

In the Arbitration under Chapter 11
of the North American Free Trade Agreement
and the UNCITRAL Arbitration Rules

between

Methanex Corporation, Claimant/Investor
and
United States of America, Respondent/Party

***AMICUS CURIAE* SUBMISSIONS**

**BY THE
INTERNATIONAL INSTITUTE FOR
SUSTAINABLE DEVELOPMENT**

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Submitted by

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INTRODUCTION

1. The International Institute for Sustainable Development is pleased to present these submissions to the Tribunal in the present NAFTA Chapter 11 Arbitration between Methanex Corp. and the United States of America. The rationale and purpose for these submissions are contained in the accompanying Application for *Amicus Curiae* Status, and will not be repeated here.

2. IISD would, however, like to repeat for the record in these submissions its acknowledgement of the Tribunal's groundbreaking decision of January 15, 2001 on the acceptance in investor-state arbitrations of *amicus* submissions, and the resolve of the Tribunal to complete and execute the *amicus* process.

TWO PRELIMINARY ISSUES

3. Prior to entering into the main body of these submissions, two preliminary points on the limits of international investment agreement arbitrations are useful to note. First, as noted in the first Chapter 11 case to be concluded, and repeated on other occasions since then, investor-state arbitrations are not intended as an insurance vehicle for all negative impacts of state actions or business events on a foreign investor. They do not shield investors from the customary risks associated with business decisions, nor do they provide an insurance program for that purpose:

It is a fact of life everywhere that individuals may be disappointed in their dealings with national authorities, and disappointed yet again when national courts reject their complaints.... NAFTA was not intended to provide foreign investors with blanket protection from this kind of disappointment, and nothing in its terms so provides.¹

4. This limitation of not using investor-state arbitrations as an "insurance policy" is complemented by a second limitation. One might not expect this to be relevant to the United States context, but the approach of the Claimant in this case makes it relevant. Investor-state arbitrations under bilateral investment treaties have noted that investors are presumed to be intelligent and aware of the environment into which they are investing. This includes the general

¹ *Robert Azinian et al v. United Mexican States*, ICSID Case No. ARB(AF)/97/2, Final Award, November 1, 1999, at para. 83, cited with approval in, e.g., *Maffezini v. Spain*, ICSID Case No. Arb/97/7, Final Award, (Nov 13, 2000), at para. 64; *Marvin Feldman v. Mexico*, ICSID Case No ARB(AF)/99/1, Final Award, (16 December 2002), at para. 111 and especially at para. 112 where it is applied specifically to expropriation claims [*Feldman*].

legal, political and administrative culture.² Investment agreements cannot, therefore, be relied upon as a bulwark against factors that might affect an investment environment that investors should know about, or to insure against the consequences of such general circumstances.

5. In the present context, Methanex as a global business should be presumed to have been well aware of two critically relevant factors. First, California is a global leader, and always has been, on environmental regulation making. That was the environment that Methanex was entering. Furthermore, investment agreements cannot become shields against first movers in the areas of environmental and human health protection. While this Tribunal is dealing only with one NAFTA Chapter 11 complaint, a ruling that makes it unduly difficult under international investment law for first instance measures by host governments will have enormous consequences as foreign capital moves globally and is increasingly covered by, at present, over 2100 reasonably similar Bilateral Investment Treaties.

6. Second, Methanex should be presumed to be aware of the political culture of the United States of America. This includes the good, and in some cases, the less good. There is no doubt that the functioning of the political system of the United States is closely tied to private donations. But this is not new, and this is not, per se, an issue that can be subject to proper litigation under Chapter 11. The United States political system cannot be put on trial in an investor-state arbitration. In so far as Methanex has stated it is not arguing there was any criminal corruption or wrongdoing, it must fit its case into a narrow window between not putting the system on trial as a whole, and its own admission there was no criminal conduct. IISD submits that Methanex has failed to find such a window here.

THE STARTING POINT: INTERNATIONAL LAW DOES IMPACT THE RIGHT TO REGULATE

7. The present arbitration is squarely about the restrictions that Chapter 11 places upon the right of the NAFTA national and sub-national governments to regulate to protect the environment.

8. The right to regulate is well understood as an inherent feature of sovereignty. Indeed, the sovereign right to regulate combined with the capacity to regulate can be understood as two of the four foundational elements of statehood in international law.³ The basic position, therefore, is that the starting point for analyzing restrictions on the right to regulate should start from the presumption of such a right, and analyze how an international treaty then affects that right.

Sovereignty in the strict and narrowest sense of the term implies, therefore, independence all around, within and without the borders of the country.

...

The undertaking of obligations under a treaty does not necessarily involve any abandonment of sovereignty, even though it may place restrictions on the exercise by a state of its sovereign rights.⁴

² *Alex Genin, Eastern Credit Limited, Inc v. Republic of Estonia*, ICSID Case No. Arb/99/2, Award, (June 25, 2001), at paras. 348, 365-367; *Eudoro Armando Olguin v. Republic of Paraguay* (ICSID Case No. ARB/98/5); Award, (July 26, 2001), see e.g. para. 65b.

³ Robert Jennings and Arthur Watts, eds., *Oppenheim's International Law*, 9th ed. vol. 1, (1996), at 122 [Oppenheim]. See also Ian Brownlie, *Principles of Public International Law*, 5th ed., (1998), at 70-71. The other two elements are territory and population [Brownlie].

⁴ *Oppenheim, ibid*, at 122 including n. 9.

9. International trade and investment agreements do not make the right to regulate any less a feature of sovereignty. They do not grant the right to regulate to states party to these agreements, but establish such constraints and restrictions on the exercise of that right that the Parties deem appropriate to accept.

10. At the same time, the concept of sovereignty does not act as a bulwark against the proper interpretation of international treaties that restrict the right to regulate. International agreements in various fields, including the environment, both constrain and compel use of the sovereign right to regulate. That is one aspect of their normal *raison d'être*. It is what international negotiators and lawyers seek to accomplish through international law.

11. In the context of investments, this is a reasonable starting point: investments have multiple interfaces with normal and expected government measures in all receiving environments, such as managing their environmental impacts, setting minimum wages and other labour rights, health and safety standards in industrial facilities, pensions, taxation, and so many more. Any notion that international investment law inherently makes such normal governmental activity an exception in so far as it relates to foreign investors is not only groundless but also dangerous. Applicable international investment agreements do say something about how such rights can be exercised when foreign investors are involved. The question at issue here is what *precisely* does Chapter 11 say about this?

12. Methanex seeks to divert the attention of the Tribunal from this basic principle by arguing this case should be open and shut because this is “garden variety protectionism” that NAFTA prevents. Methanex argues that this should establish a presumption against the measure because it breaches the very essence of NAFTA and outside WTO agreements. This approach is reflected over and over in Methanex pleadings, for example: “the case is about garden variety protectionism” ... “and to the concept of illegal economic protectionism in particular.”⁵ As Professors Jennings and Watts note in *Oppenheim’s International Law*, economic protectionism is *not* illegal in general or under customary international law, and nor does international law provide a blanket prohibition of discrimination by host countries between domestic and foreign investors.⁶ Only that conduct specifically covered by international treaty obligations properly construed is subject to a finding as a breach of a state’s international obligations.⁷

13. The effort to establish a broadly based presumption against certain types of measures was also rejected in the WTO. In the well known *Shrimp-Turtle* case between India, Thailand, Malaysia and Pakistan against the United States, the original panel held that the type of measure involved in that case, an extraterritorial environmental protection measure aimed at preventing the deaths of endangered sea turtles in shrimp fishing nets, was *ipso facto* inconsistent with WTO obligations by virtue of the threat it posed to the international trading system.⁸

14. The Appellate Body of the WTO swiftly and completely overruled this approach:

Maintaining, rather than undermining, the multilateral trading system is necessarily a fundamental and pervasive premise underlying the WTO Agreement;

⁵ Methanex, Reply of Claimant Methanex Corporation to US Amended Statement of Defense, (February 19, 2004), at para. 6 [*Methanex-Claimant*].

⁶ *Oppenheim*, *supra* note 4, at 931-932.

⁷ *Ibid.*

⁸ *United States- Import Prohibition of Certain Shrimp and Shrimp Products*, WT/DS58/R, Report of the Panel, (15 May 1998), at paras. 7.44-7.45

but it is not a right or an obligation, nor is it an interpretive rule which can be employed in the appraisal of a given measure under the chapeau of Article XX.⁹

15. IISD submits that the AB was quite correct to reject this effort to establish an interpretive presumption. In the present case, Chapter 11 includes rules that establish what types of protectionist measures are perfectly consistent with Chapter 11 (see the very extensive lists, for example, in Annexes 1-4 of NAFTA), what type of protectionist measures are not consistent with Chapter 11, as well as other rules that have nothing to do with protectionism. In short, the notion of garden variety, illegal protectionism as a generic concept defines neither the scope of what is included in Chapter 11 nor what is not included in Chapter 11. It is an emotionally pitched diversion.

16. It is noteworthy that the AB rejected the “illegal protectionism” approach in favour of an approach that expressly included a specific recognition of the role of sustainable development principles as part of the *internal* requirements for interpreting the WTO Agreements, drawing on the preamble to the WTO Agreement in so doing.¹⁰ This is precisely what IISD submits the tribunal should do in the present case.

17. IISD also notes that many of the narrower or more technical issues raised by the present arbitration have a significant impact on the bigger question of how Chapter 11 relates to the right to regulate. For that reason, IISD’s analysis in the sections below returns frequently to its understanding of this critical linkage.

THE TREATMENT OF ENVIRONMENTAL REGULATION IN TRADE AGREEMENTS AND IN CHAPTER 11 OF NAFTA

18. Methanex in its pleadings has raised, on several occasions, the question of the right to regulate for protection of the environment as it relates to the World Trade Organization (WTO) and NAFTA even though it is not relevant to Chapter 11. The reason for doing so seems to be to establish environmental protection as an exception to the international law rules governing foreign investment and the flow of capital at the regional or global levels. It is an effort to incorrectly incorporate certain trade law rules into Chapter 11, as well as to incorrectly impose the limitations surrounding the exception provisions of the General Agreement on Tariffs and Trade and the NAFTA itself into Chapter 11, which deals with investment-related and not trade-related obligations of the host states.

19. The way in which the WTO Agreements or the relevant trade-related portions of NAFTA relate to environmental law-making is complex, but it can be set out in the following general schema:¹¹

⁹ *United States- Import Prohibition of Certain Shrimp and Shrimp Products*, WT/DS58/AB/R, Report of the Appellate Body, (12 October 1998), at para. 116.

¹⁰ *Ibid*, at paras. 127-160, and is particularly expressed in paras. 152-155.

¹¹ A much more expansive review of the application of trade law to the right to regulate is found in Howard Mann, “Assessing the Impact of NAFTA on Environmental Law and Management Processes”, in Commission for Environmental Cooperation, *The Environmental Effects of Free Trade: Papers Presented at the North American Symposium on Assessing the Linkages between Trade and Environment (October 2000)*, (2002) pages 219-239, online: <<http://www.cec.org/files/PDF/ECONOMY/symposium-e.pdf>> ; see also, Gabrielle Marceau and Joel Trachtman, “A Map of the World Trade Organization Law of Domestic Regulation of Goods: The Technical Barriers to Trade Agreement, Sanitary and Phytosanitary Measures Agreement, and the General Agreement on Tariffs and Trade”, 36(5) *J. World Trade* (2003), at 81.

- a. First, an environmental measure will be tested to see if in the process of making that regulation or in its application one or another constraint or prohibition under the agreements is breached.
- b. In this regard, trade law sets out a variety of rules on non-discrimination between “like products”, science-based risk assessment, risk management and proportionality, the application of the precautionary principle, and others.
- c. Each of these different obligations is set out, in the case of the WTO, in the GATT, 1994, the Agreement on Technical Barriers to Trade, the Agreement on Sanitary and Phytosanitary Measures, and to a lesser extent the General Agreement on Trade in Services. In the NAFTA, these rules come from Chapter 3 (National Treatment and Market Access for Goods), Chapter 7 (Agriculture and Sanitary and Phytosanitary Measures), Chapter 9 (Standards-Related Measures) and again to a lesser extent, Chapter 12 (Cross-Border Trade in Services).
- d. The complaining state has the burden of proof to show that a measure taken for whatever reason, including to protect the environment, breaches one of the applicable rules. It would be incorrect to characterize trade law as requiring the justification of measures to protect the environment by the state taking the measure before the complaining party has established a breach of these rules.
- e. *Only when a breach of any of the relevant rules is established* do the NAFTA Chapters cited above and the provisions of the WTO Agreements become subject to the rules of the environmental exception cited by Methanex and the United States. These are Article XX of the GATT, 1994 and Article 2101 of the NAFTA, both of which establish *additional* rights of states to take measures that are otherwise inconsistent with the basic rules and obligations. As a defense by way of additional authority to breach the generally applicable rules in certain circumstances, the burden of proof does shift to the state defending a measure to show that the conditions included in the articulation of the exceptions, designed to ensure that they are not abused, are met.

20. The structure of this approach is important to note. It draws from several different agreements in the WTO context, and several different Chapters in NAFTA, that relate to trade. The mechanism for the enforcement of this full schema is also important to note: only states can prosecute cases for obligations pertaining to trade under the WTO and NAFTA dispute settlement mechanisms.

21. By contrast, Chapter 11 contains a single, largely self-contained set of rules that governs the relationship between foreign investors from within the NAFTA countries and the NAFTA host state. On the one hand, it contains no set of risk assessment requirements for regulation making in any sphere, as Chapters 7 and 9 do, and no basis for reading these into Chapter 11 as obligations subject to litigation by foreign investors under Chapter 11. On the other hand, it contains no exception provision.

22. This last point is critical. In its latest submissions, Methanex notes that there is no exception provision for Chapter 11,¹² but then appears to carry on as if there were. Article 2101 of NAFTA parallels the general exception provision of the GATT, Article XX. By virtue of the express listing of the Chapters of NAFTA to which it applies, and the clear absence of Chapter 11 from that list, this exception is completely inapplicable to Chapter 11.¹³ Given this specific textual exclusion of the exception approach to Chapter 11, IISD submits that all of Methanex’

¹² *Methanex-Claimant*, *supra* note 5 at para. 188.

¹³ This is set out in Article 2101(1) and (2).

submissions concerning the application of the trade law approach to the issue of the right to regulate to protect the environment under Chapter 11 are either wholly irrelevant or are of particularly limited weight. (The same, it might be said here, also applies for Prof. Ehlermann's interesting, but entirely speculative assessment of how trade law might approach the present arbitration: neither the approach nor the substance of trade law are before this Tribunal.)

23. At the same time, IISD submits that the clear absence of an exception provision and approach for Chapter 11 imposes upon the Tribunal the need to understand differently how the right to regulate ought to be addressed in the context of Chapter 11. IISD notes the clear recognition of environmental protection and sustainable development in the Preamble to NAFTA, a legitimate part of the interpretational matrix for NAFTA. The environmental goals and objectives of NAFTA are, importantly, *reconfirmed* in the related and subsequent agreement among the same three parties, the North American Agreement on Environmental Cooperation (NAAEC):

*Reconfirming the importance of the environmental goals and objectives of the NAFTA, including enhanced levels of environmental protection;*¹⁴

In accordance with Article 31(2)(a) of the *Vienna Convention on the Law of Treaties*, the Tribunal can hardly fail to recognize this is an important consideration in the interpretational matrix it constructs.¹⁵

24. For present purposes, we conclude this section with the simple proposition that the effort to introduce the whole concept of environmental protection as an exception to the rules on regulating foreign investors requires the Tribunal to do what it manifestly should not: allow Methanex to litigate under Chapter 11 all of the rules in NAFTA and the WTO that are applicable to the United States.¹⁶ Rather, the ability granted to foreign investors to initiate investor-state arbitrations under Chapter 11 is limited to the designated set of rights that in turn form the potential scope of that arbitration. This does not allow for reading into Chapter 11 an approach and a provision that has been clearly excluded by the drafters of NAFTA.

THE REGULATION OF FOREIGN INVESTORS: THE PRACTICAL CONTEXT

25. Foreign investors have a broad set of relationships with their host governments, including sub-national levels of government. These relationships engender a wide range of regulatory issues: environmental impacts, wage levels, labour rights, health and safety on the job, social issues such as affirmative action programs, and many others. This is no different for domestic investors and foreign investors.

26. IISD has found nothing in the history or academic writing on NAFTA, or in relation to international investment law more generally, that suggests international investment agreements are designed to broadly shield foreign investors from the same regulatory processes and results as domestic investors may face. Indeed, this is confirmed by the very specific prohibitions on

¹⁴ *North American Agreement on Environmental Cooperation*, 32 I.L.M. 1480 (1993), Preamble.

¹⁵ The *North American Agreement on Environmental Cooperation* was completed by the three NAFTA parties as part of the process leading to the ratification of the NAFTA. It falls squarely within the terms of Article 31(2)(a) of the Vienna Convention: "31(2) The context for the purpose of the interpretation of a treaty shall comprise, in addition to the text, including its preamble and annexes: (a) any agreement relating to the treaty which was made between all the parties in connection with the conclusion of the treaty."

¹⁶ *The United Mexican States v. Metalclad Corporation*, 2001 BCSC 664, at para. 58 [*Metalclad-BCSC*].

certain types of measures in relation to foreign investors in Article 1106 of NAFTA, for example. There is no general exception from the ongoing regulatory process for foreign investors.

27. The protection of the environment and the promotion of sustainable development are two closely related aspects of state regulation that do not fall within the forms of regulation that a host state may not take in relation to foreign investors and investments. This is consistent with the Preamble and objectives of NAFTA, and has been recognized in the few international investment law arbitrations to that have ruled on this issue.

28. For example, in the *Maffezini v. Spain* arbitration, the rigorous application of environmental impact assessment requirements by the Spanish authorities was held to be perfectly consistent with the applicable bilateral investment treaty between Argentina and Spain.¹⁷

29. The present case does, however, raise specific complications for the Tribunal. This is because Methanex has no direct investment in the jurisdiction that has taken the measure. Rather, it is goods traded into that jurisdiction that are held by Methanex to constitute its investment. IISD submits that the Tribunal has correctly approached this issue in its Preliminary Award of 7 August 2002, with its requirement for a legally significant connection between the measure and Methanex as a foreign investor, as opposed to a tangential or up-stream supplier connection.¹⁸ The Tribunal, it is submitted, would be correct in continuing to show restraint in this regard.

30. One impact of an overly broad reading of the definition of “investment” in this case would be that it would invite all trade measures to be made the subject of arbitration under Chapter 11. An objective look at the history of NAFTA and of this genre of agreements would show that there was never any intention for them to become a secondary route to the litigation of any or all trade issues, in effect the privatization for foreign investors of the state-to-state trade remedies.

NATIONAL TREATMENT AND REGULATION

31. If the Tribunal resolves the ongoing jurisdictional issues in favour of Methanex, then a number of issues become live. The critical element of this arbitration hinges on the issue of discrimination. Indeed, since the sole argument that IISD has identified on the Article 1105 claim is the same element of discrimination alleged in Article 1102, we make no additional arguments on Article 1105.

32. IISD focuses its submissions on the national treatment claim on two issues that will invariably overlap to some degree. The first is the question of “in like circumstances” and what this means in the investment context. The second is the issue of intent, including the notion of “impermissible intent” and what type of differences in treatment are valid under Article 1102. The issues raised will also include questions concerning the burden of proof and nature of the proof required.

“In Like Circumstances”

¹⁷ *Maffezini v. Spain*, ICSID Case No. ARB/97/7, Final Award, (November 13, 2000), at para. 67: “The Tribunal has carefully examined these contentions, since the environmental impact assessment procedure is basic for the adequate protection of the environment and the application of appropriate preventive measures. This is true, not only under Spanish and EEC law, but also increasingly so under international law.”

¹⁸ *Methanex v. United States*, Preliminary Award on Jurisdiction and Admissibility, (7 August, 2002), at para. 139.

33. One of the key issues raised in the current arbitration is whether Methanex is “in like circumstances” with the producers of other gasoline oxygenates, in particular ethanol. It is beyond dispute that if Methanex is not in like circumstances with ethanol producers, its case is lost (at least under Articles 1102 and 1105).

34. As IISD understands Methanex’ arguments on this point, it essentially defines and limits the criteria for this comparison as being commercial/competitive relations. If methanol is in a competitive relation with ethanol, it is in like circumstances. This is derived from Methanex’ interpretation of the “like products” test under trade law.

35. For reasons already explained, IISD does not agree with the broader viewpoint that trade law approaches can simply be transferred to investment law. In this particular context, both the text and the context support IISD’s view. In addition, and beyond this, IISD submits that Methanex is incorrect in its assessment of the scope and of the factors relevant to the “like products” test. These are returned to in sequence below.

36. Textually, one may note that the term “like products” is found in other key, environment-related contexts in NAFTA in relation to the trade in goods. It is in Article 301 of NAFTA by reference back to Article III of the GATT; Article 712(4) where “like goods” is used; and Article 904(3) (also like goods). By contrast, “like circumstances” is used in Chapter 11 and in Chapter 12, Article 1202 on Services, where investments in the service sector by service providers are covered. IISD submits that this difference in language merits careful attention before transferring the trade approach undoubtedly relevant to Chapters 3, 7 and 9 to Chapter 11. The differences reflect the different nature of trade in goods as compared to the making of investments.

37. IISD does not argue that commercial/competitive issues and key concepts related to it are irrelevant. Certainly they are not. Rather, IISD submits that the notion of “like circumstances” does not end with the jurisprudence of like products.

38. Textually, of course, the term “products” is not the same as the term “circumstances”. The latter is obviously a broader term that requires, in its plural use, all of the surroundings of an investment to be considered in the comparison of likeness. The type of enterprise and what it produces or sells may be a starting point, but it is not the end point. Indeed, there is no express limit as to what may be validly considered under the language of “circumstances”. And how could there be? Each investment by its nature is expected to be different: in size, location, labour force issues, technology used, etc. No single “cookie-cutter” approach to circumstances could be expected to capture these differences.

39. Thus, “circumstances” cannot be limited to the physical characteristics of a product produced by an investment or of the investment itself. Investments are not just physical things. They leave a “footprint” on the ground in terms of impacts on the environment, in the community, and so on. These impacts cannot be disassociated from an investment’s “circumstances” simply because it is foreign owned. Similarly, commercial substitutability is not an appropriate limitation to apply to the notion of circumstances: there is no textual basis for this and the contextual element that the term “circumstances” implies clearly suggests that substitutability is not enough.

Regulatory-based Differences, Like Circumstances and National Treatment

40. In the *US-Mexico Trucking Services* case under Chapter 12 of NAFTA, the panel expressly dealt with the issue of regulatory-based differences in a “like circumstances” context. (This issue was not raised as part of the Chapter 11 component of that panel hearing.) It accepted

that differential treatment for legitimate regulatory objectives related to safety was a valid consideration for the panel. It further stated that “such differential treatment should be no greater than necessary for legitimate regulatory reasons such as safety, and that such treatment be equivalent to the treatment accorded to domestic service providers.”¹⁹ In the present case, the prohibitions on the use of MTBE are equally applicable to all domestic providers of MTBE and any source of methanol as a feedstock for MTBE. There is no *de jure* or *de facto* distinguishing between suppliers of methanol or MTBE. As California has chosen a zero risk towards MTBE contamination, IISD submits that the measure is necessary to achieve that objective.

41. This is perfectly consistent with the reasoning of the WTO Appellate Body in the *EC-Asbestos* case, where the Appellate Body held that whether a measure is more restrictive than necessary must be tested first against the objective that is set by the government. Where a zero risk level is set, as it was by the European Union in the *Asbestos* case, the Appellate Body ruled that other risk management measures that might carry a risk of failure were not reasonably available alternative measures to meet the zero risk tolerance level set by the government.²⁰

42. What Methanex is effectively challenging in this case is the ability of California to set a zero risk level for MTBE, a product for which Methanex provides one constituent component.²¹ But Methanex can make this claim only under the provisions of Chapter 11. It cannot adduce all of the WTO and NAFTA trade-related provisions. The issue of intent, the only one IISD submits Methanex can legitimately raise to challenge this risk level, is discussed below.

43. The *US-Mexico Trucking* panel noted that its inclusion of valid regulatory objectives as distinguishing factors should not be read so broadly as to make the disciplines contained therein meaningless.²² IISD has no issue with this caution. However, as with all tests that are somewhat “accordion-like” in nature, the degree to which one may squeeze the test closed or stretch it open must be determined by the context.

44. IISD submits that a critical additional factor is important in this regard: the Panel in that case expressly notes in its interpretation of Article 1202 the presence of the applicable exception provision in Article 2101 of NAFTA, which allows for exceptions for environmental and human health reasons.²³ Chapter 11 has no applicable exception provision. Consequently, IISD submits that the Tribunal should have increased leeway to define when legitimate regulatory objectives provide relevant distinguishing circumstances. Otherwise, the absence of an exception provision would lead to very significant limitations on the ability of a state to be able to establish valid distinctions between investors on the basis of the actual impacts and effects of their investments. How else, for example, could the governmental response to a site-specific environmental assessment be accommodated?

¹⁹ *In The Matter of Cross-Border Trucking Services (File No. USA-Mex-98-2008-01)*, Final report of the Panel, (February 6, 2001), at paras. 257, 258.

²⁰ *European Communities – Measures Affecting Asbestos and Asbestos-Containing Products*, Report of the Appellate Body, AB-2000-11, WT/DS135/AB/R, (12 March 2001), at paras. 173-174, where “controlled use” or reliance on others using the product with due care were rejected as an alternative to a zero risk policy. Reliance upon proper underground storage tank constitutes an equivalent type of controlled use alternative in the present case [*EC-Asbestos*].

²¹ *Methanex-Claimant*, *supra* note 5 at para. 29.

²² *Ibid*, at para. 259.

²³ *Ibid*, at para. 260 *et seq.*

45. This is precisely consistent with the simple statement of the *Feldman* Tribunal that “the concept of discrimination has been defined to imply *unreasonable* distinctions between foreign and domestic investors in like circumstances.”²⁴

46. There is no indication in Chapter 11 that it was intended to prevent host states from making such legitimate distinctions, as long as they are not undertaken, in the words of counsel for Methanex at the April 2003 hearings, for “impermissible” purposes.²⁵

The Real Scope of the Like Products Test in Trade Law

47. IISD submits that a broader approach to the understanding of like circumstances and the regulatory distinctions that flow from it is supported, rather than negated, by trade law. While IISD does not accept the direct applicability of the trade law approach in the present case, it may be noted that Methanex in its submissions in any event misstates that test, as does Prof. Ehlermann in his opinion prepared for Methanex.

48. Although IISD has neither the space nor any need to rebut Prof. Ehlermann’s opinion on a point by point basis, a brief few points may be made. Methanex, relying upon Prof. Ehlermann and the cases he raises, seeks to establish that trade law does not permit the potential negative impacts of a product on the environment or on human safety and health to be accounted for under the “like products” definition.

49. The key case in this regard is the *EC-Asbestos* decision by the Appellate Body (AB) of the WTO in 2001. It has not been superceded by any subsequent cases. The AB in that case notes, as it always has, that there is no one “precise and absolute definition” of what is “like”, but that “The accordion of “likeness” stretches and squeezes in different places as different provisions of the WTO agreements are applied.”²⁶ While the AB then maintains the broad parameters of the test as to maintain competitive conditions of products, the AB also notes that not all products that are in some competitive relationship are like products under GATT Article III:4, the key provision relating to the regulation of products.²⁷

50. Prof. Ehlermann correctly notes the four criteria used by the AB in the *Asbestos* case, as in other prior cases:

- a. Physical properties, nature and quality of the products;
- b. End uses;
- c. Consumer tastes and habits; and
- d. Tariff classification.²⁸

51. Prof. Ehlermann then notes, correctly, but incompletely, that the AB then declined to introduce a separate criterion of the health risk of a product.²⁹ What Prof. Ehlermann glosses over is the extent to which health risks were then associated by the AB with the first criterion on the physical properties of a product, and the third criterion on consumer tastes, such as to have the AB overrule the determination of the Panel on its finding that cement products containing

²⁴ *Feldman*, *supra* note 1 at para. 170.

²⁵ There are some 10 references to this notion by counsel at the one day hearing, eight by counsel for Methanex, two by counsel for the United States, that counsel for IISD have identified with a simply word search function of the transcript.

²⁶ *EC-Asbestos*, *supra*, note 20 at para. 88.

²⁷ *Ibid*, at para. 99.

²⁸ Opinion of Prof Ehlermann, Nov. 4, 2002, at paras. 26-27 [Ehlermann].

²⁹ *Ibid*, at para. 26.

asbestos were like cement products without asbestos.³⁰ Although the AB did not substitute a finding that they were not like products, it effectively did so by finding that Canada, the complainant in the case, had failed to meet its burden of proof to establish that they were like products. In short, what the AB declined to do directly through a new criterion, it did just as effectively through the well recognized existing criteria of physical characteristics and consumer tastes.³¹

52. Just as important as establishing that the harmful properties of a product are legitimately distinguishing elements, the AB also made it clear that each element of the test was important. Prof. Ehlermann states in his opinion that “Although all the evidence under the four criteria has to be examined carefully, evidence under the second (end uses) and third (consumer tastes and habits) is more important than evidence related to the first (physical properties) and fourth criterion (tariff classification).”³² The first criterion is, of course, the principal one for examining the harmful affects of a product as part of the like products analysis.

53. With all due respect to Prof. Ehlermann, IISD submits there is no basis in the Appellate Body decision in the *EC-Asbestos* case for this proposition.³³ Indeed, it appears to IISD to say precisely the opposite:

*More important, the adoption of a particular framework to aid in the examination of evidence does not dissolve the duty or the need to examine, in each case, all of the pertinent evidence.*³⁴

54. IISD submits that Methanex’ overall reliance on the trade tests as focusing only on competitive relationships to the exclusion of the impacts of a product on human health or the environment are incorrect statements of the relevant law, irrespective of its applicability in the present arbitration.

55. IISD submits that the Tribunal should rely upon what the Appellate Body has actually said in the relevant cases, not on what a former member of that body subsequently says he thought it said. The cases speak for themselves on this point, and for the relevance of product characteristics and their potential impacts as legitimate distinguishing features under an even more narrowly drawn commercial substitutability test.

56. In addition, and finally on this issue, IISD notes that prior trade law jurisprudence also distinguishes between products that are final and usable in and of themselves, and products that are constituent elements of a separate final product that competes with another like product. This is exactly the hurdle Methanex must overcome in the present case, as signaled by the Tribunal in its Preliminary Award. IISD submits that trade law does not assist Methanex in this regard.

³⁰ Amelia Porges and Joel Trachtman, “Robert Hudec and Domestic Regulation: The Resurrection of Aim and Effects”, 37(4) J. World Trade (2003): 783-799 at 795; see also Frieder Roessler, “Beyond the Ostensible”, 37(4) J. World Trade: 771-781 (2003) at 776-779. The author, Executive Director of the Advisory Centre on WTO Law, notes here that regulatory distinctions highlighting health and environmental effects can be brought in under both Article III through the physical properties analysis, and Article XX of the GATT.

³¹ *EC-Asbestos*, *supra*, note 20 at paras. 113, 114, 121-123, 128, 130, 141.

³² Ehlermann, *supra* note 28 at para. 37.

³³ Donald Regan, “Further Thoughts on the Role of Regulatory Purpose Under Article III of the General Agreement on Tariffs and Trade”, 37 J. World Trade 7317-760, 2003 at 751 [Regan]. Prof. Robert Hudec, for example describes the four criteria as a “package”: “GATT/WTO Constraints on National Treatment: requiem for an ‘Aim and Effects’ Test”, 32 International Lawyer 619 (1998) at 626.

³⁴ *EC-Asbestos*, *supra*, note 20 at para. 102, reinforced by reference to the failure of the Panel to do this as a major flaw in the panel decision in the case, at paras. 109, 114 among several others.

57. In the case of *United States- Lamb Meat*, the Appellate Body in the context of the WTO Agreement on Safeguards ruled on the issue of “like and directly competitive products” and comparative domestic industries. As the comparison in the present arbitration is between foreign investments and domestic investments, this is particularly germane. In essence, the Appellate Body in *US-Lamb Meat* took the view that likeness does not exist between imported products and different products that are inputs into domestic like products. In a lengthy passage, the AB in that case stated:

In our view, [under Article 4.1(c) of the Agreement on Safeguards] input products can only be included in defining the “domestic industry” if they are “like or directly competitive” with the end products. If an input product and an end-product are not “like” or “directly competitive”, then it is irrelevant, under the Agreement on Safeguards, that there is a continuous line of production between an input product and an end-product, that the input product represents a high proportion of the value of the end-product, that there is no use for the input product other than as an input for the particular end-product, or that there is a substantial coincidence of economic interests between the producers of these products. In the absence of a “like or directly competitive” relationship, we see no justification, in Article 4.1(c) or any other provision of the Agreement on Safeguards, for giving credence to any of these criteria in defining “domestic industry”.³⁵

58. Applying the above to the present case, Methanex would have to establish that methanol was in direct competition with ethanol as an oxygenate, and not through being a constituent element of MTBE. In fact, Methanex appears to take the opposite approach in this case. Methanex makes it absolutely clear in its latest submissions that “Methanex’ primary argument is that methanol is, *through MTBE*, already used as an oxygenate in the manufacture of RFG and oxygenated gasoline, and as described above, in the eyes of refiners competes directly with ethanol.”³⁶ In other words, Methanex’ primary claim is through the role of methanol as an input product into MTBE, a chemically distinct product from methanol which Methanex does not manufacture, and which is far from the only use of methanol. By treating an input product as like the end-use product, Methanex directly contradicts the logic of *US- Lamb Meat*.

59. This approach is also supported in the recent *Feldman* award under Chapter 11, where the Tribunal held that producers of a final product and re-sellers of that product were not in like circumstances, even though both may have sold cigarettes, the product in question.³⁷

THE ISSUE OF INTENT IN NATIONAL TREATMENT

60. Closely related, indeed almost completely intertwined, with the preceding discussion is the issue of “intent” as it relates to the determination of the national treatment obligations. IISD takes as its starting point the language used, as already noted, by counsel for Methanex of “impermissible intent”.

61. There is no question that all types of regulations can be used for nefarious reasons, and that environmental regulations can be nefariously used as well. IISD has no issue with the role of international tribunals in using the properly applicable provisions of international agreements to assess whether a measure cloaked as environmental is, in fact, not environmental in its intent.

³⁵ *United States – Safeguard Measures on Imports of Fresh, Chilled or Frozen Lamb Meat From New Zealand and Australia*, WT/DS177/AB/R, (1 May 2001), at para. 80.

³⁶ *Methanex-Claimant*, *supra* note 5 at para. 29; see also para. 30 (emphasis added).

³⁷ *Feldman*, *supra* note 1 at paras. 170-171.

62. The main issues here are what role proof of positive, *bona fide* intent plays in the equation, how proof of “impermissible intent” is to be made, and the relationship between them. Methanex, in its latest submissions, seems to highlight this point:

Third, Methanex argued that when a government decision is motivated by a variety of factors, proof of an illicit intent will invalidate the decision even if the actor also had (or might have had) a permissible motive for doing the same act: [I]t is incorrect to pose the question of motivation [as]: did the decision-maker make this decision to serve legitimate or to serve illicit purposes... It is entirely possible that he had both objectives in mind, but the rule should be invalidated if the illicit objective played any material role in the decision.³⁸

63. When combined with issues of the proof of intent, IISD submits that this position reveals the nub of the national treatment issue in the present context: how to find and weigh permissible versus impermissible intent.

64. Methanex argues repeatedly that it is up to the United States to establish the validity of the environmental measures as an exception to the rules under Chapter 11.³⁹ However, as demonstrated above, there is no exception provision in Chapter 11, simply an integrated conception that requires the evaluation of, in the words of Methanex and US counsel, permissible and impermissible intents. Thus, there is no basis for apportioning to the United States the proof of legitimate intent unless and until the claimant Methanex has made out a sufficient case of impermissible intent.

65. IISD accepts that smoking guns on impermissible intent will not often be found. Inferences, circumstantial evidence and the like may, in such circumstances, have to be relied upon. But, recognizing the difficulties of a claimant in meeting its evidentiary burden does not require alleviating the claimant of its burden.

66. Nor does it require making it virtually impossible to overcome any evidence the claimant may adduce through circular or internally inconsistent rules of proof and burden of proof. Where the analysis by Methanex, in particular its submission quoted in paragraph 62 above, appears to IISD to break down is in its virtually complete denial of the capacity of the United States to prove permissible intent. This is especially so if what is required to establish impermissible intent is proof of a different *de facto* impact of the measure on a foreign investor as compared to the comparable domestic investor. If a *de facto* impact is proof of impermissible intent, and this cannot be outweighed by proof of permissible intent, then any differential impacts of a measure will automatically establish a breach of Article 1102. In fact, under this approach, there is no way for the United States to be able to respond.

67. Such a set of rules on evidence and proof would, it is submitted, leave the intent of Article 1102 in ruins. Clearly, regulations imposed on any investor – domestic or foreign – will have impacts. Clearly, in a world where capital moves increasingly freely and industrial production is increasingly concentrated in the hands of fewer market participants in many sectors, very significant differences in the impacts of regulations are going to arise. If differences in impact are made the basis for determining the impermissible intent behind the measure, foreign investors who face a larger impact than comparable domestic investors by virtue of being market leaders in a given product, by virtue of being sole players in a market on one given product line,

³⁸ *Ibid.*, at para. 160, cited to P. Brest, *Palmer v. Thompson: An Approach to the Problem of Unconstitutional Legislative Motive*, 1971 Sup. Ct. Rev. 95 at 120-121, omitted above.

³⁹ The latest instance is at *ibid.*, at paras. 188-197.

or for other economic or technical reasons, will essentially find themselves immune from new regulations to protect the public welfare and public interest.

68. IISD submits that the tests, the standard of proof and the burden of proof that this Tribunal looks to should take into account the real world consequences that those tests and standards would result in. While investor-state tribunals do not create law that is binding upon other tribunals, it is well known that other tribunals will look to previous cases to help determine the correct approach to the law, and to establish a consistent stream of law when possible. Thus, decisions of first impression, and this is one in several important respects, play a key role in the development of international law in this area.

69. IISD submits that the proof of permissible intent must be relevant to establishing the validity of a measure. Even under the rigid trade law approach advocated by Methanex, which involves a total exclusion of regulatory distinctions in the like product analysis (an approach that IISD rejects), permissible intent is relevant. It is examined under Article XX of the GATT, the exception for major public policy measures. But as we have pointed out, the structure of Article 1102 does not allow for this bifurcation between substantive provisions and exceptions. If consideration of permissible intent is not made in the analysis of like circumstances and less favourable treatment (we will return to the similar issue under expropriation below), Chapter 11 provides nowhere else for it to be made.

70. As we have argued, the simple fact of differences in treatment cannot be conclusive proof of impermissible intent.

*The test of discrimination is the intention of the government: the fact that only aliens are affected may be incidental, and if the taking is based on economic and social policies, it is not directed against particular groups simply because they own the property involved.*⁴⁰

Rather, in the context of the national treatment obligation, proof of impermissible intent requires a showing akin to a demonstration of bad faith or lack of bona fides. This may come from a completely disproportionate response to a problem, from the (improper) design of the measure in question, from a lack of a plausible relationship between the measure and the declared objective or from the inability of the measure to achieve the objective.

71. Nor, it is submitted, should one lightly assume that a response is inappropriate to the circumstances. It is important to recall paragraphs 40-46 here, which noted that trade law clearly allows the state to choose the level of risk and level of protection it believes is appropriate for the public interest. Too low a burden of proof for establishing impermissible intent would effectively gut the ability of states with large foreign capital inflows to choose their levels of risk and protection. In the case of the NAFTA, it would also create an internal inconsistency favouring foreign investors over domestic investors under a national treatment rule.

72. A further question is the role of subjective versus objective proof of intent and how intent is to be established. While no perfect solutions exist, utilitarian approaches based on principle can be identified.

73. In IISD's submission, the appropriate standards for a Tribunal sitting under Chapter 11 flows from administrative law concepts of extending significant deference to host state governments. This is not an abdication of responsibility, but the setting of a standard which is

⁴⁰ *Brownlie, supra* note 3 at 54, n. 96

both well known and well understood, while still clearly allowing for a claimant to show, as part of its burden of proof, the lack of *bona fides* or the presence of bad faith. One author has phrased such a standard in relation to the GATT, which IISD submits is appropriate to the present case as well:

Generally, questions about degrees of deference seem to me too amorphous to bear much discussion. But here it seems there is a clearly right answer in principle: the tribunal should defer to the regulator's decision unless the regulator's conclusion seems so unsupported and improbable that the tribunal thinks it must have been insincere, a mere cover for protectionist purpose.⁴¹

74. This approach is similar to one applied in a bilateral investment treaty case in the context of expropriation and the analysis of legitimacy of a measure under the public purpose criteria applicable in that context. IISD submits this is equally applicable in both contexts.⁴²

KNOWLEDGE AND INTENT

75. The pleadings of Methanex also create a further difficulty. Methanex appears to argue that the knowledge by California of the different impacts amounts to proof of impermissible intent. Essentially, because California knew the impact would be higher on Methanex than any other company, it is deemed to have intended to harm Methanex, and thereby to have shown impermissible intent.

76. A leap from knowledge to impermissible intent is, in IISD's submission, one step too far. Democratic governments today work in highly transparent ways. Stakeholder consultations, economic impact studies, environmental impacts studies, outside peer reviews, and many other similar devices are used to glean information about a possible problem, weigh options, and determine directions. Under the "knowledge = intent" formulation, as soon as a foreign investor makes a host state aware that the impacts of a proposed measure upon it will be greater than on a domestic competitor, that government would either be precluded from taking the measure, no matter how useful, or would be subject to damages for breaching national treatment obligations. Neither option is viable or appropriate for governments seeking to make informed choices in protecting the public interest. In addition, national treatment obligations are comparative in nature, not absolute standards as represented by Article 1105 of NAFTA. National treatment obligations are not intended to *favour* foreign investors by creating additional barriers to public interest legislation that impacts foreign investors. They are designed to ensure national treatment, not *supra*-national treatment.

77. Further, the corollary of the "knowledge = intent" argument is that lack of knowledge is a preferable situation. After all, if what I know is to be held against me, I am better off to avoid knowing. This is, of course, a wholly untenable situation and one no Tribunal should encourage.

78. IISD wishes to address just one other element of the pleadings by Methanex on this point. This is using the so-called "Baptist-bootlegger" coalition as evidence against a state. First, as the US correctly points out, this amounts to holding the state responsible for the acts of third parties manifestly not under its control. Second, and equally critical, this is evidence only of the truth that in a transparent consultation process those with similar end-goals will find ways to help each other out in many circumstances. This is not an environmental law phenomenon, as much as it is

⁴¹ Regan, *supra* note 33 at 746.

⁴² *Antoine Goetz v. Republic of Burundi* (ICSID Case No. ARB/95/3), 15 ICSID Review (2000), 458 at para. 126.

a broad phenomenon of all policy processes leading to new legislative or regulatory measures. IISD submits that the notion that this is evidence of any kind for a Tribunal to establish impermissible intent strains credibility and any appropriate rules of evidence.

EXPROPRIATION AND REGULATION

79. While Methanex appears to have tied its Article 1105 case to its national treatment claim, it has taken its claim under Article 1110 beyond this. IISD submits that the most recent articulation of the claim, in the February 2004 Reply submissions, place before this Tribunal the issue of regulatory takings.

80. The state of international law on expropriation has recently been described by Yves Fortier, Q.C., as follows:

To paraphrase a former partner (and mentor) of mine: the meaning of “expropriation” and the protection against expropriatory conduct afforded international investors is “clearly ambiguous.” The law is, truly, in a state of flux. My modest purpose today, in these brief remarks, has been to draw attention to that fact, and to propose that counsel and their clients take to heart a maxim that reverberates throughout the cases: caveat investor!⁴³

81. However, the other half of the equation in the face of such uncertainty is, *caveat host state!* For the impacts of the uncertainty are just as great for the host state seeking to protect the public welfare as the investor seeking to determine its rights and obligations.

82. IISD submits that there are four distinct categories of possible expropriation under Article 1110:

- a. The taking of title to property, in whole or in part;
- b. The use of police, administrative or legal powers to take control of the operation of an investment, or shut the investor out of its rights of control and ownership, without the transfer of title;
- c. Creeping expropriation: the use of a series of measures that cumulatively rather than individually accomplish the removal of ownership or control of an investment; and
- d. The disputed notion of regulatory taking, whereby the diminution of economic value due to a regulation that protects the public interest becomes the basis for a finding of expropriation.

83. The first three of these are well established in international law. IISD does not consider them to be controversial. It is the last of these that has raised numerous concerns, and is the focus of Mr. Fortier’s comments quoted above and IISD’s submissions below.

84. IISD believes that it is important to understand the manner in which the United States and Methanex have formulated the relevant issues. The United States has stated: “It is a principle of customary international law that, where economic injury results from *bona fide* regulation within the police powers of a State, compensation is not required.... Thus, as a general matter, States are not liable to compensate aliens for economic loss incurred as a result of a nondiscriminatory

⁴³ L. Yves Fortier, *Caveat Investor: The Meaning Of “Expropriation” And The Protection Afforded Investors Under NAFTA*, NEWS From ICSID, Vol. 20, No. 1, (Summer 2003): 1 at 13.

action to protect the public health.”⁴⁴ Whether one cites this as a health measure or an environmental measure is irrelevant, the result would be the same as a *bona fide* public protection measure.

85. Methanex first quotes the above, then subtly but importantly restates this formulation: “The U.S. argument is based on the proposition that expropriation for a public health purpose does not give rise to liability”.⁴⁵ What is the difference? It lies in the well understood distinction between a carve-out from a definition or concept, and an exception to that definition or concept.

86. The initial formulation of the United States, which IISD submits is correct, leaves *bona fide* public health and welfare measures, traditionally understood as measures under the police powers of a state, *outside* the concept of an expropriation: they are not expropriations of any kind. That is why they are not subject to compensation. The Methanex re-formulation, in contrast, says such measures are expropriations, but by exception are not subject to compensation. Again, the strategic goal of Methanex in this formulation is clear: to place the burden of proof on the United States to show the measure is not compensable as opposed to having the burden to show the measure is not *bona fide* fall on itself. Again, one finds critical issues of burden of proof and quality of proof acting as a shield for extremely important issues of principle in the interpretation of Chapter 11. IISD believes that the Tribunal must resolve the issue of substance and principle before setting out the relevant proof and evidence issues.

87. The reformulation by Methanex is at odds with the theoretical clarity that the *Santa Elena v. Costa Rica* case brings to this field. That case concerned the actual taking of title to property by Costa Rica to establish a national biodiversity reserve. The Tribunal in that case was faced with a prior determination by both parties that an expropriation had taken place through the transfer of title. It therefore said nothing on the issue of when an expropriation has taken place, but sat only to hear arguments on the quantum of compensation due. On that basis, it ruled that once an expropriation has taken place, compensation is due even if it is for an environmental purpose.⁴⁶ IISD takes no issue with this finding: if an expropriation takes place, compensation should be paid.

88. The approach apparently taken by Methanex runs directly counter to the consistency and clarity seen in the *Santa Elena* case: that an environmental exception to compensation does not apply if there has been a determination of expropriation. In addition, the Methanex approach to establish an exception to *compensation* after a finding of expropriation would open a morass of uncertainty for governments and investors alike: the default position would be compensation is required for all economically significant regulatory impacts on foreign investors unless a Tribunal found, by way of exception, that the measure was not compensable. No government, it is submitted, could operate effectively to protect the public welfare in such circumstances.

89. IISD submits that the US approach of determining the primary issue of whether or not a measure is an expropriation is the correct approach, and dovetails properly with the *Santa Elena* decision. It is also in keeping with the traditional concept of the police powers carve-out and hence with the understanding that the interpretation of NAFTA should be in accordance with the general principles of international law.

⁴⁴ United States, Amended Statement of Defense of the Respondent United States of America, December 5, 2003, at paras. 410, 411.

⁴⁵ *Methanex-Claimant*, *supra* note 5 at para. 212.

⁴⁶ *Compania del desarrollo de Santa Elena v. Republic of Costa Rica*, (CASE No. ARB/96/1) 15 ICSID Review (2000):169, at paras. 71-72.

90. This difference in formulation mirrors, almost precisely, the split in NAFTA cases on this issue. This split is best highlighted by reference to the *Metalclad* case on the one hand, and the *Feldman* case on the other hand, the first and the last cases so far to address the issue.

91. The regulatory expropriation issue came to light first in the *Metalclad v Mexico* arbitration under NAFTA.⁴⁷ That tribunal found that a measure to prevent the use of land as a landfill and establish it as a state wildlife protected area, but without taking underlying title, was a measure tantamount to expropriation and required compensation. In making this determination, the Tribunal ruled that (1) the purpose or intent of the measure was not a relevant concern; and (2) simply the effect was relevant, and as it was significant a taking or expropriation was made out.⁴⁸

92. In stating that the motive or intent of a measure it defined as being tantamount to expropriation was irrelevant, the Tribunal effectively foreclosed reference to the police powers carve-out from expropriation. Indeed, it undertook no such analysis at all. If intent is not relevant, then the underlying public purpose intent of any police powers measure is not relevant and the carve-out is removed. This may or may not have been the intent of the *Metalclad* Tribunal, but it is the effect of its legal position.

93. The more recent decision of *Feldman v. Mexico* looks at matters differently:

*The Article 1110 language is of such generality as to be difficult to apply in specific cases. In the Tribunal's view, the essential difference is whether the actions of the Mexican government constitute an expropriation or nationalization, or are valid government activity.... If there is a finding of expropriation, compensation is required, even if the taking is for a public purpose, non-discriminatory and in accordance with due process of law and Article 1105(1).*⁴⁹

94. The Tribunal carries on, quoting with emphasis the passage from the Restatement of the Law Third: The Foreign Relations of the United States:

*A state is not responsible for loss of property or for other economic disadvantage resulting from bona fide general taxation, regulation, forfeiture for crime, or other action of the kind that is commonly accepted as within the police powers of states, if it is non-discriminatory.*⁵⁰

.....

*To paraphrase Azinian, not all government regulatory activity that makes it difficult or impossible for an investor to carry out a particular business, change in the law or change in the application of existing laws that makes it uneconomical to continue a particular business, is an expropriation under Article 1110. Governments, in the exercise of regulatory power, frequently change their laws and regulations in response to changing economic circumstances or changing political, economic or social considerations. Those changes may well make certain activities less profitable or even uneconomical to continue.*⁵¹

⁴⁷ *Metalclad-BCSC*, *supra* note 16 at 664.

⁴⁸ *Metalclad v. Mexico*, Final Award, 2 September 2000, paras. 103, 109-111.

⁴⁹ *Feldman*, *supra* note 1 at para. 98.

⁵⁰ *Ibid*, at para. 105.

⁵¹ *Ibid*, at para. 112.

95. In the end, the *Feldman* Tribunal seems to establish its dividing line on the basis of whether the claimant was deprived of a “fundamental right of ownership” as opposed to the degree of interference with the business or a business line.⁵²

96. The difference between the *Metalclad* and *Feldman* approaches, and the formulations of the United States and Methanex, are critical: it is whether normal, non-discriminatory and *bona fide* regulations get defined as expropriations subject to compensation except in exceptional circumstances, or whether regulations are not expropriations and therefore not subject to compensation unless a complainant can show they are not *bona fide*. It is, in the language of Methanex in a different context, a binary choice for the Tribunal.

THE AWARDING OF COSTS

97. Finally, IISD wishes to make some observations on the awarding of costs in this case. The right of Methanex to use the Chapter 11 process is undoubted. However, there is no right to do so cost free. The use of the investor-state process is not cost free for governments and taxpayers, who foot the costs for representation in these proceedings. Governments and the public also foot the bill for the uncertainties associated with these arbitrations. The fact is that Chapter 11 arbitrations can be used for strategic purposes, to mount opposition to environmental and other regulatory measures that could have an economic impact on an investor. Indeed, a book heavily relied on by Methanex in this case advocates just that.⁵³ If arbitrations are to be permitted for strategic purposes without costs, there are two certain results: an endless series of cases against any national or sub-national measures and/or uncertainty and regulatory chill for governments and public.

98. IISD submits that the Tribunal should take this matter into account in awarding costs.

⁵² *Ibid*, at paras. 119, 152 referencing this as the key test in the *Pope & Talbot v. Canada* finding there was no expropriation.

⁵³ Alan Rugman, John Kirton, Julie Soloway, *Environmental Regulations and Corporate Strategy: A NAFTA Perspective*, (1999). This book is, at least in significant part, designed as a “how to” manual: a toolkit for companies to use to help oppose or reduce the burden of new environmental measures that have economic impacts upon them. For North American investors, two of the strategic tools expressly cited by the authors include investor-state arbitration under Chapter 11, and the “citizen submission” process under Articles 14 and 15 of the North American Agreement on Environmental Cooperation (NAAEC), the so-called NAFTA environmental side agreement. Indeed, these are highlighted early: “However, by far the most striking development has been the use of NAFTA’s many innovative dispute settlement mechanisms and institutions to mount new political strategies.”⁵³ Methanex also made a “citizen submission” under Articles 14 and 15 of NAAEC notwithstanding the fact that that Article 14(3) and Article 45(3) of the Agreement clearly state that once an international arbitration is initiated a citizen submission cannot proceed. The submission was declared inadmissible. Methanex’s awareness that California was but the canary in the mineshaft of regulatory bad news for MTBE makes a strategic approach plausible.

All of which is respectfully submitted by the International Institute for Sustainable Development, this 9th day of March, 2004, by counsel for the International Institute for Sustainable Development:

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