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LITIGATION UPDATES

FACING ARBITRATION FOR ENVIRONMENTAL REGULATION: ARBITRATION UNDER CHAPTER 11 OF THE NORTH AMERICAN FREE TRADE AGREEMENT BETWEEN METHANEX CORPORATION AND THE UNITED STATES OF AMERICA

By *Rekha Rao**

INTRODUCTION

The Methanex case involves a California state law protecting the environment and public health, which came under increasing scrutiny and involved a lengthy legal dispute within the confines of the North American Free Trade Agreement (“NAFTA”). The Methanex case initiated from a claim filed by Canadian-based Methanex Corporation under NAFTA Chapter 11 against the United States, based on an investment dispute rising from a California state environmental protection measure.

SCIENTIFIC BACKGROUND REGARDING MTBE

In 1999, the Governor of California released Executive Order D-55-99 that ordered the removal of Methyl Tertiary-Butyl Ether (“MTBE”) from California gasoline at the earliest possible date, but no later than December 31, 2002.¹ In March 2002, the Governor extended the phase out for another year, until March 2003.² MTBE is a chemical made of oxygen, but often is added to gasoline to boost its octane content, specifically to meet clean fuel requirements.³ The oxygen content in gasoline helps the gasoline burn more completely and reduce the harmful emissions from automobiles.⁴ MTBE has been used by the United States in different forms since 1979, and is a volatile clear liquid that dissolves easily into water.⁵ MTBE poses a health risk when it enters the drinking water supply from leaking underground storage tanks, pipelines, spills, emissions from marine engines into lakes and reservoirs, and minimally from air deposition.⁶ The World Health Organization has claimed that MTBE presents a risk to the water supply as a known carcinogen.⁷ California passed the ban on MTBE because of its contamination of drinking supplies, and consequent potential for negative health and environmental impacts.⁸

BACKGROUND ON NAFTA CHAPTER 11

Methanex Corporation filed suit against the United States in June 1999, as a party to NAFTA under the treaty’s Chapter 11. NAFTA entered into force on January 1, 1994 and since its initiation, multinational corporations have used its dispute settle-

ment mechanism to bring suits against national public regulations in Mexico, Canada, and the United States.⁹ Chapter 11 of NAFTA provides rights to foreign investors and their investments within NAFTA countries, and protects them from regulations and measures taken by governments.¹⁰ Under Chapter 11, the definition of “measure” is broad and entails laws adopted by national, state, or provincial legislatures; regulations that implement these laws; local or municipal laws and bylaws; and policies that affect government interaction with businesses.¹¹ Chapter 11 also governs laws and regulations that existed prior to its entry into force, unless specifically excluded in the statute, and excludes all state laws in force before 1994.¹² These provisions of NAFTA became controversial because they decreased government’s ability to maintain and pursue regulations and laws created for the public good.¹³ Chapter 11 also holds two dispute settlement processes: the first can be seen in the Methanex case where an investor state process is instigated directly by the investor against the host state, and the second involves a state-to-state dispute resolution process that can also be found in Chapter 20.¹⁴ The first type of dispute resolution process remains the most common, with 17 cases brought before panels until 2001. Chapter 11 contains three different types of environmental statutes: (1) Article 1114 states that nothing in Chapter 11 prevents a country from establishing an environmental measure that is otherwise inconsistent with the Chapter; (2) the second paragraph of Article 1114 states that no country should avoid relaxing environmental legislation in exchange for trade lenient measures; and (3) Article 2101 of NAFTA includes the general exceptions to NAFTA, including those environmental measures meant to protect human, animal and plant life, health, and conservation of natural resources.¹⁵

METHANEX’S CLAIMS

Methanex filed a claim under Article 1110 of NAFTA. Article 1110 states: “no Party shall directly or indirectly nation-

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alize or expropriate an investment of an investor of another Party in its territory or take a measure tantamount to nationalization or expropriation of such an investment...[without] compensation.”¹⁶ Methanex claims that the effect of Governor Davis’ phase-out measure had the effect of expropriating part of Methanex’s business and requires a compensation claim for damages.¹⁷ In 2000, Methanex brought the one billion dollar claim against the United States for violation of Article 1110 by enacting the specific regulations to phase out MTBE in California, and turned the investment dispute into the single largest takings claim in U.S. history.¹⁸

NAFTA TRANSPARENCY ISSUES

One of the main issues and dispute resolution landmarks of this case has been its transparency. NAFTA Chapter 11 claims notoriously lack transparency in their dispute resolution process.¹⁹ Specifically, in this case non-profit organizations petitioned and won the right to present amici briefs to the dispute resolution arbitration panel in support of a claimant. The Center for International Environmental Law, Earthjustice representing Bluewater Network, Communities for a Better Environment, and the International Institute for Sustainable Development all petitioned to write supporting briefs for the United States, and succeeded to present their cases to the tribunal as amicus briefs.²⁰ This became the first time NAFTA stated that it has the authority to accept amici briefs in dispute resolution arbitrations, and allowed third party participation in investor and state arbitration.²¹

In June 2004, the Arbitration Tribunal, headed by President V.V. Veeder, Q.C., Arbitrator Professor W. Michael Reisman, and Arbitrator J. William Rowley, Q.C., began its final hearings and listened to the arguments for each party at the World Bank headquarters in Washington, D.C. Another aspect of transparency apparent in this case included the availability of the Tribunal hearings via videotape to the public. Representatives from non-governmental organizations and groups interested in the outcome of the case who attended these hearings were able to ascertain the main arguments from each party. The Tribunal has not reached a decision on the case to date, but the case remains a first step into full transparency surrounding international investment disputes under NAFTA.



ENDNOTES: FACING ARBITRATION

- ¹See California Energy Commission: MTBE Phase-Out, Energy Commission Phase-Out Study (explaining the reasoning and scientific basis behind the phase out planned by the state of California), available at <http://www.energy.ca.gov/mtbe> (last visited Nov. 15, 2004).
- ²See *id.*
- ³See United States Environmental Protection Agency: MTBE Overview (articulating the specific uses of MTBE, and the environmental consequences of its production and use), at <http://www.epa.gov/mtbe/>, (last visited Nov. 15, 2004).
- ⁴See *id.*
- ⁵See *id.*
- ⁶See *id.*
- ⁷See Julia Ferguson, *California Concerned About Water: Canadian Corporation Files NAFTA Expropriation Claim Against United States*, 1999 COLO. J. INT’L ENVTL. L. & POL’Y 65, 66 (1999).
- ⁸See California MTBE Phase Out Study, *supra* note 1.
- ⁹See INTERNATIONAL INSTITUTE FOR SUSTAINABLE DEVELOPMENT AND WORLD WILDLIFE FUND, PRIVATE RIGHTS, PUBLIC PROBLEMS: A GUIDE TO NAFTA’S CONTROVERSIAL CHAPTER ON INVESTORS RIGHTS (2001).
- ¹⁰See North American Free Trade Agreement, Jan. 1, 1994, ch. 11.
- ¹¹See *id.*
- ¹²See *id.* See also GUIDE TO NAFTA’S CONTROVERSIAL CHAPTER ON INVESTORS’ RIGHTS, *supra* note 9, at 10.
- ¹³See North American Free Trade Agreement, Dec. 17, 1992, ch. 11, 19 U.S.C. §§ 3301-3473 (1993).
- ¹⁴See *id.*; North American Free Trade Agreement, Dec. 17, 1992, ch. 20, 19 U.S.C. §§ 3301-3473 (1993).
- ¹⁵See *id.*
- ¹⁶See North American Free Trade Agreement, Dec. 17, 1992, ch. 11, art. 1110 19 U.S.C. §§ 3301-3473 (1993); Ferguson, *supra* note 7.
- ¹⁷See Ferguson, *supra* note 7.
- ¹⁸See Joel C. Beauvais, Student Article, *Regulatory Expropriations under NAFTA: Emerging Principles & Lingering Doubts*, 10 N.Y.U. ENVT. L.J. 245, 245-46 (2002).
- ¹⁹See 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, 555 (2001) (arguing that NAFTA dispute resolution procedures need transparency, which can be attained by allowing public access to the dispute resolution process in every way, and that disclosure of the consultative process between the investor and the host state that is not prohibited by any provision within NAFTA).
- ²⁰See, e.g., *Submission of Non-Disputing Parties Bluewater Network, Communities for a Better Environment, and Center for International Environmental Law*, In the Arbitration Under Chapter Eleven of the North American Free Trade Agreement and the UNCITRAL Arbitration Rules Between Methanex Corporation, Claimant/Investor, and United States of American, Respondent/Party (March 9, 2004).
- ²¹See *A Backgrounder on the Controversial Case Under NAFTA’s Chapter 11, and on IISD’s Involvement*, International Institute for Sustainable Development, (Aug. 31, 2004), available at http://www.iisd.org/investment/methanex_background.asp (last visited Nov. 30, 2004).