twenty-first century investors would be discouraged from investing in foreign states

if they are guaranteed protection only against treatment that is egregious, outrageous, or shocking. The history of friendly relations between the Parties also suggests that a broader reading is appropriate. It is difficult to imagine that the Parties intended for the NAFTA to offer investment protection only against outrageous and shocking behavior, while each Party offers stronger investment protection in BITs with states with whom the Parties have less close relationships.

Although it is true that there is no universally accepted definition of "fair and equitable treatment", the fact that this protection appears in many BITs and multilateral investment treaties suggests that it is evolving into a standard of customary international law. The great and increasing number of BITs and multilateral investment treaties suggests a trend towards greater investment protection. Interpreting the "fair and equitable treatment" provision of the NAFTA too narrowly runs contrary to this trend. However, fair and equitable treatment must not be interpreted too broadly. Too broad a reading subjects states' legitimate regulatory efforts to great risk, particularly in the areas of public health and the environment. Providing investment protection should not come at the cost of inhibiting states' abilities to enact legitimate regulation. Instead, a balance must be struck: investors deserve protection that is greater than simply against outrageous and shocking state behavior, but not to the extent that there is no predictability for the Parties or that unwisely distorts states' regulatory authority. In conclusion, although Article 1105 clearly refers only to customary international law, the "fair and equitable treatment" provision of the NAFTA should be read more expansively than the 1926 *Neer* standard, taking into account the increasing trend towards greater investment protection in the twenty-first century.