NAFTA, SOVEREIGNTY AND TRADEOFFS

By

Damara Griffith

The Federalist Society
for Law and Public Policy Studies

The Federalist Society takes no position on particular legal or public policy initiatives. All expressions of opinion are those of the author or authors. We hope this and other white papers will help foster discussion and a further exchange regarding current important issues.

NAFTA, SOVEREIGNTY AND TRADEOFFS

I. Introduction

The North American Free Trade Agreement (NAFTA) is now in its tenth year of existence and the Agreement is widely held to be an economic success.[1] The United States, Canada and Mexico are now close to completing the implementation process, and the citizens of the three countries are already reaping the benefits of the trade pact. The NAFTA region has experienced growth in trade and investment and millions of jobs have been created. Between 1994 and 2001, trade between the United States, Canada and Mexico grew by 128%, and Mexico has now surpassed Japan as the United States' second largest trading partner.[2]

Despite the economic accomplishments of NAFTA, the Agreement has received criticism at all stages of its development for its erosion of American sovereignty. Some critics are concerned about the high-profile role that American environmental and labor nongovernmental organizations (NGOs) played in the creation of NAFTA and in other aspects of the Agreement. Others have focused on the limitations that the investor protection provisions of NAFTA have placed on the ability of federal and state governments to determine domestic policies.

The fact is that there are tradeoffs that must be made in international trade agreements. It would be difficult for the United States to negotiate an agreement for the liberalization of trade and investment where the concessions offered by the United States are not comparable to those the we would expect from our trading partners. Therefore, to the extent that governments make policies through international trade agreements, they must restrict our own system of self-government at home. The question is how much and what aspects of our sovereignty are we willing to relinquish in exchange for the benefits of free trade and increased, secure investment opportunities.

This paper provides an overview of NAFTA and the tensions that exist between American sovereignty and the promotion of free trade and investment under NAFTA. Part II defines sovereignty as the term is used in this paper. Part III reviews the history of NAFTA, including the negotiation process and the incentives behind the Agreement and then gives a brief overview of the terms of NAFTA. Part IV examines three of the most controversial aspects of NGO participation in NAFTA. Finally, Part V outlines NAFTA's investment protection mechanisms and considers key case studies illustrating some of the tradeoffs that have been made between NAFTA and American sovereignty.

---

[1] North American Free Trade Agreement, Dec. 17, 1992, 32 I.L.M. 605, art. 105, *available at* http://www.sice.oas.org/tradee.asp [hereinafter NAFTA] (entered into force Jan. 1, 1994).

[2] Joint Statement, NAFTA Free Trade Commission, Building on a North American Partnership (July 31, 2001) *at* http://www.dfait-maeci.gc.ca/nafta-alena/NAFTA_Communique-en.asp (last visited Feb. 22, 2003) (proclaiming the success of the first seven years of NAFTA). The Commission also pointed out that trade among the three NAFTA countries has grown from less than US$297 billion in 1993, to more than US$676 billion, or more than US$1.8 billion per day. *Id*.

II. Sovereignty

Over the past decade, academic and popular attention has focused on global trends that seem to be eroding national sovereignty.[3] Private actor participation in international law and the exercise of law-making authorities by international organizations has dramatically increased in recent years. Sovereign states are now increasingly finding themselves subject to international regulation that has limited the areas where nations are free from external influence. Some of the chief complaints against NAFTA concern the limitations it has placed on the ability of national and state sovereigns to determine and act on their domestic policy priorities.

Generally, when people criticize international agreements for eroding sovereignty, they are using the term sovereignty to mean the ability of a state to have the final say on issues that affect the people of that state. This is sovereignty as exclusive territorial jurisdiction. There is a well-entrenched notion that statehood is defined by a sovereign ability to determine domestic priorities.[4] Some scholars focus on different conceptions of sovereignty, such as international sovereignty which is the view that sovereignty means having status in the international community whereby states have the capacity to operate internationally by forming treaties and bringing international claims.[5] This latter is not the meaning of sovereignty that is presented in this paper. Sovereignty refers rather to the capacity of the state to have the final say on issues that affect that state.

III. NAFTA Background

A. NAFTA Negotiations

After nearly four years of discussion and negotiation between the United States, Mexico and Canada, the North American Free Trade Agreement (NAFTA) entered into effect on January 1, 1994. NAFTA is a comprehensive free trade pact which integrates the economies of Mexico, Canada, and the United States. While geographically the countries are neighbors, there are significant differences between the economies and legal systems of these countries. The United States and Canada are both highly industrialized countries, but Mexico is still a developing

---

[3] *See* JEREMY RABKIN, WHY SOVEREIGNTY MATTERS 93-96 (1998) (advocating the revival of the traditional American view on the proper role of international commitments, including the assumption that there are limits on what matters treaty can govern and what questions international law can settle); John R. Bolton, *Should We Take Global Governance Seriously?*, 1 CHI. J. INT'L L. 205, 206 (2000) (warning that the threats of "globalism" can no longer be ignored); Jack Goldsmith, Sovereignty, International Relations Theory, and International Law: Sovereignty: Organized Hypocrisy, 52 STAN. L. REV. 959, 959 (2000) (noting conventional wisdom that sovereignty in the sense of a nation's exclusive and absolute power within its territory "appears to have diminished significantly in the past half century as a result of economic globalization, transportation and communications advances, the rise of nongovernmental organizations (NGOs), and the spread of international human rights law"); Kal Raustiala, Sovereignty and Multilateralism, 1 CHI. J. INT'L L. 401, 418-419 (2000) ("[W]e are increasingly choosing to regulate at the international level .... Sovereignty traditionally conceived will necessarily be compromised ...").

[4] Tollefson, *Games Without Frontiers: Investor Claims and Citizen Submissions Under the NAFTA Regime*, 27 YALE J. INT'L L. 141, 146 (2002). *See also* Goldsmith, supra note 3, at 967 (noting that the traditional conception of sovereignty is "the exclusion of external actors from domestic authority structures").

[5] Duncan B. Hollis, *Private Actors in Public International Law: Amicus Curiae and the Case for the Retention of State Sovereignty*, 25 B.C. INT'L & COMP. L. REV. 235, 249 (2002) (arguing that international sovereignty, as defined by states having international legal personality, "is reinforced rather than eroded by recent examples of private actor participation an international institutional law-making).

economy. The populations of the three countries vary widely, with approximately 30 million people in Canada, almost 300 million in the United States and around 100 million people in Mexico. The primary interest for both Canada and Mexico was in securing greater access to the giant United States market. The United States overshadows the market power of Canada and Mexico with a GDP of $6,952 billion, which accounted for 89.5 percent of the North American Economy in 1995.[6] By contrast, at $569 billion, the Canadian economy constituted a mere 7.3 percent, and Mexico's GDP of $250 billion represented only 3.2 percent of the North American economy.[7]

A free trade agreement between Canada and the United States predated NAFTA, however the extension of this bilateral agreement to Mexico was not anticipated at the time. The Canada-United States Free Trade Agreement, which took effect on January 1, 1989, included no provisions for the accession of new countries into the free trade agreement.

Yet, only a year after the Canada-U.S. FTA went into force, Mexico initiated talks with the United States regarding a bilateral free trade agreement between the two countries. Nearly a decade of recession, inflation and debt had left Mexico in enormous need of investor capital. Initially President Salinas looked to establishing sectoral trade agreements with Europe. Following the conclusion of a debt restructuring agreement with Mexico's creditor banks, Salinas and and a group of ministers set out on an eight-day trip to Europe, including the World Economic Forum in Davos, Switzerland, in search of foreign investment.[8] However, the competition for investment presented by the newly opened Eastern European economies proved to be too great, and Salinas found little interest among European investors.[9]

Still facing the need to make their economy more attractive to foreign investors, Mexico shifted gears and began to consider a comprehensive bilateral trade agreement with the United States, and in early February 1990 Salinas proposed a free trade pact to President Bush. [10] Canada was initially ambivalent about joining the trade negotiations with the United States and Mexico, but ultimately the Canadian government decided that in order to protect their interests in the North American market, participation in negotiations for a common market would be necessary.[11]

On September 25, 1990 President Bush notified the appropriate Congressional committees of his intent to negotiate a free trade agreement with Mexico.[12] By February 1991, Bush revised his notification of intent to include Canada as a party to the free trade

---

[6] MAXWELL A. CAMERON & BRIAN W. TOMLIN, THE MAKING OF NAFTA: HOW THE DEAL WAS DONE 15 (2002). The figures are based on 1995 data.
[7] *Id*.
[8] WILLIAM A. ORME, UNDERSTANDING NAFTA: MEXICO, FREE TRADE, AND THE NEW NORTH AMERICA 30 (1996); MARYSE ROBERT, NEGOTIATING NAFTA: EXPLAINING THE OUTCOME IN CULTURE, TEXTILES, AUTOS AND PHARMACEUTICALS 28 (2000).
[9] CAMERON & TOMLIN, *supra* note 6, at 62.
[10] *Id*. at 63.
[11] *Id*.
[12] Harold H. Koh, *The Fast Track and United States Trade Policy*, 18 BROOK. J. INT'L L. 143, 153 (1992). Under the Omnibus Trade and Competitiveness Act of 1988, the President is required to provide sixty days notice to the Senate Finance and House Ways and Means Committees of his intent to enter into trade negotiations. 19 U.S.C. § 2902(c)(3)(C) (1988).

negotiations.[13] With fast track authority scheduled to expire on June 1, 1991, on March 1 of that year President Bush requested that Congress grant a two year extension of Fast Track procedures to allow the Administration to complete negotiations of both the Uruguay Round and NAFTA.[14]

The battle that ensued foreshadowed the major role that environmental and labor issues would play in the final resolution of NAFTA. One-house extension disapproval resolutions were introduced in both the House and Senate with Congress requesting that President Bush define how the Administration would deal with the environmental and labor concerns that had already been raised against NAFTA.[15] After the President submitted an action plan in which he pledged to work with Congress to draft implementing legislation that would address the environmental and labor concerns, Congress agreed to extend Fast Track for both the Uruguay Round and NAFTA.[16]

Formal negotiations on NAFTA commenced between the three countries in June 2001, and were largely completed during a marathon negotiation in July of 1992.[17] The leaders of the three countries signed the NAFTA Agreement on December 17, 1992 in their respective capitals. However, President Bush's signature did not mean that NAFTA was ready to be transmitted to Congress for ratification. On the contrary, since President Bush lost the U.S. Presidential election, it was then in President Clinton's hands.

During the presidential campaign, labor and environmental groups and key members of the Democratic party convinced President Clinton that negotiating side agreements on labor and the environment was necessary, leading Clinton to make a campaign promise to pursue such agreements if he won the presidential election.[18] Thus, in March 1993 after Clinton took office, the three countries commenced negotiating side agreements on labor and the environment.

That spring the future of NAFTA appeared uncertain and the Administration geared up for a contentious ratification battle.[19] Congress was split over the negotiation of the side agreements with many Republicans threatening to oppose NAFTA's passage if the side agreements granted too much power and many Democrats demanding strong side agreements before they would support NAFTA.[20] The Clinton Administration openly negotiated the side agreements with the understanding that the negotiations were necessary to secure ratification of NAFTA in the United States.[21] Ultimately the negotiators were able to secure an agreement that satisfied enough members of both political parties to win passage of NAFTA. The side agreements were completed and Congress finally approved NAFTA in November 1993.[22]

---

[13] C. O'Neal Taylor, *Fast Track, Trade Policy, and Free Trade Agreements: Why the NAFTA Turned into a Battle*, 28 GEO. WASH. J. INT'L L. & ECON. 1, 33 (1994).
[14] Koh, *supra* note 12, at 153.
[15] *Id*. at 154.
[16] *Id*. at 155.
[17] CAMERON & TOMLIN, *supra* note 6, at 163-175.
[18] ROBERT, *supra* note 8, at 42.
[19] CAMERON & TOMLIN, *supra* note 6, at 185.
[20] *Id*. at 189.
[21] *Id*. at 201.
[22] ROBERT, *supra* note 8, at 44.

President Clinton then signed the Agreement on December 8, 2003, and NAFTA entered into force on January 1, 2004.[23]

B. The Terms of NAFTA

NAFTA creates a free trade zone encompassing Canada, the United States and Mexico. The Agreement is based on roughly equivalent concessions granted between the trading partners that are designed to expand and improve trade. NAFTA contains eight parts, including objectives and definitions; trade in goods; technical barriers to trade; government procurement; investment, services and related matters; intellectual property; administration; and exceptions to the agreement.[24]

NAFTA provides for the elimination of tariffs and most non-tariff barriers on regional trade to be phased in over ten years.[25] It also liberalizes restrictions on the flow of investment in North America. Provisions to promote investment include providing national and most-favored-nation treatment to investors from NAFTA parties.[26] In addition NAFTA limits performance requirements, forbids restrictions on capital movements and outlaws most expropriation without fair compensation.[27] Other objectives of NAFTA include the promotion of conditions of fair competition, the protection of intellectual property rights, and creation of a framework for further multilateral cooperation in order to expand and enhance the benefits of the agreement and to resolve disputes. [28]

The side agreements that were concluded with NAFTA are the North American Agreement on Environmental Cooperation (NAAEC) and the North American Agreement on Labor Cooperation (NAALC).[29] These side agreements established institutions and procedures to further cooperation among the NAFTA countries on environmental and labor issues.[30] The agreements also provide mechanisms for dispute settlement on environmental and labor issues, and in some instances provided for the possibility of imposing trade sanctions in the event that a NAFTA country is found not to be enforcing their own environmental or labor laws.

IV. NGO Participation in NAFTA

Conservative academics and politicians point to increasing participation by nongovernmental organizations in international governance as being a threat to national

---

[23] *Id*.
[24] NAFTA, *supra* note 1, pts. 1-8.
[25] GARY C. HUFBAUER & JEFFREY J. SCHOTT, NAFTA: AN ASSESSMENT 2 (1993); NAFTA, *supra* note 1, art. 102.
[26] NAFTA, *supra* note 1, ch. 11.
[27] *Id*.
[28] NAFTA, *supra* note 1, art. 102.
[29] North American Agreement on Environmental Cooperation, Sept. 14, 1993, 32 I.L.M. 1480 (entered into force Jan. 1, 1994) *available at* http://www.sice.oas.org/tradee.asp [hereinafter NAAEC]; North American Agreement on Labor Cooperation, Sept. 14, 1993, 32 I.L.M. 1449 (entered into force Jan. 1, 1994) *available at* http://www.sice.oas.org/tradee.asp [hereinafter NAALC].
[30] JOSEPH A. MCKINNEY, CREATED FROM NAFTA: THE STRUCTURE, FUNCTION, AND SIGNIFICANCE OF THE TREATY'S RELATED INSTITUTIONS 12 (2002).

sovereignty.[31] Private, international, nongovernmental organizations are now playing a historically unprecedented role in global governance. While NGOs have been somewhat active in the international community for over 200 years, NGO involvement in international law and policymaking has intensified substantially over the last 30 years.[32] International NGOs have dramatically increased in number, size and variety. The Yearbook of International Organizations 2002/2003 profiles more than 25,500 international NGOs, which are active in nearly 300 countries and territories in the world today.[33]

Many NGOs provide invaluable humanitarian assistance to countries in need and other welcome contributions to society. But there is an ever-growing segment of NGOs who focus their energies in the international arena in an attempt to gain greater leverage over national governments.[34] At the international level, these organizations seek functional equivalency with national governments as the representatives of the people,[35] despite the fact that they are unelected, often have narrow memberships, and are free from the constraints of the checks and balances found in the American democratic system of government. These interest groups seek seats at the table in international negotiations and policymaking, and international organizations such as the United Nations and European Union have provided structures to allow for the such participation.[36] Even the term "nongovernmental organization" is becoming outmoded. The new term these organizations use to refer to themselves is "civil society."[37]

However, in the NAFTA context, environmental and labor interest groups have generally played a strong, yet appropriately contained role in U.S. trade policy. American NGOs have influenced NAFTA through domestic political processes including grass roots lobbying efforts to influence political campaigns, efforts to establish relationships with members of Congress and trade policy officials, and through the American court system. American NGOs did not have seats at the bargaining table and did not have decision-making power equivalent to that of the government actors from the United States, Canada and Mexico.

There are three primary areas of NAFTA in which the participation of NGOs is thought to have diminished national sovereignty. The most commonly referenced form of participation is

---

[31] *See, e.g.*, Kenneth Anderson, *The Limits of Pragmatism in American Foreign Policy: Unsolicited Advice to the Bush Administration on Relations with International Nongovernmental Organizations*, 2 CHI. J. INT'L L. 371, 386 (2001); Bolton, *supra* note 3, at 206.; RABKIN, *supra* note 3, at 41-42.

[32] Steve Charnovitz, *Two Centuries of Participation: NGOs and International Governance*, 18 MICH. J. INT'L L. 183, 261 (1997).

[33] YEARBOOK OF INTERNATIONAL ORGANIZATIONS 2002/2003 (Union of International Associations, Ed., 11th ed. 2002).

[34] RABKIN, *supra* note 3, at 42. Jeremy Rabkin points out that public-interest advocacy NGOs are active in the environmental arena where they have gained new prestige by globalizing their rhetoric. These organizations now have transferred "deliberations from the U.S. political system, with its own set of checks and balances, to international gatherings with none of those safeguards." *Id*.

[35] Bolton, *supra* note 3, at 215.

[36] Jose E. Alvarez, *The New Treaty Makers*, 25 B.C. INT'L & COMP. L. REV. 213, 223 (2002). These structures include various forms of non-voting status and providing access to documents. John Bolton observes that NGOs increasingly crowd the meeting halls at international conferences, where they participate as functional equals to nation-states. Frequently we are seeing that interest groups that are obscure minorities in their own countries are viewed as powerful actors in complex global negotiations. Bolton, *supra* note 3, at 215.

[37] Charnovitz, *supra* note 32, at 188.

the pressure levied by environmental and labor interest groups during the formation of NAFTA, which ultimately resulted in the addition of side agreements on the environment and labor. Since NAFTA came into force, two aspects of NGO participation under NAFTA have engendered controversy. These include the citizen submissions process for environmental complaints against the national governments of the NAFTA countries and the participation of NGOs in investor-state NAFTA arbitrations as amicus curiae. Despite the fact that NGOs have been very active in all three of these aspects of NAFTA, it is difficult to say that they have reduced the ability of the national governments of the NAFTA parties to have the last say on issues that affect their countries.

A. NGO Involvement in the Formation of NAFTA

In 1992 and 1993, such slogans as "race to the bottom" and "giant sucking sound" characterized the media landscape of the NAFTA trade negotiations.[38] These slogans were the result of pressure tactics by anti-NAFTA interest groups and political activists who advocated the inclusion of environmental and labor provisions in NAFTA. The environmental and labor NGOs were the two groups that were best positioned to influence the decisions being made on trade policy.

The environmental groups were actually split over NAFTA.[39] While many opposed the trade accord, some major environmental groups did endorse it.[40] Labor and environmental interest groups teamed up with political actors in order to strengthen their influence over the issues to be included in the NAFTA negotiations. The anti-NAFTA interest groups were able to use these relationships with political actors to create the political leverage necessary to threaten the NAFTA negotiations with the possibility of defeat in Congress if sufficient provisions for sustainable development and labor policies were not included.[41] At the same time, the pro-NAFTA interest groups were able to use their political relationships to develop policy alternatives that recognized environmental and labor concerns.[42]

---

[38] Environmentalists made the argument that NAFTA would create a "race to the bottom," in which companies move their operations to the trading partner with the lowest environmental protection standards. Separately, in addition to the complaints of labor groups, Ross Perot often used the "giant sucking sound" image as a presidential candidate in 1992. For example, in the third presidential debate, held October 19, 1992, he said: "You implement that NAFTA ... and you're going to hear a giant sucking sound of jobs being pulled out of this country right at a time when we need the tax base to pay the debt and pay down the interest on the debt and get our house back in order." Campaign ' 92: Transcript of the Third Presidential Debate, WASH. POST, Oct. 20, 1992, at A22, available at 1992 WL 2160870.

[39] Bush administration officials took steps to convert some of the environmental groups over to a pro-NAFTA and pro-Fast Track position out of concern that a united coalition among labor and environmental opponents to Fast Track could stall or defeat trade agreement negotiations. JOHN J. AUDLEY, GREEN POLITICS AND GLOBAL TRADE, 54 (1997). U.S. Trade Representative, Carla Hills, met with representatives from some of the environmental NGOs who were not considered fundamentally opposed to trade. Daniel Esty, Greening the GATT: Trade, Environment, and the Future, 94 (Institute for International Economics, 1994).

[40] Proponents of NAFTA included the National Wildlife Federation (the nation's largest conservation group with 5.3 members and supporters), the Environmental Defense Fund, Conservation International, the Natural Resources Defense Council, the World Wildlife Fund, and the National Audubon Society. Keith Schneider, *Environmental Groups Are Split on Support for Free-Trade Pact*, N.Y. TIMES, Sept. 15, 1993, at A1, A20; AUDLEY, *Supra* note, 39, at 55.

[41] AUDLEY, *supra* note 39, at 4.

[42] *Id*. at 4, 49-50.

The environmental and labor NGOs successfully pressured President Bush to include their issues in the administration's negotiating agenda during the Congressional battle over Fast Track reauthorization for NAFTA and the Uruguay Round of trade negotiations. The impending expiration of Fast Track authorization in mid-1991 and President Bush's request to Congress for reauthorization gave environmental and labor NGOs the opening they needed to gain leverage over U.S. negotiators and pressure them to consider environmental and labor concerns in the NAFTA negotiations.[43] In May 1991, the Bush Administration responded to congressional concerns over labor and environmental issues by proposing a "parallel" track for environmental issues related to NAFTA,[44] and Congress approved the extension of Fast Track authority. From that point on, labor and environmental groups participated in consultations with negotiators from the Office of the U.S. Trade Representative (USTR) and other Bush Administration officials regarding the proposed content of NAFTA.[45]

Environmental interest groups also resorted to litigation to impose their agendas on the Administration's NAFTA negotiations. Public Citizen, Friends of the Earth and the Sierra Club sued the Office of the USTR in 1991 in an attempt to force the U.S. Trade Representative to conduct an environmental impact statement (EIS) on NAFTA.[46] This suit was unsuccessful. The D.C. District Court dismissed the case for lack of standing,[47] and the Court of Appeals affirmed the dismissal, because NAFTA was still under negotiation and thus the USTR's failure to prepare an EIS did not constitute a final agency action upon which the court could exercise judicial review under the Administrative Procedure Act (APA).[48]

The environmental groups attempted the suit again after the leaders of the three countries signed NAFTA but before the agreement was transmitted to Congress for ratification. This time the D.C. District Court found in favor of the plaintiffs and ordered the USTR to prepare an EIS "on NAFTA with all deliberate speed."[49] However, the Court of Appeals reversed this decision, holding once again that NAFTA was not "final agency action" and therefore not justiciable under the APA.[50] This time the court made the finding because the Trade Acts vest discretion with the President regarding whether to submit NAFTA to Congress. It is the President's actions which more directly affect the environmental groups' members, and since the President's actions are not "agency action" within the meaning of the Administrative Procedure Act they are unreviewable.[51] The Supreme Court denied certiorari.[52]

---

[43] *Id*. at 48.
[44] *Id*. at 56-7.
[45] Taylor, *supra* note 13, at 3.
[46] Public Citizen v. United States Trade Rep., 782 F. Supp. 139, 140 (D.D.C. 1992), *aff'd*, 970 F.2d 916 (D.C. Cir. 1992).
[47] *Id*. at 144.
[48] Public Citizen v. United States Trade Rep., 970 F.2d 916, 917 (D.C. Cir. 1992). Section 704 of the APA allows only review of "final" agency action. 5 U.S.C. § 704; *see* Lujan v. National Wildlife Fed'n, 497 U.S. 871, 882, (1990).
[49] Public Citizen v. United States Trade Rep., 822 F. Supp. 21, 22 (D.D.C. 1993), *rev'd* 5 F.3d 549 (D.C. Cir. 1993), *cert. denied*, 510 U.S. 1041 (1994).
[50] Public Citizen v. United States Trade Rep., 5 F.3d 549, 550 (D.C. Cir. 1993).
[51] *Id*. at 553.
[52] Public Citizen v. United States Trade Rep., 510 U.S. 1041 (1994).

Thus, the end result of the pressures NGOs brought to bear on the development of NAFTA was the negotiation of two side agreements on labor and the environment. The NAFTA countries negotiated a supplementary agreement entitled the North American Agreement on Labor Cooperation (NAALC), which set forth a group of objectives generally designed to emphasize cooperation to improve the circumstances of laborers in each of the three NAFTA countries.[53] Among other goals, the NAFTA countries agreed to improve working conditions and living standards throughout the NAFTA region and to promote labor principles such as the freedom of association, the right to collective bargaining, the right to strike, the prohibition of forced labor, minimum employment standards, and equal pay for women and men.[54]

The environmental negotiations resulted in the North American Agreement on Environmental Cooperation (NAAEC).[55] The NAAEC created the North American Commission for Environmental Cooperation, which consists of a Council, a Secretariat that is responsible for the day-to-day administration of the Commission and a Joint Public Advisory Committee.[56] The Commission's purpose is to focus on measures to promote the effective enforcement by the NAFTA parties of their environmental laws and regulations.[57] In addition the Commission is responsible for monitoring environmental conditions and making resources available to help remedy any deficiencies.[58] The Council for Environmental Cooperation, which is composed of cabinet-level representatives from the three NAFTA parties, was formed to act as the governing body of the Commission, and the Council is charged with ensuring consultation and cooperation among the parties to NAFTA in order to prevent disputes related to environmental issues.[59]

B. Citizen Submissions Under the North American Agreement on Environmental Cooperation

The compromise secured by President Clinton in the form of the North American Agreement on Environmental Cooperation left American sovereignty largely intact with respect to the determination of environmental standards and enforcement.[60] The NAAEC provided for almost no coercive measures or sanctions to enforce the environmental goals of the agreement. While the impetus had been to put teeth into the accord, "there was a fall-off in enthusiasm because of the possible loss of sovereignty."[61]

The NAAEC relies much more on the effects of public participation and transparency than it does on sanctions to persuade the NAFTA parties to enforce their own environmental

---

[53] NAALC, *supra* note 29.
[54] MCKINNEY, *supra* note 30, at 34.
[55] NAAEC *supra* note 29.
[56] *Id*. art.8.
[57] MCKINNEY, *supra* note 30, at 92.
[58] *Id*.
[59] NAAEC, *supra* note 29, at arts.8-11.
[60] Tollefson, *supra* note 4, at 167.
[61] Joseph F. DiMento & Pamela M. Doughman, *Soft Teeth in the Back of the Mouth: The NAFTA Environmental Side Agreement Implemented*, 10 GEO. INT'L ENVTL. L. REV. 651, 680 (1998). *See also* Jonathan Graubart, *Giving Meaning to New Trade-Linked "Soft Law" Agreements on Social Values: A Law-in-Action Analysis of NAFTA's Environmental Side Agreement*, 6 UCLA J. Int'l L. & Foreign Aff. 425, 429 (2001-2002) (outlining some of the significant limitations to the citizen submissions process, including the Secretariat's lack of authority to compel changes in behavior from the accused government).

laws. In order for a NAFTA country to be sanctioned for not enforcing its environmental laws, the CEC Council would have to vote to pursue a complaint against the country to arbitration.[62] Unlike the citizen submission process whereby complaints may be filed by any NGO or person residing in the region, only another NAFTA party can actually initiate arbitral proceedings against the offending party under the party-to-party dispute settlement process provided for in Part V of the NAAEC.[63]

NGOs are able to play an important role in monitoring and promoting enforcement of environmental laws under the NAAEC due to the "citizen submissions" process established by the agreement. In Article 14 (Submissions on Enforcement Matters), the NAAEC provides that the Secretariat may consider appropriately prepared submissions from any NGO or person asserting that a NAFTA party is failing to effectively enforce its environmental law. The Agreement broadly defines NGO to mean "any scientific, professional, business, non-profit, or public interest organization or association" that is not affiliated with the government.[64] While several submissions have been made by business corporations and a few more were made by individuals, so far most of the submissions to the Secretariat have been made by environmental or public health NGOs.[65]

The citizen submission process does not include any provisions for trade sanctions or arbitration. The culmination of the submission process involves making the factual record generated from a complaint public.[66] Before a complaint may be submitted to the Secretariat it must first be submitted to the relevant authorities in the accused country and all private remedies must be exhausted.[67] In order for the Secretariat to accept the submission, the complaint must be directed at a government's failure to effectively enforce its laws rather than the legal violations of a company or industry.[68] Article 14 of the NAAEC explicitly precludes the consideration of submissions that are intended to harass an industry.[69]

Once a submission is accepted by the Secretariat it decides whether further investigation of the issues and a response from the accused country are warranted.[70] The policy is that the country will then have thirty to sixty days to respond to the complaint. However, in deference to national sovereignty the reality is that the Secretariat must rely on the country's willingness to cooperate with the investigation of the complaint.[71] In addition, a government may voluntarily provide the information to the Secretariat but then require that the information remains confidential.[72]

---

[62] Tollefson, *supra* note 4, 168.
[63] *See* NAAEC, *supra* note 29, arts. 22-24, 31-36.
[64] NAAEC, *supra* note 29, art. 45.1(b).
[65] *See* Graubart, *supra* note 61, at 446; Tollefson, *supra* note 4, 169. For a list of citizen submissions, see the official web page of the CEC Secretariat. CEC Secretariat, Citizen Submissions on Enforcement Matters: Status, *available at* http://www.cec.org (last visited Feb. 20, 2003).
[66] Articles 14 and 15 of the NAAEC govern the citizen submission process. NAAEC, *supra* note 29, arts. 14-15.
[67] MCKINNEY, *supra* note 30, at 99.
[68] Graubart, *supra* note 61, at 432.
[69] NAAEC, *supra* note 29, art. 14.1(d).
[70] *Id*.
[71] Tollefson, *supra* note 4, 177.
[72] *Id*.

Once the response is received, the Secretariat will determine whether or not a factual record should be developed and then make a recommendation to the CEC Council.[73] Based on a two thirds vote the Council will make the final determination on whether to prepare a factual record. If the Council votes in favor of publishing a factual record, the record will then proceed through preparation and comment periods, including a period when NGOs may provide additional input, and then eventually will be released to the public.[74]

In practice thus far, the Council for Environmental Cooperation has approved the development of a factual award for only a few submissions. Thirty-six citizen submissions have been filed since 1995.[75] Eight complaints have been lodged against the United States, thirteen against Canada and eighteen against Mexico. Twenty-five of the files are now closed, and of those only three factual records have been published. Two of these records concern Mexico and one involves Canada. However, the number of published factual records should soon increase, because the CEC Council has voted in favor of developing a factual record for seven of the eleven files that are currently active, and the Secretariat has recommended that the Council vote in favor of preparing factual records on two additional files. Only one of the open complaints is against the United States, and the Council has recommended that a factual record be prepared in that case.

C. NGO Participation through Amicus Curiae Briefs

A third aspect of NGO participation in NAFTA that has garnered significant controversy is the question of participation by third parties in NAFTA investor-state arbitrations. The investment chapter of NAFTA provides that investors may bring claims against a foreign NAFTA government for certain damages the investors incur in those countries.[76] The chapter allows investors to select from three established sets of arbitral rules,[77] however most arbitral rules are silent on the issue of amicus participation.[78] There are various schools of thought on this issue. Some academics and practitioners are concerned that allowing the opinions of NGOs and other private interests to be heard in investor-state arbitrations in which they would otherwise have no standing constitutes a further erosion of sovereignty.[79] Others believe that the participation in international tribunals by amicus curiae does not further diminish sovereignty. Advocates of this position view the increasing participation of NGOs in the international arena as developments that confirm sovereignty's continuing vitality, because they view sovereignty is defined by having an international legal personality such that a state has the capacity to exercise rights and duties in the international legal order.[80]

---

[73] *Id*. at 99.
[74] *Id*.
[75] CEC Secretariat, *supra* note 64.
[76] NAFTA, *supra* note 1, ch. 11.
[77] *Id*. art. 1120.
[78] Denyse Mackenzie, *Investment Disputes and NAFTA Chapter 11*, 95 AM. SOC'Y INT'L L. PROC. 196, 201 (2001) (suggesting that arbitral rules are presumably silent on amicus participation because they are generally intended to address private disputes).
[79] Bolton, *supra* note 3, at 206 (condemning the loss of sovereignty occurring as a result of increasing NGO participation in global governance); RABKIN, *supra* note 3, at 42.
[80] Hollis, *supra* note 5, at 237, 254.

Nongovernmental organizations have requested permission to intervene in two investor-state arbitrations as amicus curiae. Although the NAFTA tribunals determined that they have the authority to accept amicus briefs, to date, no amicus briefs have been filed and accepted by a NAFTA tribunal. The two arbitral tribunals who have determined that they have authority to accept amicus curiae briefs are the *Methanex* and *UPS* tribunals.

In the first case, *Methanex v. United States*,[81] several environmental NGOs, petitioned the tribunal for permission to make oral and written submissions before to the tribunal. The NAFTA parties did not agree on how such petitions should be addressed. Canada supported amicus participation in *Methanex*, but wanted to see clear rules on amicus participation developed by all of the NAFTA parties so that there is a consistent approach regarding amicus curiae in all investor-state arbitrations.[82] Mexico, on the other hand, was against the admission of amicus briefs. The Government of Mexico felt that if amicus curiae submissions were allowed, amici would have greater rights than the NAFTA parties themselves, due to the limited scope of the NAFTA party submissions allowed under Article 1128 of NAFTA. Mexico also expressed concern that a legal procedure, such as the admission of amicus curiae, which is alien to its legal tradition and was not agreed to under NAFTA might be imported into NAFTA dispute settlement proceedings.[83] The United States gave little credence to the Mexican position on the issue and urged the tribunal to accept the petitioners' briefs in the *Methanex* case.[84]

Ultimately, the *Methanex* tribunal found that nothing in the investment chapter of NAFTA or the United Nations Commission on International Trade Law (UNCITRAL) Arbitration Rules either conferred upon the Tribunal the power to accept amicus submissions or expressly withheld such power.[85] In light of this absence of clear authority, the Tribunal based its decision on Article 15(1) of the UNCITRAL Arbitration Rules, which grants arbitration tribunals broad procedural powers to conduct arbitrations in such manner as they consider appropriate.[86] The *Methanex* tribunal concluded that under Article (15)(1) it does have the power to accept written amicus curiae submissions from the Petitioners, but that it could not add the petitioners as parties or allow them to participate in the hearings or have access to confidential documents.[87]

---

[81] Methanex Corp. v. United States, Decision of the Tribunal on the Petition of Third Persons to Intervene as "Amici Curiae", UNCITRAL Arb., para. 9, Jan 15, 2001, *at* http://www.state.gov/documents/organization/6039.pdf [hereinafter Methanex Decision re: Amicus Intervention].

[82] *Methanex Corp. v. United States, Submission of the Government of Canada re: Amicus, UNCITRAL Arb., Nov. 10, 2000*, paras. 3-5, *at* http://www.state.gov/documents/organization/3935.pdf (last visited Feb. 22, 2003).

[83] Methanex Decision re: Amicus Intervention, *supra* note 81, para. 9.

[84] Methanex Corp. v. United States, United States Response Canada's and Mexico's Submissions Concerning Petitions for Amicus Curiae Status, Nov. 22, 2000, *at* http://www.state.gov/documents/organization/3965.pdf

[85] Methanex Decision re: Amicus Intervention, *supra* note 81, para. 23.

[86] *Id*. paras. 25-26.

[87] Methanex Decision re: Amicus Intervention, *supra* note 81, para. 47. Despite this decision, the tribunal did not accept any amici curiae at the time, because the arbitrators found it premature to make a decision on whether the proffered amicus briefs would helpful to the tribunal in determining the issues in dispute. *Id*. para. 52. On January 31, 2003, the NGOs again petitioned the tribunal to accept them as amici and allow them to submit briefs to the tribunal. Methanex v. United States, Joint Amicus Motion, UNCITRAL Arb., Jan. 30, 2003, paras. 17-19 *at* http://www.state.gov/s/l/c5818.htm. The tribunal has yet to rule on this petition.

In *UPS v. Government of Canada*,[88] the Council of Canadians and Canadian Union of Postal Workers sought to intervene as full parties and then also as amici curiae if the tribunal refused to permit intervention as full parties. Once again, the NAFTA parties split on the issue of amicus submissions with the United States and Canada in support of allowing written submissions on the merits, while Mexico again argued that the tribunal had no jurisdiction to make such an order. The *UPS* tribunal held that the tribunal had no power to admit the petitioners as parties to the arbitration, but that they did possess the authority to allow submissions of written amicus briefs.[89]

Some investor-state arbitrations under NAFTA are of interest to the public and there may at times be justification for arbitration tribunals to permit petitioners who have sufficient interest in the outcome of the dispute to submit additional information to the tribunal through amicus curiae briefs. This is not to say that such third party NGOs or other petitioners should be allowed to actually join the arbitration as parties. Allowing interested petitioners to introduce their viewpoints into an arbitration via written submission would not give them any rights as a party or as a non-disputing NAFTA party.[90] Instead, the issue is really about allowing the tribunal to have the discretion to admit submissions where the issues under consideration are public in character and where the tribunal believes the petitioners are capable of providing assistance beyond that provided by the disputing parties.

V. The Tradeoffs Between Foreign Investment Protections and Sovereignty

By signing any international agreement a state naturally surrenders some amount of its sovereignty. However, there are substantial economic and political benefits to be gained from liberalizing trade and investment between countries that make international free trade agreements desirable. The question is how much state autonomy are we willing to forgo in return for the economic benefits that can be gained from the promotion of free trade and the protection of our foreign investments under a multilateral trade regime.

There are many complicated trade-offs in NAFTA. Unlike NGO participation in NAFTA, the Agreement's provisions for the protection of foreign investments have clearly eroded some amount of American sovereignty. By agreeing to include compulsory binding arbitration of investment disputes, and a right for foreign investors to compensation for the expropriation of their property, all three parties to NAFTA have surrendered substantial sovereign freedoms. However, in exchange for these sacrifices, the countries have gained a neutral forum in which to settle disputes and the benefit of secure investments abroad.

Unlike other multilateral trade regimes, NAFTA provides foreign investors, who suffer damages as a result of the actions of other participating states, with a private right of action against the host state.[91] NAFTA allows aggrieved investors to seek compensation directly from

---

[88] United Parcel Service of America, Inc. v. Government of Canada, Decision of the Tribunal on Petitions for Intervention and Participation as Amici Curiae, UNCITRAL Arb., para. 60, Oct 17, 2001, *at* http://www.state.gov/s/l/c3749.htm [hereinafter UPS Amicus Decision].
[89] *Id*. paras. 39, 43, 61, 73.
[90] *Id*. para. 61.
[91] There are, however, many bilateral investment treaties (BITs) that include similar rights for investor-state dispute resolution.

a NAFTA party government through a process of binding arbitration. This provision has engendered significant controversy in recent years as investors have begun bringing cases against the three NAFTA governments.

During the negotiation of NAFTA, the United States pushed for the inclusion of investor protections due to concerns about the risks that existed for American and Canadian businesses investing in Mexico. The primary objectives for the investment chapter of NAFTA were to liberalize Mexican restrictions on foreign investment and to solidify legal protections for investors in Mexico.[92] Mexican negotiators agreed to these demands because Mexico was eager to promote foreign direct investment.[93]

The United States is the largest capital exporter in the world, but over the last twenty years, it has also become a net capital importer.[94] This makes defining international investment policy goals complicated, because the United States must be concerned about the ramifications of investment policies on both the large number of American investors abroad and the many foreign investors in the United States. Under NAFTA, whatever protections the United States seeks to obtain for its investors in other countries must also be provided to the foreign investors who do business in the United States. This conundrum is the source of much of the controversy over the investment protection provisions included in Chapter 11.

A. Chapter 11 Investment Protections and Dispute Mechanism Procedures

Chapter 11 of NAFTA provides the framework for NAFTA's foreign investment protections. Section A of the chapter includes provisions for national and most favored nation (MFN) treatment, an international minimum standard of treatment, the prohibition of certain performance requirements and a right to compensation for government expropriation.[95] In addition, over half of the chapter is dedicated to the resolution of investment disputes between a party to NAFTA and an investor from another participating country using binding international arbitration where attempts to settle a claim through consultation or negotiation fails.

Article 1116 gives NAFTA investors the right to submit a dispute to an international arbitration tribunal if a foreign party to NAFTA has breached an obligation listed under Section A of Chapter 11. A disputing investor has the option of submitting the claim to arbitration under three different sets of arbitration rules:[96] the ICSID Convention,[97] the Additional Facility Rules

---

[92] United States General Accounting Office Report to the Congress, North American Free Trade Agreement: Assessment of Major Issues, Vol. 2 (Sept. 1993), at 19.
[93] *See* CAMERON & TOMLIN, *supra* 6, at 63; Tollefson, *supra* note 4, 148.
[94] Arturo Guillen Romo, *Foreign Direct Investment in America Under NAFTA*, 2002, *available at* http://www.geocities.com/intam99/ied.htm (last visited Feb. 22, 2003). This paper was given at the 12th International Conference of the International Trade and Finance Association (ITFA) and Ramkhamhaeng University of Thailand *"The Survival Strategies in the Global economy"*. May 29 - June 2, 2002. Bangkok, Thailand.
[95] NAFTA, *supra* note 1, art. 1102-1110.
[96] NAFTA, *supra* note 1, art. 1120.
[97] ICSID is the International Centre for Settlement of Investment Disputes, and it is a division of the World Bank. Convention on the Settlement of Investment Disputes between States and Nationals of Other States, Mar. 18, 1965, 17 U.S.T. 1270, 575 U.N.T.S. 159 (entered into force Oct. 14, 1966) [hereinafter ICSID Convention].

of ICSID,[98] or the UNCITRAL Arbitration Rules.[99] An additional stipulation is that Article 1121 investors must waive their right to any further recourse to local remedies in the host state, including proceedings before courts or administrative tribunals relating to the issue under dispute, in order to submit a claim under Article 1116.[100]

NAFTA does not provide for a permanent arbitration tribunal. Instead ad hoc panels composed of three arbitrators are formed for each arbitration.[101] One arbitrator is appointed by each of the disputing parties and the third, the presiding arbitrator, is jointly agreed upon by the disputing parties. If the parties fail to agree on a presiding arbitrator, Article 24 states that the Secretary-General shall serve as the appointing authority.

The purpose of international arbitration is to provide a neutral forum for the resolution of disputes between countries or companies from different countries. However, the trade-off for allowing a truly neutral arbitration system to exist is that international arbitrations are virtually unreviewable, which further diminishes a nation's sovereignty under the Agreement. Countries that are signatories to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards have all agreed to honor the final and binding awards issued by international arbitration panels.[102] All three parties to NAFTA are now signatories to the Convention.[103]

Article V of the New York Convention outlines the circumstances under which a national court may refuse to enforce an arbitral award,[104] but these circumstances are extremely limited. Article V does not allow for a substantive reexamination of the decision of the case such as a national court would perform on appeal. Under Article V, courts may refuse to recognize and enforce international arbitral awards primarily due to extrinsic, procedural failures in the arbitration. These extrinsic factors include situations where the contract is said to be invalid under the law, where the defendant party was not given proper notice of arbitration and was unable to present his case, where the award is outside the terms of the arbitration clause, or where the composition of the arbitral panel or procedure was not in accordance with the agreement of the parties.[105] Then, in the second part of Article V, the Convention reserves the right for each signatory country to refuse enforcement of an arbitral award where a national court finds that the subject matter of the dispute is non-arbitrable under the law of that country or where recognition or enforcement of the award would be contrary to the public policy of that country.

---

[98] The Additional Facility was established to administer arbitration proceedings between States and nationals of other States which fall outside the scope of the Convention on the Settlement of Investment Disputes between States and Nationals of Other States.

[99] The United Nations Commission on International Trade Law (UNCITRAL) was established by the General Assembly in 1966 (Resolution 2205(XXI) of 17 December 1966), available at, http://www.uncitral.org/en-index.htm (last visited Oct. 11, 2002).

[100] NAFTA, *supra* note 1, art. 1121.

[101] *Id*. art. 1123.

[102] Convention on the Recognition and Enforcement of Foreign Arbitral Awards, June 10, 1958, 21 U.S.T. 2517, 330 U.N.T.S. 38 (entered into force June 7, 1959) [hereinafter New York Convention].

[103] The United States joined the Convention in 1970.

[104] New York Convention, *supra* note 102, art. V.

[105] *Id*. art. V(1).

The United States has approached the dispute mechanism of binding arbitration cautiously. It took twelve years beyond the date of the convention for the United States to finally accede to the New York Convention on the Recognition and Enforcement of Arbitral Awards. In addition, U.S. courts have at times declared various matters to be non-arbitrable due to public policy considerations in accordance with the exceptions allowed under the New York Convention.[106] These non-arbitrable areas of law have included such federal matters as the 1933 Securities Act, patents, ERISA claims at termination of employment, bankruptcy matters, the Commodities Exchange Act and the Civil Rights Act. U.S. courts have also found claims for punitive damages under state law non-arbitrable in the past.

However, a line of cases shows that U.S. courts have grown more supportive of international arbitration in recent years and that there is now a strong presumption in favor of enforcement of arbitration clauses.[107] Justice Blackman outlines the justification for this trend in the case *Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth Inc.*[108] In *Mistubishi*, Justice Blackman found the respondent's antitrust claims to be arbitrable due to "concerns of international comity, respect for the capacities of foreign and transnational tribunals, and sensitivity to the need of the international commercial system for predictability in the resolution of disputes."[109]

B. State Sovereignty: Tradeoffs under NAFTA

The promotion of free trade and foreign investment under NAFTA has diminished the autonomy of state and local governments in addition to limiting some measure of national sovereignty. In the United States, NAFTA was negotiated as an executive agreement and then ratified and implemented into law by both houses of Congress.[110] Thus NAFTA carries the same force of authority in domestic U.S. law as a treaty. Article 105 of NAFTA explicitly requires the United States, Canada and Mexico to ensure that "state and provincial governments" observe the provisions of NAFTA.[111]

Many of the cases that have gone to international arbitration since NAFTA was implemented have involved the activities of state and local governments. Critics complain that NAFTA has weakened a state's ability to govern within its borders. In various cases, private investors have sought recourse for damages due to policy decisions and regulations implemented by state and municipal governments. Investors have also attempted to circumvent long-standing state laws, and to appeal the decisions of state courts to NAFTA tribunals.[112]

---

[106] *See, e.g.*, Wilko v. Swan, 346 U.S. 427, 432 (1953).
[107] *See* Scherk v. Alberto-Culver Co., 417 U.S. 506 (1974); The Bremen v. Zapata Off-Shore Co., 407 U.S.1 (1972).
[108] Mitsubishi Motors Corp. v. Soler Chrysler-Plymouth Inc., 473 U.S. 614 (1985).
[109] *Id*. at 629.
[110] North American Free Trade Agreement Implementation Act, Pub. L. No. 103-182, 107 Stat. 2057 (1993) [hereinafter NAFTA Implementation Act].
[111] NAFTA, *supra* note 1, art. 105. *See also*, NAFTA Implementation Act, *supra* note 110, at Sec. 102(b)(1)(A) (directing that the President use "the intergovernmental policy advisory committees on trade established under section 306(c)(2)(A) of the Trade and Tariff Act of 1984 [to] consult with the States for the purpose of achieving conformity of State laws and practices with the Agreement").
[112] For further elucidation of the cases where these things have occurred, see the case studies of *Metalclad*, *Mondev*, and *Loewen*, below.

It is to be expected that an international agreement that liberalizes trade and investment will have some impact on the ability of state and local governments to take certain actions within their borders. Philip Allott has referred to a "sovereignty/higher law paradox" to say that international legal relations limit the sovereign freedom of a state system "in its totality."[113] These relations are self-limiting in character and "apply to each state system monolithically, affecting expectations about the behavior of every person within a state system." The impact these tradeoffs have on state and local governments is apparent in the case studies below. Once again, the United States must decide how much sovereignty it is willing to relinquish in return for the benefits that can be gained from such international trade and investment agreements.

C. Investors' Right to Compensation for Expropriation

The provision of a right for investors to be compensated for government expropriation is one of the most controversial aspects of Chapter 11.[114] Now that a number of arbitrations have taken place, the potential impact of this investment protection provision on national and state sovereignty is discernable. The provision has limited the sovereign power of the participating countries to carry out domestic policy activities. There is growing concern about the impact that the investor dispute provisions of Chapter 11 will have on the social policies of the NAFTA member states. The fear is that governments will be forced to regularly compensate foreign investors for non-discriminatory regulatory policy decisions that are made for the benefit of the public. Compensation is not ordinarily paid to property and business owners for a loss of value caused by non-discriminatory municipal bylaws, taxation measures or environmental laws as long as the actions are taken in good faith.[115]

Many of the cases initiated against the NAFTA states have involved environmental and health policy regulations where private investors have claimed that the government's policies are "tantamount to the nationalization or expropriation" of their property or business prospects.[116] Arbitral awards for huge sums have been made to compensate for some investors' losses, and in other cases governments have agreed to settle with the investors. The danger that private companies could use international tribunals to force U.S. states to either overturn laws or pay exorbitant sums in order to keep those laws has angered liberal activists and conservative politicians alike.[117] Some critics of the NAFTA investment dispute resolution process argue that NAFTA has turned environmental regulation on its head. Instead of the "polluter pays principle," governments and therefore taxpayers now "pay polluters to stop polluting."[118] Critics

---

[113] Philip Allott & Sir John Boroughs, *Mare Nostrum: A New International Law of the Sea*, 86 AM. J. INT'L. L. 764, 775 (1992).
[114] Tollefson, *supra* note 4, at 158.
[115] *Id*. at 159.
[116] NAFTA, *supra* note 1, art. 1100 (providing that "No Party may directly or indirectly nationalize or expropriate an investment of an investor of another Party in its territory or take a measure tantamount to nationalization or expropriation of such an investment ("expropriation"), except: (a) for a public purpose (b) on a non-discriminatory basis; (c) in accordance with due process of law and Article 1105(1); and on payment of compensation . . ..").
[117] Robert Collier, *Canadian Trade Challenge Falls Flat: But More Fights May Be Coming*, S.F. CHRON., Nov. 17, 2002, at 14.
[118] Tollefson, *supra* note 4, at 148.

also fear that the continuing success of investor suits will have a chilling effect on governments' willingness to enact new environmental and health regulations.[119]

The expropriation and compensation provision of NAFTA Chapter 11 provides greater protection to foreign investors than the domestic investors of any of the three NAFTA parties enjoy. In the application of the provision, the impact on the sovereign powers of the Canadian and Mexican governments is even greater than the erosion of American sovereignty because the domestic takings laws of Canada and Mexico are even further from NAFTA's expropriation provisions than are the United States' provisions. Thus the Chapter 11 allows for the potential overcompensation for legitimate regulation and creates an unfair competitive advantage of foreign investors over domestic investors.[120]

1. Ethyl Corp. v. Government of Canada

Ethyl Corporation is a Virginia-based corporation with a wholly owned Canadian subsidiary, Ethyl Canada, that was the sole Canadian importer and distributor of the gasoline additive methylcyclopentadienyl manganese tricarbonyl (MMT).[121] In the mid 1990s the Canadian government became concerned about possible health risks posed by MMT, and in April 1997 the Canadian Parliament passed a law that banned importing MMT or trading it between provinces within Canada.[122] Shortly after the new law was passed, Ethyl Corporation filed a notice of arbitration pursuant to Chapter 11 of NAFTA.[123] Ethyl claimed that the Canadian government had violated several articles of Chapter 11 and thereby expropriated anticipated profits and damaged the reputation of the company.[124] Specifically, Ethyl claimed that Canada breached its obligations under NAFTA Chapter 11, including Article 1102 (National Treatment), Article 1106 (Performance Requirements), and Article 1110 (Expropriation and Compensation).

In July of 1998, Canada and Ethyl agreed to settle the case. The Canadian government rescinded its prohibition on trading MMT, paid Ethyl $10 million, and issued a letter stating that MMT posed no health risk.[125] This case and other arbitrations for regulatory expropriations that have been brought against Canada have led Canada to express displeasure with Chapter 11 of NAFTA and especially with the expropriation provisions in Article 1110 of that Chapter.[126]

---

[119] Gregory Starner, *Taking a Constitutional Look: NAFTA Chapter 11 as an Extension of Member States' Constitutional Protection of Property*, 33 LAW & POL'Y INT'L BUS. 405, 434 (2002).
[120] Jenny Harbine, NAFTA Chapter 11 Arbitration: Deciding the Price of Free Trade, 29 ECOLOGY L. Q. 371, 388 (2002).
[121] MMT is a manganese based fuel additive that is designed to prevent automobile engine knocking.
[122] Manganese-Based Fuel Additives Act, ch. 11, 1997 S.C. (Can.).
[123] Ethyl Corp. v. Canada, Notice of Arbitration, UNCITRAL Arb., Apr. 14, 1997, *at* http://www.state.gov/documents/organization/4004.pdf (last visited Feb. 22, 2003).
[124] *Id*. at 2.
[125] Rene Lettow Lerner, *International Pressure to Harmonize: The U.S. Civil Justice System in An Era of Global Trade*, 2001 B.Y.U. L. Rev. 229, 246 (2001).
[126] *Id*. at 247; Tollefson, *supra* note 4, at 161-162.

2. Metalclad Corp. v. United Mexican States

In August 2000, an arbitral award was rendered in the proceeding instituted by the American waste disposal company, Metalclad Corporation, against Mexico.[127] This case raised issues of federalism and national sovereignty in the application of NAFTA's investment protection provisions. The issue in dispute involved the construction of a waste management facility in Guadalcazar in the state of San Luis Potosi, Mexico. The subsidiary of Metalclad that was responsible for constructing the facility obtained authorization for construction from federal authorities in Mexico,[128] and proceeded to invest $22 million in developing the facility.[129] Environmental demonstrations against the facility around the time it was completed in March 1995 led to more negotiations between Metalclad and the Mexican government.[130] In November 1995, Metalclad concluded an agreement with federal environmental agencies, which established the conditions under which the waste management facility would operate.[131] Then two months later, the local municipality of Guadalcazar, which had never made a decision on the construction permit requested by Metalclad in 1994, finally issued a denial of the construction permit for the landfill.[132] The Municipality also obtained an injunction with respect to the operation agreement Metalclad had concluded with the federal environmental agencies, which prevented Metalclad from operating the facility it had constructed.[133]

After lengthy negotiations, Metalclad filed a Chapter 11 claim with the ICSID for arbitration against Mexico under Additional Facility rules.[134] The claim alleged that the interference of the local governments of San Luis Potosi and Guadalcazar with the development and operation of Metalclad's hazardous waste facility violated Articles 1105 (Minimum Standard of Treatment) and 1110 (Expropriation and Compensation) of NAFTA Chapter 11. The ICSID tribunal ultimately found that the actions of the Mexican state and municipal authorities violated the "fair and equitable treatment" provisions of NAFTA Article 1105 and that Mexico had violated Article 1110 because allowing the interference of the Municipality was tantamount to the expropriation of Metalclad's investment.[135] The tribunal awarded Metalclad damages in the amount of $16.7 million.[136] This award was partially set aside after Mexico challenged the arbitral award before the British Columbia Supreme Court.[137]

---

[127] Metalclad v. United Mexican States, Award (ICSID Case No. ARB(AF)/97/1, Aug. 30, 2000) *at* http://www.state.gov/documents/organization/3998.pdf (last visited Feb. 22, 2003) [hereinafter Metalclad Award].
[128] United Mexican States v. Metalclad Corp., [2001] B.C.L.R. (3d) 359 (deciding the result of Mexico's challenge to the arbitration award issued by an international tribunal on August 30, 2000).
[129] Starner, *supra* note 119, at 425.
[130] Metalclad Award, *supra* note 127, paras. 45-46.
[131] *Id*. paras. 47-49.
[132] *Id*. para. 50.
[133] *Id*. para. 56.
[134] Metalclad v. United Mexican States, Notice of Intent (ICSID Case No. ARB(AF)/97/1, Jan. 2, 1997) *at* http://www.state.gov/documents/organization/3997.pdf (last visited Feb. 22, 2003).
[135] Metalclad Award, *supra* note 127.
[136] *Id*.
[137] United Mexican States v. Metalclad Corp., [2001] 95 B.C.L.R. (3d) 169. The jurisdiction of the British Columbia Supreme Court was determined based on the fact that Vancouver, British Columbia had been named as the place of arbitration. *Id*. para. 39.

D. Denial of Justice Claims Before Chapter 11 Tribunals

Several cases brought before NAFTA tribunals have drawn concern that a new supranational court, in the form of the arbitral tribunals, has been created by NAFTA, which acts as an appellate court for NAFTA claims. It was feared that this court would trump the decisions of the U.S. Courts after all U.S. judicial remedies have been exhausted and potentially allow foreign investors to circumvent state statutes. There have been two important arbitrations in which foreign investors essentially appealed the decisions of U.S. state courts to NAFTA tribunals under claims that those decisions constituted denials of justice in violation of Article 1105. In *Loewen*, a Canadian corporation has initiated Chapter 11 arbitration proceedings seeking damages in excess of $600 million for alleged injuries arising out of litigation in the Mississippi state courts in which the company was ordered to pay $500 million.[138] In a second case, *Mondev*, a Canadian real-estate developer alleged that the Massachusetts Supreme Court acted in a manner that was arbitrary and capricious and thus constituted a denial of justice when it upheld the statutory sovereign immunity of the respondent.[139] These cases have attracted considerable public criticism in the United States.[140]

1. Loewen Group, Inc. v. United States

The *Loewen* arbitration grew out of a Mississippi court case where a Mississippi businessman, O-Keefe, filed suit against his competitor, the Canada-based funeral home conglomerate, the Loewen Group, for anti-competitive and predatory acts and claimed $105 million in damages.[141] The case resulted in a jury verdict of $500 million awarded to O'Keefe. Rather than post the $625 million bond necessary to stay execution of the judgment pending appeal in the Mississippi court system, Loewen settled the suit for $175 million, and then proceeded to file a claim against the United States under Chapter 11 of NAFTA.[142] Despite the fact that Loewen has disclaimed any intent to use Chapter 11 as an alternative form of appeal, Loewen is looking to the arbitration to correct errors allegedly made at trial, as one would do on appeal.[143]

In the NAFTA suit, Loewen claimed that the jury's unreasonably large verdict amounted to a substantive denial of justice under Article 1105, while the exorbitant bond requirement which effectively prevented Loewen from appealing the case presented a procedural denial of justice. Loewen also alleged that the court's admission of extensive anti-Canadian and pro-

---

[138] The Loewen Group, Inc. v. United States, Notice of Arbitration (ICSID Case No. ARB(AF)/98/3, Oct. 10, 1998) *at* http://www.state.gov/documents/organization/3922.pdf (last visited Feb. 22, 2003).
[139] Mondev Int'l, Ltd. v. United States, Award (ICSID Case No. ARB(AF)/99/2, Oct. 11, 2002) *at* http://www.state.gov/documents/organization/14442.pdf (last visited Feb. 22, 2003), [hereinafter Mondev Award].
[140] *See* Paul Magnusson, *The Highest Court You've Never Heard Of: Do NAFTA Judges Have Too Much Authority?*, BUS. WK., Apr. 1, 2002, at 76; Chris Mooney, *In Our Own Back Yard: NAFTA Allows Foreign Corporations to Evade State Regulations by Suing the U.S. Before International Tribunals. One of the Most Important of these Little-Known Cases Originated in Boston*, BOSTON PHOENIX, Aug. 30 – Sep. 6, 2001, *available at* http://www.bostonphoenix.com/boston/news_features/top/features/documents/01791880.htm (last visited, Feb. 22, 2003).
[141] Loewen Notice of Arbitration, *supra* note 138, paras. 2-6.
[142] *Id*.
[143] William S. Dodge, *Loewen v. United States: Trials and Errors Under NAFTA Chapter Eleven*, 52 DEPAUL L. REV. 563, 564 (2002).

American testimony violated the national treatment provision of Article 1102 of NAFTA by discriminating against a foreign investor.[144] Finally, Loewen alleged that the discriminatory conduct, exorbitant verdict, exorbitant bond requirement and coerced settlement were tantamount to an uncompensated expropriation under Article 1110.[145] This dispute is still pending under the Additional Facility Rules of ICSID.

2. Mondev Int'l, Ltd. v. United States

The Canadian real-estate developer, Mondev, sued the city of Boston and the Boston Redevelopment Authority (BRA) over a contractual dispute.[146] Then, after losing on appeal before the Massachusetts Supreme Judicial Court (SJC) and having the United States Supreme Court deny its petition for *certiorari*, Mondev initiated international arbitration proceedings against the United States pursuant to Article 1116 of NAFTA and the Additional Facility Rules of ICSID claiming that the United States had breached its obligations under Chapter 11 due to the Massachusetts court's decision and the acts of Boston and BRA.

The initial dispute arose out of a "Tripartite Agreement" between the city of Boston, the BRA and a subsidiary of Mondev, LPA, which provided for the development of an area in downtown Boston. After complications arising out of an option held by Mondev to purchase and develop an additional piece of property, Mondev filed suit against the city of Boston and the BRA in Massachusetts. It is worth noting that this suit was filed in 1992, well before the NAFTA was implemented. At the trial level the Massachusetts jury gave a verdict in favor of Mondev and against both Boston and the BRA for breach of the Tripartite Agreement.[147] This indicates that Boston and the BRA had in some way acted in bad faith in their dealings with the Mondev subsidiary. However, the Massachusetts Superior Court rendered a judgment notwithstanding the verdict with respect to BRA due to BRA's statutory sovereign immunity. On appeal, the Massachusetts Supreme Judicial Court affirmed the trial court's decision regarding sovereign immunity for BRA.[148] The SJC did, however reverse the Superior court's finding against the city of Boston.[149]

In its Notice of Arbitration, Mondev claimed that the SJC decision against Mondev, the enactment by the Massachusetts legislature of the sovereign immunity statute, the statute's enforcement by the SJC, and the refusal by the Supreme Court to grant a writ of certiorari all constituted a denial of justice and measures tantamount to an expropriation of an investment.[150] The Mondev tribunal determined that only the denial of justice claim under Article 1105(1) need be resolved in the NAFTA arbitration proceedings, because the Tribunal lacked jurisdiction to

[144] Loewen Notice of Arbitration, *supra* note 138, para. 7.
[145] *Id*.
[146] Lafayette Place Assoc. v. Boston Redevelopment Auth., 694 N.E.2d 820 (1998).
[147] *Id*. at 825.
[148] *Id*. at 836 (holding the BRA immune from suit for intentional torts due to a Massachusetts statute); Mondev Award, *supra* note 139, para. 40.
[149] Lafayette Place, *supra* note 146, at 831.
[150] Mondev Int'l, Ltd. v. United States, Notice of Arbitration (ICSID Case No. ARB(AF)/99/2, Sep. 1, 1999) para. 2, *at* http://www.state.gov/documents/organization/3931.pdf (last visited Feb. 22, 2003).

pass upon acts that occurred before NAFTA came into force.[151] *Mondev*, was decided on October 11, 2002, and the arbitral tribunal has dismissed all of Mondev's claims.

The tribunal's decision in *Mondev* has essentially resolved the concern of investors using denial of justice claims before NAFTA tribunals as a form of appeal from local courts where the investors have lost on the merits. The *Mondev* tribunal stated clearly that while parties have the option to seek local remedies under NAFTA, "if they do so and lose on the merits, it is not the function of NAFTA tribunals to act as courts of appeal."[152] The tribunal went on to reiterate the following points which were made by an earlier NAFTA tribunal in *Azinian v. United Mexican States*: "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 seized has plenary appellate jurisdiction."[153]

The *Mondev* tribunal established that the proper test for a denial of justice is "whether the shock or surprise occasioned to an impartial tribunal leads, on reflection, to justified concerns as to the judicial propriety of the outcome, bearing in mind on the one hand that tribunals are not courts of appeal, and on the other hand that Chapter 11 of NAFTA … is intended to provide a real measure of protection [for investments]."[154]

VI. Conclusion

The United States accepted various tradeoffs between American sovereignty, on the one hand, and free trade and increased investment, on the other hand, when it entered into the North American Free Trade Agreement. Despite these tradeoffs and substantial participation by NGOs, NAFTA has had only a minimal impact on American sovereignty.

While the increasing participation of nongovernmental organizations in global governance generally threatens national sovereignty, the NGO participation in NAFTA has not significantly diminished the sovereign power of the United States. The role of American NGOs in the formation of NAFTA, although prominent, was largely confined to traditional methods of public interest advocacy politics. Thus, during the negotiation of NAFTA, labor and environmental NGOs acted within the checks and balances of the American democratic process to express their views on the trade agreement and pressure the government to address their concerns. NGO participation in NAFTA through the citizen submission process and amicus briefs to NAFTA arbitration tribunals has also had only a limited impact on American sovereignty. The fact that the citizen submission process excludes private actors from involvement in any formal sanctions against foreign states protects the sovereignty of the NAFTA members. On the issue of amicus curiae, the *Methanex* and *UPS* tribunals determined that NGOs may not intervene in NAFTA arbitrations as full parties to the proceedings or participate in the arbitrations except through written amicus briefs. Allowing a neutral panel of arbitrators the discretion to receive written amicus briefs where they believe the additional information will be helpful to the tribunals' deliberations has significantly less impact on the

[151] Mondev Award, *supra* note 139, para. 96.
[152] Mondev Award, *supra* note 139, para. 126.
[153] 39 I.L.M. 537, 552 para. 99, 1990, *quoted in* Mondev Award, *supra* note 136, para. 126.
[154] Mondev Award, *supra* note 139, para. 127.

sovereignty of the NAFTA parties than allowing third party petitioners to become parties to the dispute.

Some of the investor protection provisions in Chapter 11 of NAFTA present a more substantial intrusion upon American sovereignty. Two of the most controversial tradeoffs are the agreement to waive sovereign immunity and allow binding investor-state arbitrations in exchange for the benefits of a neutral forum for investment dispute resolution, and the agreement to include a broad expropriation provision which opens the United States to potential liability for legitimate environmental regulations, but in exchange provides the benefit of greater security for American investments in Mexico and Canada.

Investor-state arbitrations such as those which have already resulted in awards against NAFTA states, or in the case of *Ethyl* a settlement reversing an environmental law and $10 million in damages, do compromise the ability of states to freely pursue domestic policy priorities. However, cases like *Mondev*, where the tribunal refused to allow a foreign investor to use the investor-state arbitration process as a court of last resort after the investor lost on the merits in an American court, may limit the extent to which American sovereignty is compromised.

Our Purpose

The Federalist Society for Law and Public Policy Studies is a group of conservatives and libertarians interested in the current state of the legal order. It is founded on the principles that the state exists to preserve freedom, that the separation of governmental powers is central to our Constitution, and that it is emphatically the province and duty of the judiciary to say what the law is, not what it should be. The Society seeks both to promote an awareness of these principles and to further their application through its activities.

THE FEDERALIST SOCIETY
for Law and Public Policy Studies
1015 18th Street, NW, Suite 425
Washington, D.C. 20036

Phone (202) 822-8138
Fax (202) 296-8061

www.fed-soc.org

The Courts must declare the sense of the law; and if they should be disposed to exercise WILL instead of JUDGMENT, the consequences would be the substitution of their pleasure for that of the legislative body."

The Federalist No. 78