
NOTES

INDIRECT EXPROPRIATION UNDER NAFTA AND DR-CAFTA: POTENTIAL INCONSISTENCIES IN THE TREATMENT OF STATE PUBLIC WELFARE REGULATIONS

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INTRODUCTION

One of the most critical aspects of the relationship between the United States and its southerly neighbors derives from the flow of dollars from U.S. investors into the developing economies of Central and South America. The signing of the North American Free Trade Agreement (NAFTA),¹ followed a

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

decade later by the negotiation of the Dominican Republic-Central American Free Trade Agreement (DR-CAFTA),² demonstrates that developing nations are eager to benefit from importing direct investment capital from the United States. The agreements have not been without controversy, however, and one main source lies in Chapter 11 of NAFTA, which governs the admission and treatment of foreign investments in host countries.³ Specifically, the provision prohibiting indirect expropriation has been particularly problematic given the inconsistent manner in which tribunals have interpreted its terms.⁴

In order to avoid the same pitfalls of NAFTA's expropriation provision, the parties to DR-CAFTA updated the language of the analogous section, providing an annex that explicitly elucidates the test for determining indirect expropriation.⁵ Although the language of the test was meant to clarify statements by previous NAFTA tribunals,⁶ a recent NAFTA case, decided after DR-CAFTA was negotiated and signed, interpreted "indirect expropriation" to create a seemingly stronger presumption in favor of state public welfare regulations than previous cases.⁷ The inconsistent standards of these agreements may thwart a core purpose of the accords. The United States, as investment exporter, may not be able to achieve as much trade and investment liberalization as expected, and the developing parties will not realize their full potential in creating an atmosphere friendly to foreign investment.

This Note will examine several NAFTA arbitral decisions construing the term "indirect expropriation" and compare them with the language contained in DR-CAFTA. It will then demonstrate how the facts giving rise to the NAFTA cases may produce different results under a DR-CAFTA analysis. Part I of this Note provides a brief history of bilateral investment treaties and describes the origins and the text of the expropriation provisions found in

² Dominican Republic-Central America-United States Free Trade Agreement, Aug. 5, 2004, Hein's No. KAV 7157 [hereinafter DR-CAFTA].

³ The inordinate attention may be due to the historically contentious nature of customary international law with respect to expropriation. Stephen M. Schwebel, *The United States 2004 Model Bilateral Investment Treaty: An Exercise in the Regressive Development of International Law*, in GLOBAL REFLECTIONS ON INTERNATIONAL LAW, COMMERCE, AND DISPUTE RESOLUTION 815, 815 (Gerald Aksen et al. eds., 2005).

⁴ See discussion *infra* Part II.

⁵ See DR-CAFTA, *supra* note 2, annex 10-C.

⁶ Compare *Metalclad Corp. v. United Mexican States*, 40 I.L.M. 36, 50 ¶103 (ICSID 2000) (defining expropriation to include "depriving the owner . . . of the use or reasonably-to-be-expected economic benefit of property"), with DR-CAFTA, *supra* note 2, annex 10-C(4)(a)(ii) (including as a factor in determining indirect expropriation "the extent to which the government action interferes with distinct, reasonable investment-backed expectations" of the property owner). The actual language of the DR-CAFTA annex resembles more closely U.S. Supreme Court precedent on "regulatory takings." See *infra* note 205.

⁷ See *Methanex Corp. v. United States*, 44 I.L.M. 1345, 1455-58 (NAFTA Ch. 11 Arb. Trib. 2005).

NAFTA and DR-CAFTA. Part II explains how three earlier NAFTA tribunals interpreted the phrase “indirect expropriation,” and analyzes the most recent attempt at such an interpretation. Finally, Part III contains a description of the relevant DR-CAFTA provision, highlighting important distinctions between the NAFTA and DR-CAFTA regimes and demonstrating how NAFTA decisions could have turned out differently if they had been decided under the DR-CAFTA regime.

I. HISTORY OF INVESTMENT TREATIES AND EXPROPRIATION

In the wake of the debt crises of the 1980s, developing countries in North and Central America began looking to foreign investment, rather than foreign lending, to provide development capital. Mexico was the first to diligently pursue foreign investment, approaching the United States about the possibility of negotiating a free trade agreement in 1990.⁸ Almost three years later, on December 17, 1992, Canada, Mexico, and the United States signed NAFTA.⁹ NAFTA entered into force on January 1, 1994, and the three parties have experienced mixed blessings of increased trade liberalization coupled with political controversy ever since.¹⁰

A. *The “Indirect Investment” Controversy*

The indirect investment controversy derives primarily from Chapter 11 of NAFTA.¹¹ Within that chapter, the section prohibiting expropriation of a foreign investor’s investment¹² draws continued attention from

⁸ See MAXWELL A. CAMERON & BRIAN W. TOMLIN, *THE MAKING OF NAFTA: HOW THE DEAL WAS DONE* 62 (2000).

⁹ See *id.* at 182.

¹⁰ See, e.g., PUB. CITIZEN’S GLOBAL TRADE WATCH, *NAFTA’S THREAT TO SOVEREIGNTY AND DEMOCRACY: THE RECORD OF NAFTA CHAPTER 11 INVESTOR-STATE CASES 1994-2005: LESSONS FOR THE CENTRAL AMERICA FREE TRADE AGREEMENT*, at viii (2005) [hereinafter PUB. CITIZEN], available at <http://www.citizen.org/documents/chapter%2011%20report%20final.pdf> (arguing that NAFTA’s investor-state arbitration threatens the “sovereign immunity shield” of the United States and gives foreign investors rights beyond those available to domestic investors); Neil Harvey, *Rural Reforms and the Zapatista Rebellion: Chiapas, 1988-1995*, in *NEOLIBERALISM REVISITED: ECONOMIC RESTRUCTURING AND MEXICO’S POLITICAL FUTURE* 187, 194 (Gerardo Otero ed., 1996) (pointing out that the inclusion of corn and coffee in the agricultural portion of the NAFTA negotiations was one of the many impetuses for the Zapatista uprising in 1994); Strom C. Thacker, *NAFTA Coalitions and the Political Viability of Neoliberalism in Mexico*, J. INTERAMERICAN STUD. & WORLD AFF., Summer 1999, at 57, 74 (indicating that after 1994, foreign investments in Mexico became more stable, entering in the form of direct investment rather than portfolio investment).

¹¹ NAFTA, *supra* note 1, ch. 11; see also CAMERON & TOMLIN, *supra* note 8, at 100 (laying out Mexico’s opening position in the NAFTA negotiations with regard to the investment issue).

¹² NAFTA, *supra* note 1, art. 1110.

commentators.¹³ Article 1110 proscribes not only physical takings of private property, but also indirect takings and “measure[s] tantamount to nationalization or expropriation.”¹⁴ To resolve disputes arising under this and other provisions of Chapter 11, Articles 1116 and 1117 establish a process by which private investors of one party may bring an arbitration claim against another party to the treaty.¹⁵ Unfortunately, NAFTA tribunals have provided little clarity in interpreting the term “indirect expropriation,” and have inconsistently applied their interpretations in the context of “regulatory takings.”¹⁶

Despite these shortcomings, the success of NAFTA as a whole in bringing foreign investment into Mexico and stabilizing its economy piqued Central America’s interest.¹⁷ In January 2003, representatives from Costa Rica, El Salvador, Guatemala, Honduras, and Nicaragua met with U.S. Trade Representative Robert Zoellick to begin negotiating a region-wide free trade agreement that would allow them preferential access to the United States – one of the world’s largest import and export markets.¹⁸ Within its text, DR-CAFTA attempts to bring light to the term “indirect expropriation” and effectuate Central America’s intent to establish an investment-friendly environment. However, inasmuch as the text in DR-CAFTA differs from the standard articulated in *Methanex Corp. v. United States*, the new treaty could

¹³ See generally Vicki Been & Joel C. Beauvais, *The Global Fifth Amendment? NAFTA’s Investment Protections and the Misguided Quest for an International “Regulatory Takings” Doctrine*, 78 N.Y.U. L. REV. 30 (2003); Elyse M. Freeman, Note, *Regulatory Expropriation Under NAFTA Chapter 11: Some Lessons from the European Court of Human Rights*, 42 COLUM. J. TRANSNAT’L L. 177 (2003); HOWARD MANN, THE FINAL DECISION IN METHANEX V. UNITED STATES: SOME NEW WINE IN SOME NEW BOTTLES (2005), http://www.iisd.org/pdf/2005/commentary_methanex.pdf.

¹⁴ NAFTA, *supra* note 1, art. 1110(1).

¹⁵ See *id.* arts. 1116-17.

¹⁶ Compare *S.D. Myers, Inc. v. Canada*, 40 I.L.M. 1408, 1440 ¶282 (NAFTA Arb. 2000) (“Expropriations tend to involve the deprivation of ownership rights; regulations a lesser interference.”), with *Methanex Corp. v. United States*, 44 I.L.M. 1345, 1457 ¶15 (NAFTA Ch. 11 Arb. Trib. 2005) (finding the measure in question to be a valid regulation rather than an expropriation because it “was made for a public purpose, was non-discriminatory and was accomplished with due process”). See also discussion *infra* Part II.

¹⁷ Peter Hakim, *Is Washington Losing Latin America?*, FOREIGN AFF., Jan./Feb. 2006, at 39, 48-49 (asserting that most Latin American countries need productive economic ties with the United States).

¹⁸ Press Release, Office of the U.S. Trade Representative, United States and Central American Nations Launch Free Trade Negotiations (Jan. 8, 2003), available at http://www.ustr.gov/Document_Library/Press_Releases/2003/January/United_States_Central_American_Nations_Launch_Free_Trade_Negotiations.html. The Dominican Republic began discussing the option of joining CAFTA in March 2003. Press Release, Office of the U.S. Trade Representative, Joint Statement of the U.S. and the Dominican Republic (Mar. 7, 2003), available at http://www.ustr.gov/Document_Library/Press_Releases/2003/March/Joint_Statement_of_the_US_the_Dominican_Republic.html.

be interpreted in future cases to grant more investor protection at the expense of state regulatory activity than is granted under NAFTA.

This inconsistency could lead to problems for both investment exporters and host countries. Investment exporting nations desire clear standards in the interests of their private investors, so that investors can be sure the host country will treat their investment at least as well as it treats domestic firms. Private investors who fear that the host nation (often a developing country) will attempt to slowly nationalize their property will be less likely to invest. Likewise, host nations have an interest in establishing clear treaty guidelines so that they can avoid unnecessary litigation from private investors.

Some commentators have argued that the inconsistency in interpretation of international agreements has more to do with the context of the award and the individual arbiters than the actual import of the terms.¹⁹ Despite there being “no neutral commercial court of compulsory jurisdiction” in the international arena, it remains important to establish as much neutrality and credibility within international institutions as possible.²⁰ With this goal in mind, creating a more consistent standard for indirect expropriation across the board would set up clear guidelines for capital-importing nations in their treatment of foreign investment, and allow foreign investors to invest with more certainty.

B. *Investment Treaties: A General History*

In order to fully understand the origins of these investment provisions, it is important to understand the history and development of investment treaties worldwide. The investment chapters in both NAFTA and DR-CAFTA derive from the relatively recent history of bilateral investment treaties (BITs).²¹ The first modern BIT, between Germany and Pakistan, was signed in 1959.²² Over time, the number of BITs in force has grown exponentially.²³ In 1959, only two BITs were signed: one between Germany and Pakistan, and another between Germany and the Dominican Republic.²⁴ During the late 1980s and early 1990s, interest in investment expanded, and by 1999, around 160 nations

¹⁹ William W. Park, *Text and Context in International Dispute Resolution*, 15 B.U. INT’L L.J. 191, 192 (1997) (“Who interprets an international agreement will frequently be more significant than *what* the applicable law says about the agreement’s construction.”).

²⁰ *Id.* (comparing the lack of neutrality in the international context with the hometown advantage that a U.S. domestic court would provide a U.S. businessperson).

²¹ See INT’L CTR. FOR SETTLEMENT OF INV. DISPUTES, *BILATERAL INVESTMENT TREATIES*, at Introduction (2005), <http://www.worldbank.org/icsid/treaties/treaties.htm> [hereinafter ICSID, BITs].

²² *Id.* at Chronological List of Bilateral Investment Treaties.

²³ *See id.*

²⁴ *Id.*

had entered into more than 1,300 BITs.²⁵ With NAFTA, investment provisions made their way into multilateral treaties for the first time.²⁶

Investment treaties and investment provisions within multilateral treaties cover four core “substantive areas”: admission of the foreign investment into the host state, national treatment, dispute settlement, and expropriation.²⁷ The purpose of most BITs is twofold: (1) to provide insurance for investment exporting countries “against expropriation or other arbitrary treatment of investments,”²⁸ and (2) to allow developing nations to send a signal to the global community that they “not only welcome[] foreign investment but will also facilitate and protect certain foreign ventures.”²⁹

The dispute resolution procedure, unique to some of these investment agreements, allows private investors of one party to bring a claim against another party to the agreement.³⁰ Investor-state arbitration has become increasingly controversial with the advent of claims against governments for seemingly regulatory activity.³¹ These claims have become increasingly more common under NAFTA as investors complain that certain state regulatory activities constitute measures “tantamount to expropriation.”³²

Expropriation, or nationalization, occurs when a government “tak[es] or modifi[es] . . . an individual’s property rights.”³³ Under U.S. law, this usually takes place via eminent domain – the power of a government to “take privately owned property . . . [for] public use, subject to reasonable compensation.”³⁴ The scope of a government’s power to take property, however, has been widely contested in the international sphere.³⁵ Article 1110 of NAFTA offers

²⁵ W. Michael Reisman & Robert D. Sloane, *Indirect Expropriation and Its Valuation in the BIT Generation*, 2003 BRIT. Y.B. OF INT’L L. 115, 115.

²⁶ ICSID, BITs, *supra* note 21, at Introduction n.3.

²⁷ *Id.* at Introduction.

²⁸ Reisman & Sloane, *supra* note 25, at 116.

²⁹ *Id.* (quoting RUDOLF DOLZER & MARGRETE STEVENS, *BILATERAL INVESTMENT TREATIES* 12 (1995)). Interestingly, the United States has signed forty-six BITs, all with developing nations. David A. Gantz, *Contrasting Key Investment Provisions of the NAFTA with the United States-Chile FTA*, in *NAFTA INVESTMENT LAW AND ARBITRATION: PAST ISSUES, CURRENT PRACTICE, FUTURE PROSPECTS* 393, 400 & n.30 (Todd Weiler ed., 2004) [hereinafter *NAFTA INVESTMENT LAW AND ARBITRATION*].

³⁰ See BUREAU OF ECON. AND BUS. AFFAIRS, U.S. BILATERAL INVESTMENT TREATY PROGRAM (2006), <http://www.state.gov/e/eb/rls/fs/2006/22422.htm>. This dispute resolution procedure is characteristic of the U.S. bilateral investment treaty program. See *id.*

³¹ See *PUB. CITIZEN*, *supra* note 10, at 2-6.

³² See, e.g., *Pope & Talbot, Inc. v. Canada*, 28-29 ¶¶81-84 (NAFTA Ch. 11 Arb. Trib. June 26, 2000), <http://www.appletonlaw.com/cases/P&T-INTERIM%20AWARD.PDF>.

³³ BLACK’S LAW DICTIONARY 621 (8th ed. 2004).

³⁴ *Id.* at 562; see also *infra* note 205 (discussing U.S. takings law).

³⁵ See Schwebel, *supra* note 3, at 821 (“There are few if any issues in international law today on which opinion seems to be so divided as the limitations on a state’s power to

protection for private investors not only from *direct* expropriation, but also from *indirect* expropriation – regulatory action that may “depriv[e] the owner, in whole or in significant part, of the use or reasonably-to-be-expected economic benefit of property.”³⁶ NAFTA investment tribunals have devoted much energy to the question of whether an indirect expropriation has occurred in each of the distinct factual circumstances underlying the conflicts before them.³⁷

C. *Chapters 10 and 11: The Expropriation Provisions Compared*

Chapter 11 of NAFTA purports to protect foreign investors from both direct and indirect expropriation. Article 1110 states in relevant part:

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
- (d) on payment of compensation³⁸

On its face, this provision prohibits not only direct and indirect expropriation, but also any “measure tantamount to expropriation.”³⁹ This sparse language has given rise to so much ambiguity in NAFTA arbitration that the drafters of DR-CAFTA decided it was necessary to significantly change the language to provide more clarity.⁴⁰

expropriate the property of aliens.” (quoting *Banco Nacional de Cuba v. Sabbatino*, 376 U.S. 398, 428 (1964)).

³⁶ *Metalclad Corp. v. United Mexican States*, 40 I.L.M. 36, 50 ¶103 (ICSID 2000); see also Guillermo Aguilar Alvarez & William W. Park, *The New Face of Investment Arbitration: NAFTA Chapter 11*, 28 YALE J. INT’L L. 365, 378 (2003) (“NAFTA Article 1110 extends protection against un-compensated expropriation to measures ‘tantamount to nationalization or expropriation,’ thus encompassing takings that have often been referred to as ‘creeping’ expropriation.”).

³⁷ See, e.g., *S.D. Myers, Inc. v. Canada*, 40 I.L.M. 1408, 1440 ¶¶280-85 (NAFTA Arb. 2000) (tying the conclusion to the precise facts of the case).

³⁸ NAFTA, *supra* note 1, art. 1110(1). Although the United States wanted to include the language “prompt, adequate and effective,” to describe how the compensation should be paid, Mexico refused because the same language had been used against Mexico when President Cárdenas nationalized the oil industry in 1938. CAMERON & TOMLIN, *supra* note 8, at 100. As a result, Article 1110 outlines the same requirement in different words. NAFTA, *supra* note 1, art. 1110(2)-(6).

³⁹ NAFTA, *supra* note 1, art. 1110(1).

⁴⁰ See OFFICE OF THE U.S. TRADE REPRESENTATIVE, *THE FACTS ON HOW TRADE AGREEMENTS LIKE CAFTA PROTECT MILLIONS OF AMERICAN INVESTORS* (2005), http://www.ustr.gov/assets/Trade_Agreements/Bilateral/CAFTA/Briefing_Book/asset_upload

Five Central American countries signed DR-CAFTA in May 2004,⁴¹ and the Dominican Republic followed three months later.⁴² DR-CAFTA, like NAFTA, is a multilateral treaty aimed at liberalizing trade between the United States and its southern neighbors.⁴³ The agreement covers a wide range of trade issues including national treatment of goods, market access, sanitary and phytosanitary measures, technical barriers to trade, trade in services, intellectual property rights, environmental measures, and foreign investment.⁴⁴

Analogous to Article 1110 of NAFTA, Article 10.7(1) of DR-CAFTA provides that “[n]o Party may expropriate or nationalize a covered investment either directly or indirectly through measures equivalent to expropriation or nationalization (‘expropriation’), except: (a) for a public purpose; (b) in a non-discriminatory manner; (c) on payment of prompt, adequate, and effective compensation . . . ; and (d) in accordance with due process of law.”⁴⁵ In contrast to NAFTA, DR-CAFTA contains an annex describing exactly those factors that tribunals should consider when determining whether the government action constitutes indirect expropriation.⁴⁶ The annex states that the determination “requires a case-by-case, fact-based inquiry” in which the tribunal must consider:

- (i) the economic impact of the government action, although the fact that an action or series of actions by a Party has an adverse effect on the economic value of an investment, standing alone, does not establish that an indirect expropriation has occurred;
- (ii) the extent to which the government action interferes with distinct, reasonable investment-backed expectations; and
- (iii) the character of the government action.⁴⁷

Finally, the text of DR-CAFTA makes an explicit exception for government regulatory actions that are “designed and applied to protect legitimate public

d_file743_7228.pdf (“Building on the NAFTA experience, CAFTA takes new steps to ensure that investors cannot abuse the process.”).

⁴¹ Press Release, Office of the U.S. Trade Representative, United States and Central America Sign Historic Free Trade Agreement (May 28, 2004), *available at* http://www.ustr.gov/Document_Library/Press_Releases/2004/May/United_States_Central_America_Sign_Historic_Free_Trade_Agreement.html.

⁴² Press Release, Office of the U.S. Trade Representative, Dominican Republic Joins Five Central American Countries in Historic FTA with U.S. (Aug. 5, 2004), *available at* http://www.ustr.gov/Document_Library/Press_Releases/2004/August/Dominican_Republic_Joins_Five_Central_American_Countries_in_Historic_FTA_with_UShtml.html.

⁴³ DR-CAFTA, *supra* note 2, pmbl.

⁴⁴ *Id.* table of contents.

⁴⁵ *Id.* art. 10.7(1).

⁴⁶ *Id.* annex 10-C(4)(a).

⁴⁷ *Id.*

welfare objectives, such as public health, safety, and the environment.”⁴⁸ The basis for these changes can be found in the following case studies, where NAFTA’s language was sufficiently vague to allow varying interpretations.

II. NAFTA TRIBUNALS ON EXPROPRIATION DETERMINATIONS

The controversy surrounding NAFTA’s expropriation provision derives from the history of NAFTA arbitrations interpreting the provision.⁴⁹ Of the thirty-three claims filed under Chapter 11 of NAFTA, twenty-two were based on an alleged violation of Article 1110, claiming that various government regulations constituted expropriatory measures.⁵⁰ While NAFTA prohibits direct and indirect expropriation, as well as “measure[s] tantamount to expropriation,” NAFTA contains no express definition of what constitutes either one.⁵¹ This ambiguity has left room for much interpretive debate.⁵²

The interpretive debate, in turn, has led to a plethora of arbitration regarding Article 1110 of NAFTA. This Part will first explore three representative cases that attempted to articulate “traditional notions of customary international law”⁵³ in setting parameters for indirect expropriation.⁵⁴ It will then examine one of the most recent NAFTA expropriation cases,⁵⁵ and show how it diverges from previous case law by affording stronger protection to states against private investors.⁵⁶

⁴⁸ *Id.*

⁴⁹ See OFFICE OF THE U.S. TRADE REPRESENTATIVE, *supra* note 40.

⁵⁰ Leonel Pereznieta & Sergio Puig, *The Future of NAFTA Investment Arbitration: A Mexican Perspective*, in NAFTA INVESTMENT LAW AND ARBITRATION, *supra* note 29, at 425, 430. Of the twenty-two cases involving alleged violation of Article 1110, only the *Metalclad* tribunal found the state government liable. See NAFTA INVESTMENT LAW AND ARBITRATION, *supra* note 29, at 493-502.

⁵¹ NAFTA, *supra* note 1, art. 1110(1).

⁵² See, e.g., *Metalclad Corp. v. United Mexican States*, 40 I.L.M. 36, 50 ¶103 (ICSID 2000); *S.D. Myers, Inc. v. Canada*, 40 I.L.M. 1408, 1440 ¶281 (NAFTA Arb. 2000).

⁵³ Alvarez & Park, *supra* note 36, at 379 (stating that arbitration in *Metalclad*, *Pope & Talbot*, and *S.D. Myers* has addressed “the question of what constitutes expropriation” without departing from “traditional notions of customary international law”).

⁵⁴ A prominent issue in investment arbitration is the problem of valuation of compensation in indirect expropriations. While a direct expropriation can be fairly straightforward, tribunals often find it difficult to determine the actual value lost from a regulatory expropriation. This Note’s focus is on the finding of liability under the expropriation article; for an in-depth look at the valuation of indirect expropriation under BIT arbitration, see Reisman & Sloane, *supra* note 25, at 133-49.

⁵⁵ *Methanex Corp. v. United States*, 44 I.L.M. 1345 (NAFTA Ch. 11 Arb. Trib. 2005).

⁵⁶ See *id.* at 1455-58. The fact that the *Methanex* tribunal afforded stronger protection to states is not surprising given the Free Trade Commission’s interpretive note of July 31, 2001. See NAFTA FREE TRADE COMM’N, CLARIFICATIONS RELATED TO NAFTA CHAPTER 11 (2001), <http://www.worldtradelaw.net/nafta/chap11interp.pdf>. Although the interpretive note has no direct bearing on Article 1110, it clarifies the minimum standard of treatment

A. *Historical Expropriation Under Article 1110 of NAFTA*

The following cases provide a glimpse into the factors that tribunals have heretofore employed in determining whether there has been an indirect expropriation of a private investment. Although not explicitly stated in the text of Article 1110 of NAFTA, tribunals emphasize certain factors that create a presumption in favor of expropriation. Those factors include: (1) the effects of the government action,⁵⁷ (2) reasonable reliance by the investor,⁵⁸ (3) the degree of interference with a property right or the extent of the economic harm suffered,⁵⁹ (4) the duration of the economic harm,⁶⁰ and (5) the character of the government action.⁶¹ While none of the above factors is determinative, each plays a role in laying down a general framework for indirect expropriation determinations.

1. *Metalclad*

Metalclad, a U.S. corporation, entered into an option-to-purchase agreement with COTERIN, a Mexican corporation, for the purpose of constructing a hazardous waste landfill on purchased land in the Mexican State of San Luis

required under Article 1105(1), limiting the minimum standard of treatment to that which is required under customary international law. *Id.* Optimistic commentators report that this change “puts an end to” private investors suing states for any violation of NAFTA or non-NAFTA international law under Article 1105. INT’L INST. FOR SUSTAINABLE DEV., NOTE ON NAFTA COMMISSION’S JULY 31, 2001 INITIATIVE TO CLARIFY CHAPTER 11 INVESTMENT PROVISIONS (2001), http://www.iisd.org/pdf/2001/trade_nafta_aug2001.pdf. On the other hand, critics point out that “the state parties whose representatives form the interpretive panel, are also respondents in Chapter 11 arbitrations,” which in their view explains why the interpretive note was “suspiciously in the interest of the states.” Perezniето & Puig, *supra* note 50, at 432. This potential lack of impartiality could have colored the *Methanex* tribunal’s determination under Article 1105, thereby tainting the whole award in favor of the government-respondent. *See id.* at 432-33. Interestingly, the substance of the interpretive note has been incorporated into DR-CAFTA. *See* DR-CAFTA, *supra* note 2, annex 10-B.

⁵⁷ *See, e.g.,* Metalclad Corp. v. United Mexican States, 40 I.L.M. 36, 50 ¶103 (ICSID 2000) (“[E]xpropriation . . . includes . . . covert or incidental interference with the use of property . . .”).

⁵⁸ *See, e.g., id.* ¶107 (“These measures, taken together with the representations of the Mexican federal government, on which Metalclad relied . . . amount to an indirect expropriation.”).

⁵⁹ *See, e.g.,* Pope & Talbot, Inc. v. Canada, 37 ¶102 (NAFTA Ch. 11 Arb. Trib. June 26, 2000), <http://www.appletonlaw.com/cases/P&T-INTERIM%20AWARD.PDF> (“[T]he test [for indirect expropriation] is whether . . . interference is sufficiently restrictive to support a conclusion that the property has been ‘taken’ from the owner.”).

⁶⁰ *See, e.g.,* S.D. Myers, Inc. v. Canada, 40 I.L.M. 1408, 1440 ¶283 (NAFTA Arb. 2000) (“An expropriation usually amounts to a lasting removal of the ability of an owner to make use of its economic rights . . .”).

⁶¹ *See, e.g., id.* ¶281 (“Regulatory conduct by public authorities is unlikely to be the subject of legitimate complaint under Article 1110 . . .”).

Potosi.⁶² COTERIN had previously received authorization from the Mexican federal government to “construct and operate a transfer station for hazardous waste” on the land.⁶³ In September 1993, once COTERIN had been granted both federal and state permits, Metalclad exercised its option to purchase, on the understanding that only those permits were necessary for operation of the landfill.⁶⁴ Despite local resistance to the project, Metalclad began building in May 1994.⁶⁵

Construction activities ground to a halt in October when the municipality ordered Metalclad to cease building for lack of a local construction permit.⁶⁶ Although federal officials assured Metalclad that it was federal – not local – officials who had the full authority to authorize construction, they suggested that Metalclad apply for a local construction permit to maintain good relations with the municipality.⁶⁷ Metalclad then submitted an application for a local construction permit and began building anew.⁶⁸ The municipality denied Metalclad’s application in December 1995 – after construction had already been completed.⁶⁹ Additionally, the municipality filed an administrative complaint⁷⁰ and a preliminary injunction against operation of the landfill.⁷¹ From May through December 1996, Metalclad and the municipality endeavored to come to an agreement, but could not.⁷² In a final effort to keep the landfill from functioning, the Governor of San Luis Potosi issued an Ecological Decree in September 1997, declaring the area encompassing the landfill a Natural Area for the protection of rare cactus, and permanently precluding its use as a landfill.⁷³

On the basis of the municipal government’s actions, Metalclad filed a claim under Chapter 11 of NAFTA alleging, inter alia, that the government’s interference with operation of the landfill constituted a “measure tantamount to expropriation.”⁷⁴ The tribunal found that expropriation may include “covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or significant part, of the use or reasonably-to-be-expected economic benefit of property,” thus indicating that it is the *effect*

⁶² *Metalclad*, 40 I.L.M. at 41 ¶30.

⁶³ *Id.* ¶28.

⁶⁴ *Id.* at 41-42 ¶¶32-35.

⁶⁵ *Id.* at 42 ¶¶37-38.

⁶⁶ *Id.* ¶40.

⁶⁷ *Id.* ¶41.

⁶⁸ *Id.* ¶42.

⁶⁹ *Id.* at 43 ¶50.

⁷⁰ *Id.* at 44 ¶55.

⁷¹ *Id.* ¶56. The injunction was granted and was not lifted until May 1999. *Id.*

⁷² *Id.* ¶58.

⁷³ *Id.* ¶59.

⁷⁴ *Id.* at 47 ¶72.

rather than the *intent* of the government action that is important.⁷⁵ Since the tribunal found first that Mexico permitted the local government to engage in “unfair and inequitable treatment,”⁷⁶ it held that Mexico participated in denying Metalclad “the right to operate the landfill,” and had thus “taken a measure tantamount to expropriation.”⁷⁷ The arbitrators also cited the investor’s reasonable reliance on representations by the federal government as further evidence of expropriation.⁷⁸ While the tribunal conceded that the municipality’s reasons for denying the local construction permit were, in part, environmental,⁷⁹ it found as a matter of law that the Mexican federal government had exclusive authority to permit hazardous waste landfills,⁸⁰ and that the municipal government had therefore acted outside the scope of its authority.⁸¹ In the end, the finding of indirect expropriation depended on Metalclad’s reliance on federal governmental representations, the nature of the measures taken by the local government, and the economically harmful effects of those measures.⁸²

2. *Pope & Talbot*

The next case arose as a result of a Softwood Lumber Agreement (SLA) between the United States and Canada, governing Canadian softwood lumber exports.⁸³ Pope & Talbot, a U.S. corporation, operated in British Columbia and controlled three softwood lumber mills.⁸⁴ Until 1996, Pope & Talbot exported a vast majority of its softwood lumber to the United States.⁸⁵ In 1996, the United States and Canada entered into the SLA, which required Canada “to place softwood lumber on the Export Control List . . . and to require a Federal export permit for each exportation to the U.S.”⁸⁶ In addition, the SLA obligated Canada to collect fees in accordance with the quantity of softwood manufactured by each company.⁸⁷ Manufacturers producing below

⁷⁵ *Id.* at 50 ¶103.

⁷⁶ *Id.* ¶104.

⁷⁷ *Id.* The tribunal conflates the concepts of “indirect expropriation” and “measure tantamount to expropriation,” drawing no distinction between the two. *Id.* at 51 ¶¶111-12.

⁷⁸ *Id.* at 50 ¶107.

⁷⁹ *Id.* ¶106.

⁸⁰ *Id.* ¶105. It is interesting to note that the tribunal in this case seems to decide an issue of Mexican law. For a criticism of NAFTA expropriation arbitration, see PUB. CITIZEN, *supra* note 10, at xviii.

⁸¹ *Metalclad*, 40 I.L.M. at 50 ¶106.

⁸² *Id.* ¶107.

⁸³ *Pope & Talbot, Inc. v. Canada*, 2 ¶¶6-7 (NAFTA Ch. 11 Arb. Trib. June 26, 2000), <http://www.appletonlaw.com/cases/P&T-INTERIM%20AWARD.PDF>.

⁸⁴ *Id.* at 6 ¶28.

⁸⁵ *Id.* ¶29.

⁸⁶ *Id.* ¶30.

⁸⁷ *Id.* at 7 ¶30.

14.7 billion board feet could export without paying a fee; those producing between 14.7 and 15.35 billion were required to pay US\$50 for every thousand board feet in excess of 14.7 billion; and those that produced more than that were charged an additional US\$100 per one thousand board feet in excess of 15.35 billion.⁸⁸

As a result of these measures, Pope & Talbot filed a claim under Chapter 11 of NAFTA arguing, *inter alia*, that the Export Control Regime “deprived the Investment of its ordinary ability to alienate its product to its traditional and natural market.”⁸⁹ The allegations of expropriation were based first on the initial implementation of the SLA, and second, on the successive reductions in the quantity of exports permitted to pass the border free of charge.⁹⁰ The tribunal concluded that Pope & Talbot’s access to the U.S. market constituted a “property interest subject to protection under Article 1110.”⁹¹ However, it ultimately decided that the regulatory measures implemented did not “constitute an interference with the Investment’s business activities substantial enough to be characterized as an expropriation under international law.”⁹² While it refused to make a “blanket exception for regulatory measures,”⁹³ the tribunal ultimately held that the *degree of interference* with Pope & Talbot’s operations did not give rise to an expropriation because it was not “sufficiently restrictive to support a conclusion that the property ha[d] been ‘taken’ from the owner.”⁹⁴ Pope & Talbot argued that the term “tantamount to expropriation” encompassed more than the customary international law concept of expropriation,⁹⁵ but the tribunal rejected that contention, finding that Article 1110 does not require compensation for *any* interference “without regard to the magnitude or severity of the effect.”⁹⁶ In so doing, the tribunal held that it is the degree of interference with a property right that distinguishes between a proper regulation and an expropriation, and virtually ignored any reasonable reliance by the investor.⁹⁷

⁸⁸ *Id.* In 2005, Canada exported 21.5 billion board feet of softwood lumber, worth \$8.5 billion. FOREIGN AFFAIRS & INT’L TRADE CAN., *SOFTWOOD LUMBER*, <http://www.dfait-maeci.gc.ca/trade/eicb/softwood/intro-en.asp> (last visited Oct. 1, 2006). Based on those figures, one thousand board feet is worth approximately \$400. Thus the fees constituted 12.5% and 25%, respectively, of the value of the softwood lumber.

⁸⁹ *Pope & Talbot*, at 28 ¶81 (quoting Statement of Claim at 26 ¶93, *Pope & Talbot*, available at <http://www.dfait-maeci.gc.ca/tna-nac/documents/pubdoc3.pdf>).

⁹⁰ *Id.*

⁹¹ *Id.* at 33 ¶96.

⁹² *Id.*

⁹³ *Id.* at 35 ¶99.

⁹⁴ *Id.* at 37 ¶102.

⁹⁵ *Id.* ¶103.

⁹⁶ *Id.* at 34 ¶96.

⁹⁷ *Id.* at 37 ¶102.

3. *S.D. Myers*

The final foundational case to be discussed was brought by *S.D. Myers*, a U.S. corporation that specialized in, among other things, polychlorinated biphenyl (PCB) remediation.⁹⁸ In the 1990s, *S.D. Myers* began to look to the Canadian market to establish waste disposal contracts with PCB exporters.⁹⁹ Internationally, PCBs were recognized as potentially dangerous to public health beginning in the 1970s.¹⁰⁰ Both Canada and the United States have identified PCBs as dangerous substances, regulating them under the Environmental Contaminants Act and the Toxic Controlled Substances Act, respectively.¹⁰¹ Since 1980, the border between the United States and Canada has been generally closed “to the import and export of PCBs and PCB waste for disposal.”¹⁰² By the early 1990s, *S.D. Myers* began to lobby the U.S. Environmental Protection Agency (EPA) and the Canadian Minister for the Environment to open the shared border to imports of PCB waste from Canada.¹⁰³ Finally, in October 1995, “the U.S. EPA issued an enforcement discretion” agreeing, for a limited time period, not to enforce the U.S. law prohibiting PCB imports against *S.D. Myers* as long as the corporation met certain conditions.¹⁰⁴ One month later, the Minister of the Environment banned export of PCBs from Canada, largely as a result of lobbying efforts by the Canadian PCB disposal industry.¹⁰⁵ In February 1997, Canada reopened its border by further amending the PCB Waste Export Regulations,¹⁰⁶ but a Ninth Circuit decision closed the border permanently in July of that year.¹⁰⁷

S.D. Myers filed a claim under Chapter 11 of NAFTA alleging that the Canadian order banning export of PCBs and PCB waste, during the time that the United States had opened its borders for a few PCB disposal companies, was a violation of Article 1110.¹⁰⁸ *S.D. Myers* argued that as a result of the Canadian measures, it suffered a loss in sales and profits as well as a loss of its

⁹⁸ *S.D. Myers, Inc. v. Canada*, 40 I.L.M. 1408, 1415 ¶90 (NAFTA Arb. 2000). Polychlorinated biphenyl is a compound used in fire-resistant and insulating materials. *Id.* ¶94. PCB remediation consists of “analysing equipment and oil to assess the level of contamination, . . . transport[ing] . . . the oil or equipment to a facility and . . . extract[ing] . . . the PCBs from the materials.” *Id.* ¶91. The waste material must then be destroyed either by “thermal destruction at high temperatures or by chemical processing.” *Id.* ¶94.

⁹⁹ *Id.* ¶¶92-93.

¹⁰⁰ *Id.* at 1416 ¶98.

¹⁰¹ *Id.* ¶¶100-02.

¹⁰² *Id.* ¶101.

¹⁰³ *Id.* at 1417 ¶113.

¹⁰⁴ *Id.* at 1418 ¶¶118-19.

¹⁰⁵ *Id.* at 1418-19 ¶¶122-23.

¹⁰⁶ *Id.* at 1421 ¶127.

¹⁰⁷ *Id.* ¶128.

¹⁰⁸ *Id.* at 1422 ¶¶142-43.

investment in a joint venture with Myers Canada (a Canadian subsidiary).¹⁰⁹ Like the *Pope & Talbot* tribunal, the arbiters dismissed the claim under Article 1110,¹¹⁰ holding that the difference between expropriation and regulation is principally a matter of degree.¹¹¹ The tribunal determined that because the border closure was only temporary, it did not constitute expropriation.¹¹² The *S.D. Myers* tribunal also hinted that the nature of the government action, namely whether it is regulatory or confiscatory, could have some bearing on a finding of expropriation.¹¹³ The tribunal pointed out that while it is possible that rights other than property rights may be expropriated,¹¹⁴ the deprivation of rights must usually be “lasting” to some degree, not only temporary.¹¹⁵ Like the *Pope & Talbot* tribunal, the *S.D. Myers* tribunal did not discuss the reasonableness of the investor’s reliance on the status quo.¹¹⁶ In a final consideration, the tribunal stated that Canada received “no benefit from the measure.”¹¹⁷

Taken together, the tribunals in the above three cases hit on each of the five key factors in determining whether there has been an expropriation. Of utmost importance in *Metalclad* were the effects (regardless of intent) of the government action, especially whether the investor suffered irreparable harm, and whether the investor reasonably relied on the government’s representations.¹¹⁸ In *Pope & Talbot*, the tribunal leaned more heavily on the

¹⁰⁹ *Id.* at 1422-23 ¶144.

¹¹⁰ *Id.* at 1440 ¶288.

¹¹¹ *Id.* ¶282 (“Expropriations tend to involve the deprivation of ownership rights; regulations a lesser interference.”).

¹¹² *Id.* ¶¶283-84 (“An expropriation usually amounts to a lasting removal of the ability of an owner to make use of its economic rights In this case the closure of the border was temporary.”).

¹¹³ *Id.* ¶281 (“The general body of precedent usually does not treat regulatory action as amounting to expropriation. Regulatory conduct by public authorities is unlikely to be the subject of a legitimate complaint under Article 1110”).

¹¹⁴ *Id.*

¹¹⁵ *Id.* ¶283.

¹¹⁶ *Id.* ¶¶279-88 (articulating the tribunal’s rationale on the issue of expropriation and nowhere mentioning investor reliance).

¹¹⁷ *Id.* ¶287. This consideration need not be determinative. See *Alvarez & Park*, *supra* note 36, at 379 (“An indirect expropriation may occur . . . when the host state itself acquires nothing of value but ‘at least has been the instrument of its redistribution.’” (quoting ALLAHYAR MOURI, *THE INTERNATIONAL LAW OF EXPROPRIATION AS REFLECTED IN THE WORK OF THE IRAN-U.S. CLAIMS TRIBUNAL* 66 (1994))).

¹¹⁸ See *Metalclad Corp. v. United Mexican States*, 40 I.L.M. 36, 50 ¶¶107-08 (ICSID 2000) (emphasizing the harm to Metalclad, the investor’s reasonable reliance, and the lack of proper procedure surrounding the government measures).

degree of interference that the government measure had on the investment.¹¹⁹ Finally, in *S.D. Myers*, the tribunal emphasized the duration and degree of the property right interference, implying that the nature of the government action might have independent significance.¹²⁰

B. *Methanex Corp. v. United States: New Contributions*

More recently, another NAFTA tribunal attempted to interpret the terms “tantamount to expropriation” and apply them to a new set of facts.¹²¹ *Methanex Corp. v. United States* involved a California regulation that Methanex, a Canadian methanol producer, alleged had a discriminatory purpose and both an expropriatory and discriminatory effect.¹²² In holding that the regulations were not measures “tantamount to expropriation,” the tribunal relied on the non-discriminatory nature of the regulation and the lack of specific commitments made to Methanex about regulation of the methanol industry.¹²³ Unlike previous NAFTA decisions, the *Methanex* decision mentions little about the degree of the economic interference with the private investor’s investment. In addition, the tribunal established that loss of market share on its own does not constitute expropriation.¹²⁴ While NAFTA arbitration awards do not carry precedential value, the *Methanex* decision signaled a trend toward a stronger presumption in favor of state regulations, and consequently, more limited protection for foreign private investors.

1. *Methanex* Allegations

On August 3, 2005, a NAFTA tribunal handed down the final arbitration award in *Methanex*, dismissing on the merits all the claims advanced by Methanex in its Second Amended Statement of Claim.¹²⁵ Methanex’s claims were rooted in an Executive Order issued by the Governor of California and subsequent regulations governing the use of methyl tertiary-butyl ether (MTBE) as a gasoline oxygenate.¹²⁶ Gasoline oxygenates serve to reduce

¹¹⁹ See *Pope & Talbot, Inc. v. Canada*, 37 ¶102 (NAFTA Ch. 11 Arb. Trib. June 26, 2000), <http://www.appletonlaw.com/cases/P&T-INTERIM%20AWARD.PDF> (emphasizing the “substantial deprivation” of rights needed for a finding of expropriation).

¹²⁰ See *S.D. Myers*, 40 I.L.M. at 1440 ¶¶282-83.

¹²¹ *Methanex Corp. v. United States*, 44 I.L.M. 1345, 1455-58 (NAFTA Ch. 11 Arb. Trib. 2005).

¹²² *Id.* at 1455 ¶3.

¹²³ *Id.* at 1456 ¶7.

¹²⁴ *Id.* at 1457 ¶17. The tribunal acknowledged that “market share may . . . ‘constitute[] an element of the value of an enterprise,’” but limited its role to that of determining the value of compensation required. *Id.* (alteration in original) (quoting GILLIAN WHITE, NATIONALIZATION OF FOREIGN PROPERTY 49 (1961)).

¹²⁵ See *Methanex*, 44 I.L.M. at 1455-58 (dismissing separately Methanex’s claims under Articles 1101, 1102, 1105, and 1110 of NAFTA).

¹²⁶ *Id.* at 1368-72.

carbon monoxide emissions as well as other “products of incomplete combustion.”¹²⁷ Although MTBE was the “oxygenate of choice” in the 1980s, improvements in emission control technology in newer vehicles have made such gasoline additives virtually obsolete.¹²⁸ Furthermore, a study by the University of California concluded that MTBE contaminants found in the groundwater put California’s limited water supply at risk.¹²⁹ As a result of the study, California began a phase-out plan in which Governor Gray Davis directed the California Air Resources Board (CARB) to ban the use of MTBE as a gasoline additive by the end of 2002, and to identify MTBE-enhanced gasoline at the pumps for consumers.¹³⁰ Because California had no methanol production plants and the majority of their methanol was imported from Canada, Methanex claimed that California’s recent methanol regulations were disguised attempts at economic protectionism, in direct violation of U.S. commitments under NAFTA.¹³¹ Methanex further alleged that the California regulations implementing the Executive Order “provided that *only* ethanol, which is almost entirely a domestic U.S. product, could be used as an oxygenate in California gasoline.”¹³²

Methanex claimed these regulations violated Articles 1102, 1105, and 1110 of NAFTA with respect to the national treatment standard, the fair and equitable treatment standard, and the “tantamount to nationalization or expropriation” standard.¹³³ Methanex argued that the California regulations effectively “took” a large portion of its investments, “including its share of the California and larger U.S. oxygenate market.”¹³⁴ The corporation further claimed that such takings intentionally discriminated against a foreign industry in favor of the domestic ethanol industry, that they had no public purpose, that the measures did not comply with due process of law as required by Article 1110(c) of NAFTA, and that Methanex was not adequately compensated for its

¹²⁷ *Id.* at 1411 ¶4.

¹²⁸ *Id.* ¶¶7-8.

¹²⁹ *Id.* ¶¶9-10.

¹³⁰ Second Amended Statement of Claim at 7 ¶20, *Methanex*, 44 I.L.M. 1345, available at <http://naftaclaims.com/Disputes/USA/Methanex/MethanexResubAmendStateClaim.pdf>.

¹³¹ *Id.* at 4 ¶10.

¹³² *Id.* at 8 ¶22. Methanex also alleged bad faith on the part of Governor Gray Davis, claiming that he “felt he owed . . . [domestic ethanol producer] ADM in return for its political contributions.” *Methanex*, 44 I.L.M. at 1451 ¶8. However, the tribunal dismissed this assertion as based on inferential and inconclusive evidence. *Id.* at 1437-38 ¶¶56-57.

¹³³ Second Amended Statement of Claim, *supra* note 130, at 120-29 ¶¶291-320. Article 1102 of NAFTA requires that parties to the treaty afford other parties’ investors and their investments the most favorable treatment afforded domestic investors. NAFTA, *supra* note 1, art. 1102(1)-(3). Article 1105 lays down a minimum standard of treatment, requiring that each party accord fair and equitable treatment to investments of member nations in accordance with international law. *Id.* art. 1105(1).

¹³⁴ Second Amended Statement of Claim, *supra* note 130, at 129 ¶317.

loss.¹³⁵ Methanex's claim for damages was extensive, contending that California's MTBE ban "depriv[ed] Methanex . . . of a substantial portion of their customer base, goodwill, and market for methanol in California."¹³⁶ The corporation demonstrated immediate damages by pointing to the instant drop in market value of Methanex shares on the Toronto Stock Exchange (TSE), the principal market for Methanex shares.¹³⁷ According to Methanex, the initial market value loss amounted to C\$180 million,¹³⁸ and its market share never recovered from the loss.¹³⁹ The total damages suffered by Methanex, its investments, and its shareholders from the alleged violation of Articles 1102, 1105, and 1110 amounted to approximately C\$970 million.¹⁴⁰

Based on the factors from the earlier cases, Methanex had a fairly strong case. The investor demonstrated an extreme effect of the government action on the company, a substantial interference with its market share, and significant and irreparable economic harm.¹⁴¹ Despite these facts, however, the tribunal decided in favor of the United States on all three counts. It first dismissed claims that the California regulations were discriminatory under the standard of Article 1102,¹⁴² then found that Article 1105 does not "preclude[] governmental differentiations as between nationals and aliens,"¹⁴³ and finally held that California's regulations did not amount to a violation of Article 1110.¹⁴⁴

2. Applying Legal Analysis Under Article 1110 of NAFTA

In the end, the tribunal rejected Methanex's claim and held that the California regulations were "made for a public purpose, [were] non-discriminatory and [were] accomplished with due process."¹⁴⁵ Basing its reasoning on the language of Article 1110 of NAFTA, the tribunal acknowledged that "an intentionally discriminatory regulation against a foreign investor fulfils a key requirement for establishing expropriation."¹⁴⁶ However, the tribunal asserted that, as a principle of general international law, "a non-discriminatory regulation for a public purpose, which is enacted in accordance with due process . . . is not deemed expropriatory and compensable unless

¹³⁵ *Id.* at 129 ¶¶317-20.

¹³⁶ *Id.* at 129 ¶322.

¹³⁷ *Id.* at 131 ¶325.

¹³⁸ This loss represents a twenty percent drop in market value on the TSE. *Id.*

¹³⁹ *Id.* ¶326.

¹⁴⁰ *Id.* at 132 ¶327.

¹⁴¹ See *supra* text accompanying notes 136-40.

¹⁴² *Methanex Corp. v. United States*, 44 I.L.M. 1345, 1446 ¶29 (NAFTA Ch. 11 Arb. Trib. 2005); see also *supra* note 133 (describing the Article 1102 standard).

¹⁴³ *Methanex*, 44 I.L.M. at 1452 ¶14.

¹⁴⁴ *Id.* at 1457 ¶18.

¹⁴⁵ *Id.* ¶15.

¹⁴⁶ *Id.* at 1456 ¶7.

specific commitments had been given by the regulating government to the then putative foreign investor contemplating investment that the government would refrain from such regulation.”¹⁴⁷ Taking one final jab at Methanex’s claim, the tribunal held that the company’s losses in customer base, goodwill, and market share cannot *stand alone* as a protected property interest.¹⁴⁸ Finding first that the regulations were non-discriminatory and that Methanex received no specific commitments, but rather entered a market which was widely known to be subject to extensive government regulation, the tribunal determined that the California MTBE ban complied with U.S. commitments under Article 1110.¹⁴⁹

Although the tribunal did not indicate the source from which it draws this principle of general international law requiring specific commitments, a similar assertion was made in *Metalclad*.¹⁵⁰ There, the municipality denied a local construction permit to Metalclad even though the company had relied on representations by the Mexican federal government that the municipality would “issue the permit as a matter of course.”¹⁵¹ The *Metalclad* decision emphasized that the result was due not only to the municipal denial of the local construction permit, but to the corporation’s reasonable reliance on other government representations that “amount[ed] to an indirect expropriation.”¹⁵² Similar to the circumstances surrounding the *Methanex* case, local studies had shown that Metalclad’s hazardous waste landfill would be harmful to the local environment and there was some indication that environmental concerns were at least partially driving the construction permit denial.¹⁵³

Furthermore, the *Methanex* tribunal acknowledged that access to the U.S. market constitutes an investment for purposes of Article 1110,¹⁵⁴ as was also recognized in *Pope & Talbot*.¹⁵⁵ The tribunal and Methanex agreed that Article 1139(g) of NAFTA includes market share as a protected property

¹⁴⁷ *Id.* (emphasis added).

¹⁴⁸ *Methanex* and *Pope & Talbot* seem to come to different conclusions with respect to this question. Compare *id.* at 1457 ¶17 (observing that “in a comprehensive taking, [goodwill and market share] may figure in valuation,” but likely would not constitute a compensable taking in and of themselves), with *Pope & Talbot, Inc. v. Canada*, 33 ¶96 (NAFTA Ch. 11 Arb. Trib. June 26, 2000), <http://www.appletonlaw.com/cases/P&T-INTERIM%20AWARD.PDF> (“[A]ccess to the U.S. market is a property interest subject to protection under Article 1110 . . .”).

¹⁴⁹ *Methanex*, 44 I.L.M. at 1456 ¶¶9-10.

¹⁵⁰ *Metalclad Corp. v. United Mexican States*, 40 I.L.M. 36, 50 ¶107 (ICSID 2000) (emphasizing specific representations that the Mexican government made and “on which Metalclad relied”).

¹⁵¹ *Id.* at 42 ¶41.

¹⁵² *Id.* at 50 ¶107.

¹⁵³ *Id.* at 49-50 ¶¶92, 106.

¹⁵⁴ *Methanex*, 44 I.L.M. at 1457 ¶17.

¹⁵⁵ *Pope & Talbot, Inc. v. Canada*, 33 ¶96 (NAFTA Ch. 11 Arb. Trib. June 26, 2000), <http://www.appletonlaw.com/cases/P&T-INTERIM%20AWARD.PDF>.

interest.¹⁵⁶ Nonetheless, the tribunal was reluctant to find expropriation where loss of market share was the only damage suffered.¹⁵⁷ Instead the arbiters implied that market share alone does not stand as a protected property interest, but can only be considered at the valuation stage in cases of “comprehensive taking[s].”¹⁵⁸

3. Comparing the Analyses: *Methanex* vs. Prior Expropriation Determinations

Several NAFTA tribunals have interpreted expropriation for purposes of Article 1110.¹⁵⁹ *S.D. Myers* acknowledged that, “in legal theory, rights other than property rights may be ‘expropriated.’”¹⁶⁰ However, the tribunal in that case found that regulations generally carry a rebuttable presumption of not being expropriatory.¹⁶¹ The tribunal further held that the distinction between regulation and expropriation is really only a matter of the degree of interference with the private investor’s investment rights.¹⁶² The decision turned primarily on the small degree and temporary nature of the interference.¹⁶³

The *Pope & Talbot* tribunal likewise observed that, under the *Restatement (Third) of Foreign Relations Law of the United States*, whether a measure is “tantamount to expropriation” depends on “the degree to which the government action deprives the investor of effective control over the enterprise.”¹⁶⁴ The tribunal stated further that Article 1110 of NAFTA does proscribe some “nondiscriminatory regulation[s] . . . [which] fall within an exercise of a state’s so-called police powers.”¹⁶⁵ The decision concluded broadly that access to the U.S. market “is a property interest subject to protection under Article 1110.”¹⁶⁶ In the end, the *Pope & Talbot* tribunal dismissed the investor’s claim, based largely on the low degree of the

¹⁵⁶ See *Methanex*, 44 I.L.M. at 1457 ¶17. NAFTA states that “investment,” for purposes of Chapter 11, means “real estate or other property, tangible or intangible, acquired in the expectation or used for the purpose of economic benefit or other business purposes.” NAFTA, *supra* note 1, art. 1139(g) (emphasis added).

¹⁵⁷ *Methanex*, 44 I.L.M. at 1457 ¶17.

¹⁵⁸ *Id.*

¹⁵⁹ See discussion *supra* Part II.A.

¹⁶⁰ *S.D. Myers, Inc. v. Canada*, 40 I.L.M. 1408, 1440 ¶281 (NAFTA Arb. 2000).

¹⁶¹ *Id.*

¹⁶² *Id.* ¶282.

¹⁶³ *Id.* ¶284.

¹⁶⁴ *Pope & Talbot, Inc. v. Canada*, 37 ¶102 & n.81 (NAFTA Ch. 11 Arb. Trib. June 26, 2000), <http://www.appletonlaw.com/cases/P&T-INTERIM%20AWARD.PDF> (quoting RESTATEMENT (THIRD) OF FOREIGN RELATIONS LAW OF THE UNITED STATES § 712 Reporters’ Note 6 (1987)).

¹⁶⁵ *Id.* at 33 ¶96.

¹⁶⁶ *Id.*

interference with the investor's rights and on the nature of the Export Control Regime, the government action in question.¹⁶⁷

Unlike the above two cases, and distinct from the outcome of *Methanex*, the tribunal in *Metalclad* determined that the government acts constituted measures "tantamount to expropriation" for purposes of Article 1110.¹⁶⁸ In that case, the private investor had already purchased land for purposes of a landfill site, relying on the representations by the federal government that all the required permits had been filed and that the local permit would be sought by the federal authorities. The decision there turned on both the significant economic impact on the private investor and the reasonable reliance of the investor on representations made by the Mexican government.¹⁶⁹

S.D. Myers and *Pope & Talbot* are factually distinguishable from *Methanex* and therefore do not govern the outcome directly. In *S.D. Myers*, the impact of the regulatory measure was relatively small and temporary.¹⁷⁰ Similarly, *Pope & Talbot* concerned a relatively small economic impact that, besides limiting some of Pope & Talbot's export capacity, did not significantly interfere with its management or the enjoyment of its investment.¹⁷¹ By contrast, the economic impact of the California regulations in *Methanex* was considerable – both immediately and in the long-term.¹⁷²

Metalclad and *Methanex* are also distinguishable, but on different grounds. The investor in *Metalclad* relied substantially on the Mexican government's promises with regard to federal, state, and local permits.¹⁷³ Moreover, the municipality acquiesced to some degree to *Metalclad*'s construction, since it waited over a year to deny the permit and never once attempted to interrupt the building process.¹⁷⁴ However, *Methanex* did not rely on explicit governmental statements that the gasoline additive industry would not be regulated, and in fact, should have known such an industry to be subject to environmental regulation.¹⁷⁵

Despite these differences, the *Methanex* decision contributed materially to this body of NAFTA arbitration law by articulating a stronger presumption in favor of state environmental regulations. The tribunal asserted principally that the measure was non-discriminatory and that there were no specific

¹⁶⁷ *Id.* at 37 ¶¶102-03.

¹⁶⁸ *Metalclad Corp. v. United Mexican States*, 40 I.L.M. 36, 50 ¶107 (ICSID 2000).

¹⁶⁹ *Id.* ¶103.

¹⁷⁰ *See S.D. Myers, Inc. v. Canada*, 40 I.L.M. 1408, 1440 ¶284 (NAFTA Arb. 2000).

¹⁷¹ *Pope & Talbot, Inc. v. Canada*, 37 ¶102 (NAFTA Ch. 11 Arb. Trib. June 26, 2000), <http://www.appletonlaw.com/cases/P&T-INTERIM%20AWARD.PDF>.

¹⁷² Second Amended Statement of Claim, *supra* note 130, at 130-31 ¶¶323-26.

¹⁷³ *Metalclad*, 40 I.L.M. at 50 ¶107.

¹⁷⁴ *Id.* at 42-44 ¶¶42-51.

¹⁷⁵ *Methanex Corp. v. United States*, 44 I.L.M. 1345, 1456 ¶¶9-10 (NAFTA Ch. 11 Arb. Trib. 2005).

commitments to the private investor.¹⁷⁶ In so doing, the tribunal raised the standard of the “reasonable reliance” factor to require “specific commitments” from the host nation, putting more regulatory discretion in the hands of the state.

After the *Methanex* case, there appears to be a hierarchy of factors for determining indirect expropriation under NAFTA. First, the property interest in question must include more than a simple market share in order to reach the level of compensability. The *Methanex* tribunal determined that Methanex’s claim for damages was not compensable, even if it had found indirect expropriation, because the investor’s claimed injury was only loss of market share.¹⁷⁷ Second, *Methanex* distinguishes regulatory actions from expropriatory behavior primarily by their character. Rather than look to the degree of interference in order to draw the expropriation-regulation distinction, the *Methanex* tribunal relied on its prior finding of non-discrimination under Article 1102.¹⁷⁸

Third, once the tribunal determines the measures to be regulatory, it must look to see if such regulation was made in contravention of any specific commitments to the investor. The *Methanex* tribunal inquired into whether California had made any commitments to maintain the status quo prior to promulgating the regulations and found that Methanex had not relied on any promises made by California.¹⁷⁹ The final step in the analysis simultaneously examines the purposes of the regulatory measures, and the process by which they were implemented. The *Methanex* tribunal found that the public purposes were legitimate and that due process was respected, holding finally that the regulations did not constitute a violation of Article 1110.¹⁸⁰ Other factors, such as the effects of the government action and the degree and duration of economic harm to the investor, were not even considered.

III. NEW TREATY TEXT: DR-CAFTA TEXTUAL ANALYSIS

Given the interpretive uncertainty present in the NAFTA cases determining expropriation, DR-CAFTA represents an effort to bring clarity to the test of “indirect expropriation.”¹⁸¹ DR-CAFTA clarifies the NAFTA standard in three material ways: (1) by expressly conflating the concepts of “indirect expropriation” and “measures tantamount to expropriation”; (2) by supplementing the expropriation provision with an annex specifically devoted to enumerating the indirect expropriation criteria; and (3) by explicitly

¹⁷⁶ *Id.* ¶7.

¹⁷⁷ *Id.* at 1457 ¶17.

¹⁷⁸ *Id.* ¶15.

¹⁷⁹ *Id.* at 1456 ¶¶8-9.

¹⁸⁰ *Id.* at 1457 ¶¶14-15.

¹⁸¹ DR-CAFTA, *supra* note 2, annex 10-C.

permitting non-discriminatory government regulation.¹⁸² This clarification is accomplished in part by codifying some of the interpretations espoused in previous NAFTA decisions.¹⁸³ However, the test for expropriation articulated in DR-CAFTA could provide results that conflict with findings under NAFTA, and especially under the test embraced by *Methanex*.

A. *The Development and Purposes of DR-CAFTA*

Although the seven DR-CAFTA signatories¹⁸⁴ had hoped that the agreement would enter into force on January 1, 2006, even the U.S. government acknowledged that to be “an ambitious goal.”¹⁸⁵ Only one of the six Latin American signatories to the agreement was able to make the requisite internal structural reforms by March 1, 2006, while two more followed a month later.¹⁸⁶ Some blame U.S. bureaucratic processes for failing to approve the Central American nations’ compliance with the entry requirements;¹⁸⁷ others claim that political resistance in Latin America is largely responsible for the delay.¹⁸⁸ The Costa Rican presidential elections on February 6, 2006 cast additional uncertainty on DR-CAFTA implementation when Nobel Prize winner and former president Óscar Arias did not achieve the sweeping victory

¹⁸² *Id.*; see also OFFICE OF THE U.S. TRADE REPRESENTATIVE, *CAFTA RHYMES WITH NAFTA BUT IS BETTER IN MANY WAYS* (2005), available at http://www.ustr.gov/assets/Trade_Agreements/Bilateral/CAFTA/Briefing_Book/asset_upload_file133_7801.pdf.

¹⁸³ For example, an interpretation espoused in *Metalclad Corp. v. United Mexican States*, 40 I.L.M. 36, 50 ¶¶107-08 (ICSID 2000) (taking into account Metalclad’s reasonable reliance on government representations and the significant economic impact of the measure) is reflected in DR-CAFTA, *supra* note 2, annex 10-C(4)(a)(i)-(ii) (stating that whether expropriation has occurred depends on the economic impact of government action and “the extent to which [it] interferes with distinct, reasonable investment-backed expectations”).

¹⁸⁴ The DR-CAFTA signatories are the United States, Costa Rica, the Dominican Republic, El Salvador, Guatemala, Honduras, and Nicaragua. Press Release, Office of the U.S. Trade Representative, Statement of USTR Spokesman Stephen Norton Regarding CAFTA-DR Implementation (Dec. 30, 2005), available at http://www.ustr.gov/Document_Library/Press_Releases/2005/December/Statement_of_USTR_Spokesman_Stephen_Norton_Regarding_CAFTA-DR_Implementation.html.

¹⁸⁵ *Id.*

¹⁸⁶ El Salvador was the only country able to make the requisite changes by March 1, 2006. See Press Release, Office of the U.S. Trade Representative, Statement of USTR Portman Regarding Entry into Force of the CAFTA-DR for Honduras and Nicaragua (Mar. 31, 2006), available at [http://www.ustr.gov/Document_Library/Press_Releases/2006/March/Statement_of_USTR_Portman_Regarding_Entry_Into_Force_of_the_US_-_Central_America_-_Dominican_Republic_Free_Trade_Agreement_\(CA.html](http://www.ustr.gov/Document_Library/Press_Releases/2006/March/Statement_of_USTR_Portman_Regarding_Entry_Into_Force_of_the_US_-_Central_America_-_Dominican_Republic_Free_Trade_Agreement_(CA.html). The agreement went into effect with respect to Nicaragua and Honduras on April 1, 2006. *Id.*

¹⁸⁷ See, e.g., *Guatemala Misses CAFTA Deadline*, CARIBBEAN UPDATE, Feb. 2006, available at <http://www.allbusiness.com/periodicals/article/858172-1.html>.

¹⁸⁸ See, e.g., Elisabeth Malkin, *Central American Trade Deal Is Being Delayed by Partners*, N.Y. TIMES, Mar. 2, 2006, at C10.

that was expected, leaving the presidential position temporarily in limbo.¹⁸⁹ Although Costa Rica is the only one of the seven signatories not to have ratified the agreement, President Arias has made it clear that he will support ratification.¹⁹⁰ Despite many setbacks and substantial domestic resistance to the agreement, Central American countries are continuing to head in the direction of full trade liberalization with the United States.

1. General Incentives for Agreement

The DR-CAFTA agreement as a whole has its roots in Central American efforts to stabilize various local economies and enter the global economy by liberalizing trade practices. Central America has made great strides economically in the past fifteen years.¹⁹¹ The region has experienced relatively stable inflationary trends, export growth, and a reduction in fiscal deficits.¹⁹² In addition, Central America has opened trade within the region by forming a customs union¹⁹³ – the Central American Common Market.¹⁹⁴ The Caribbean Basin Initiative¹⁹⁵ provided Central American countries with “preferential access to the U.S. market,” which will be extended indefinitely when DR-CAFTA enters into force.¹⁹⁶ According to the International Monetary Fund, continued development in the region and the capability to compete with Mexico and China for U.S. investment depends partially on the implementation of DR-CAFTA and the creation of a positive investment climate for foreign investors.¹⁹⁷ For Central American countries, DR-CAFTA

¹⁸⁹ *President by a Nose*, BUS. LATIN AM., Mar. 20, 2006, at 5. Óscar Arias was declared winner of the presidential election a month later, but will be up against a constituency that largely resists ratification of DR-CAFTA. Tim Padgett & Mishelle Mitchell, *Dodging a Bullet in Costa Rica: A Leftist Candidate in Latin America Loses, for a Change, but Only by the Narrowest of Margins*, TIME ONLINE EDITION, Mar. 8, 2006, <http://www.time.com/time/world/article/0,8599,1170929,00.html>.

¹⁹⁰ *President by a Nose*, *supra* note 189, at 5.

¹⁹¹ See CENTRAL AMERICA: GLOBAL INTEGRATION AND REGIONAL COOPERATION 2-3 (Markus Rodlauer & Alfred Schipke eds., 2005) [hereinafter CENTRAL AMERICA].

¹⁹² *Id.* at 3.

¹⁹³ A customs union is a free trade area with a common external tariff among the member countries. BLACK'S LAW DICTIONARY 414 (8th ed. 2004).

¹⁹⁴ CENTRAL AMERICA, *supra* note 191, at 3.

¹⁹⁵ The Caribbean Basin Initiative is the collective name for three U.S. federal laws: the Caribbean Basin Economic Recovery Act of 1983 (CBERA), the Caribbean Basin Economic Recovery Expansion Act of 1990 (CBERA Expansion Act), and the U.S.-Caribbean Basin Trade Partnership Act of 2000 (CBTPA). The initiative was designed to promote economic development by encouraging foreign and domestic investment and diversifying Caribbean countries' economies. U.S. DEP'T OF COMMERCE INT'L TRADE ADMIN. & U.S. AGENCY FOR INT'L DEV., GUIDE TO THE CARIBBEAN BASIN INITIATIVE 1 (1994), <http://www.mac.doc.gov/cbi/webmain/guide.pdf>.

¹⁹⁶ CENTRAL AMERICA, *supra* note 191, at 3.

¹⁹⁷ *Id.* at 4-5.

represents “enhanced access to their largest export market, increased foreign direct investment, and institutional strengthening across the range of trade- and investment-related areas.”¹⁹⁸

At the same time, DR-CAFTA exposes smaller Central American economies to competition with the most powerful economy in the world.¹⁹⁹ If DR-CAFTA has the same effect in Central America parties as NAFTA did in Mexico, the economic blessings will be mixed. In Mexico, although foreign investment greatly increased once NAFTA entered into force, the “losers” under NAFTA are too often the informal sector and other small businesses that were not able to participate in the negotiations.²⁰⁰

In the United States, the private business sector as well as the general population are likewise ambivalent. Some of the same concerns that arose during NAFTA negotiations also arose in DR-CAFTA deliberations. In his verbal attacks on NAFTA during the 1992 presidential campaign, Ross Perot described the potential effect of the agreement on the U.S. economy as a “giant sucking sound,” draining the United States of investments and jobs.²⁰¹ In addition to the economic concerns, critics condemn both NAFTA and DR-CAFTA for subjecting the U.S. government to suits by foreign investors in contravention of its sovereign immunity.²⁰²

2. Shaping the Investment Provision

With respect to the DR-CAFTA investment provision, the federal government had hoped to come to an agreement that defined investment broadly and limited the regulation of foreign investment. This goal makes sense given the United States’ primary role as investment exporter, and secondary role as host state to foreign investments.²⁰³ To meet the concerns of the American public over the formation of DR-CAFTA, the Office of the United States Trade Representative (USTR) has issued several policy briefs underscoring both the protection for U.S. investors overseas and the assurance that the United States will not become more vulnerable to foreign investor

¹⁹⁸ *Id.* at 7.

¹⁹⁹ *Cf.* CAMERON & TOMLIN, *supra* note 8, at 40 (observing that the negotiation between the United States and Mexico on NAFTA’s investment provisions was not symmetrical, given the economic power wielded by the United States).

²⁰⁰ *See, e.g.,* Thacker, *supra* note 10, at 70 (pointing out that “smaller and medium-sized firms” did not have a significant role in NAFTA negotiations and were overpowered by large companies that controlled most of the economic resources).

²⁰¹ CAMERON & TOMLIN, *supra* note 8, at 40.

²⁰² *See* OFFICE OF THE U.S. TRADE REPRESENTATIVE, INVESTMENT PROVISIONS IN CAFTA (2005), available at http://ustr.gov/assets/Trade_Agreements/Bilateral/CAFTA/Briefing_Book/asset_upload_file289_7750.pdf.

²⁰³ *See* CAMERON & TOMLIN, *supra* note 8, at 100-01.

claims.²⁰⁴ The USTR also lauds DR-CAFTA for being “draw[n] directly from U.S. Supreme Court decisions [to] ensure that foreign investors have no greater rights than U.S. investors under domestic law.”²⁰⁵ Despite these efforts, forty-two state legislators signed a letter in July 2005 alleging that Chapter 10’s expropriation article will provide foreign investors with more rights than domestic firms have under U.S. regulatory takings law.²⁰⁶ They further claimed that under the provisions, individual states of the United States will not be able to defend their own regulatory actions, since the agreement only allows arbitration between the investor and the host country.²⁰⁷

Modeled substantially after the same provision in NAFTA²⁰⁸ and the U.S. Model Bilateral Investment Treaty (BIT),²⁰⁹ the investment chapter in DR-CAFTA covers a wide range of subjects governing the relationship between the private investor and the investment-importing nation. In addition to NAFTA and the Model BIT, U.S. regulatory takings law and a history of interpretive ambiguity influenced the new text of the expropriation provision in DR-CAFTA.²¹⁰

²⁰⁴ See OFFICE OF THE U.S. TRADE REPRESENTATIVE, *supra* note 40; OFFICE OF THE U.S. TRADE REPRESENTATIVE, *supra* note 182.

²⁰⁵ OFFICE OF THE U.S. TRADE REPRESENTATIVE, *supra* note 182. U.S. “takings” law is derived from the Fifth Amendment, which provides that the government may not take “private property . . . for public use, without just compensation.” U.S. CONST. amend. V. The law has since been interpreted to protect citizens not only from actual physical takings, but also from “economic injuries caused by public action.” *Penn Cent. Transp. Co. v. New York City*, 438 U.S. 104, 124 (1978). Although determinations of these “regulatory takings” are dependent on specific factual inquiries in each case, the *Penn Central* court articulated three factors pertinent to the analysis: (1) the economic impact of the regulation, (2) its interference “with distinct investment-backed expectations,” and (3) whether the government action can be characterized as a “physical invasion.” *Id.*

²⁰⁶ Rossella Brevetti, *Forty-Two State Legislators Blast CAFTA-DR Investment Provisions*, 22 Int’l Trade Rep. (BNA) 1211, 1211 (July 21, 2005). The legislators argue that the investor-state dispute resolution system “would allow foreign investors to bring ‘regulatory takings’ cases not permitted under U.S. domestic law.” *Id.*

²⁰⁷ *Id.* at 1212. The main complaint here is that the federal government is infringing on state rights in violation of the Tenth Amendment, which provides that “powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people.” U.S. CONST. amend. X.

²⁰⁸ NAFTA, *supra* note 1, ch. 11.

²⁰⁹ OFFICE OF THE U.S. TRADE REPRESENTATIVE, MODEL BILATERAL INVESTMENT TREATY (2004), available at http://www.ustr.gov/assets/Trade_Sectors/Investment/Model_BIT/asset_upload_file847_6897.pdf.

²¹⁰ See *supra* note 183 (comparing language in *Metalclad* with similar language in DR-CAFTA); see also *supra* note 205 (describing U.S. “regulatory takings” law).

B. *The Text: DR-CAFTA vs. Methanex*

Article 10.7(1) of DR-CAFTA states that a party may not “expropriate . . . a[n] . . . investment either directly or indirectly through measures equivalent to expropriation . . . except: (a) for a public purpose; (b) in a non-discriminatory manner; (c) on payment of prompt, adequate, and effective compensation . . . ; and (d) in accordance with due process of law.”²¹¹ Due to efforts by some claimants to interpret “tantamount” to extend beyond measures expropriatory in nature or effect,²¹² this new text conflates the two concepts and employs the word “equivalent” rather than “tantamount.”²¹³

In addition to the textual changes, DR-CAFTA contains an annex further clarifying the appropriate test for “indirect expropriation.”²¹⁴ Annex 10-C first states that an expropriation must interfere with “a tangible or intangible property right . . . in an investment.”²¹⁵ The provision further asserts that all determinations of indirect expropriation “require[] a case-by-case, fact-based inquiry.”²¹⁶ That inquiry must take into consideration “the economic impact of the government action . . . ; the extent to which the government action interferes with distinct, reasonable investment-backed expectations; and . . . the character of the government action.”²¹⁷ DR-CAFTA seems to recycle these factors from earlier expropriation cases in which the economic harm to the investor, reasonable reliance, and the regulatory or expropriatory nature of the government measure were each taken into account, albeit inconsistently.²¹⁸ The language of the annex implies that the factors to be taken into account must be balanced against each other, rather than considered in the hierarchical analysis that the *Methanex* tribunal applied.²¹⁹

The annex also provides that “[e]xcept in rare circumstances, nondiscriminatory regulatory actions . . . that are designed and applied to

²¹¹ DR-CAFTA, *supra* note 2, art. 10.7(1).

²¹² See *Pope & Talbot, Inc. v. Canada*, 33 ¶103 (NAFTA Ch. 11 Arb. Trib. June 26, 2000), <http://www.appletonlaw.com/cases/P&T-INTERIM%20AWARD.PDF>; *S.D. Myers, Inc. v. Canada*, 40 I.L.M. 1408, 1440 ¶285 (NAFTA Arb. 2000).

²¹³ DR-CAFTA, *supra* note 2, art. 10.7(1); see also *Metalclad Corp. v. United Mexican States*, 40 I.L.M. 36, 51 ¶111-12 (ICSID 2000) (drawing no distinction between expropriation and a measure “tantamount to expropriation”).

²¹⁴ DR-CAFTA, *supra* note 2, annex 10-C.

²¹⁵ *Id.* annex 10-C(2).

²¹⁶ *Id.* annex 10-C(4)(a).

²¹⁷ *Id.*

²¹⁸ See *Metalclad*, 40 I.L.M. at 50 ¶107 (emphasizing the reasonable reliance of the private investor); *Pope & Talbot, Inc. v. Canada*, 37 ¶102 (NAFTA Ch. 11 Arb. Trib. June 26, 2000), <http://www.appletonlaw.com/cases/P&T-INTERIM%20AWARD.PDF> (emphasizing the degree of interference and extent of economic impact); *S.D. Myers, Inc. v. Canada*, 40 I.L.M. 1408, 1440 ¶281 (NAFTA Arb. 2000) (emphasizing the regulatory nature of the government measure).

²¹⁹ DR-CAFTA, *supra* note 2, annex 10-C(4)(a).

protect legitimate welfare objectives . . . do not constitute indirect expropriations.”²²⁰ It also provides specific examples of what might be considered “legitimate public welfare objectives,” mentioning “public health, safety, and the environment.”²²¹ This language is strikingly similar to the assertion in *Methanex* that “a non-discriminatory regulation for a public purpose, which is enacted in accordance with due process . . . is not deemed expropriatory and compensable unless specific commitments had been given by the regulating government to the then putative foreign investor.”²²²

There are three key differences between the test articulated in the language of Annex 10-C and the test employed by the *Methanex* tribunal: (1) the potential treatment of intangible property interests such as market share; (2) the degree of emphasis placed on the indirect expropriation factors, especially the economic impact on the private investor; and (3) the strength of the underlying presumption in favor of state public welfare regulations.²²³ First, whereas DR-CAFTA explicitly includes intangible property rights and interests as compensable investments, *Methanex* emphasizes that market share is not enough to “stand alone.”²²⁴ Second, DR-CAFTA requires that each indirect expropriation determination take into account, at a minimum, the economic impact of the regulation, the interference with “distinct, reasonable investment-backed expectations,” and the nature of the government regulations, while the *Methanex* tribunal made no mention of the degree of interference with the investor’s property interest.²²⁵

Finally, Paragraph 4(b) of Annex 10-C of DR-CAFTA also employs language different from NAFTA’s with respect to nondiscriminatory regulatory government actions. The *Methanex* tribunal adopted a strong presumption in favor of the regulating government by limiting the exception to cases in which there were “specific commitments” made by the state to the private investor contrary to the regulations imposed.²²⁶ By contrast, DR-CAFTA employs a more general term, “rare circumstances,” to carve out an exception to the same presumption.²²⁷ Given the vague nature of the term “rare circumstances,” it could be a comparatively broad exception to the presumption in favor of “nondiscriminatory regulatory actions.”²²⁸ The

²²⁰ *Id.* annex 10-C(4)(b).

²²¹ *Id.*

²²² *Methanex Corp. v. United States*, 44 I.L.M. 1345, 1456 ¶7 (NAFTA Ch. 11 Arb. Trib. 2005).

²²³ Compare DR-CAFTA, *supra* note 2, annex 10-C, with *Methanex*, 44 I.L.M. at 1456 ¶7.

²²⁴ *Methanex*, 44 I.L.M. at 1456 ¶7.

²²⁵ See *id.* at 1455-57.

²²⁶ *Id.* at 1456 ¶¶9-10 (emphasis added).

²²⁷ DR-CAFTA, *supra* note 2, annex 10-C(4)(b).

²²⁸ Stephen M. Schwebel argues that “rare circumstances” is too narrow an exception for purposes of investment arbitration. See Schwebel, *supra* note 3, at 815. He expresses

question then arises: What constitutes a “rare circumstance”? The ambiguity of this phrase will likely encourage lawyers to use creative arguments to push the limits of the exception, ultimately decreasing certainty and foreseeability for both host states and private parties.

C. *A DR-CAFTA Analysis of Methanex and Other Hypotheticals*

Under a DR-CAFTA regime, the facts involved in *Methanex* would likely have resulted in a decision similar to the decision reached under NAFTA. DR-CAFTA requires a “case-by-case, fact-based inquiry” for determinations of indirect expropriation.²²⁹ That inquiry must first take into account the three balancing factors under Annex 10-C of DR-CAFTA.²³⁰ *Methanex* experienced extreme economic injury as a result of the measure, including a catastrophic dive in the corporation’s market value.²³¹ With regard to distinct, reasonable investment-backed expectations, *Methanex* depended heavily on its share of the California market.²³² However, the evidence showed that the company’s reliance on the lack of restrictive regulation (given the nature of its business) was not reasonable.²³³ The third balancing factor, the character of the government action, would likewise probably weigh in favor of the government-respondent under DR-CAFTA. If a DR-CAFTA tribunal were to determine the character of the measure based on the degree of interference with the investor’s property interest, *Methanex*’s case would be a stronger one.²³⁴ However, there is strong evidence that the California regulations would be found regulatory, despite the substantial impact on *Methanex*’s property interest. The facts reveal that the regulations were non-discriminatory in nature²³⁵ and motivated primarily by a concern for the environment.²³⁶ Also, if degree of interference with a property interest were the test by which a DR-CAFTA tribunal distinguished between regulatory and expropriatory

concern that it would permit governments, albeit with good motives, to deprive a foreign investor of the value of its investment “except in rare circumstances,” putting the presumption too much in favor of the host state. *Id.* at 822. Given this analysis, Schwebel should be even more concerned by the more restrictive language of the *Methanex* decision, which permits only one “rare circumstance” in which an investor can overcome that presumption.

²²⁹ DR-CAFTA, *supra* note 2, annex 10-C(4)(a).

²³⁰ *Id.*

²³¹ Second Amended Statement of Claim, *supra* note 130, at 131 ¶325.

²³² *Id.*

²³³ *Methanex Corp. v. United States*, 44 I.L.M. 1345, 1456 ¶9 (NAFTA Ch. 11 Arb. Trib. 2005).

²³⁴ Second Amended Statement of Claim, *supra* note 130, at 131 ¶325.

²³⁵ *Methanex*, 44 I.L.M. at 1449 ¶38.

²³⁶ *See id.* at 1368-72.

action, then the first and the third balancing factors would be effectively identical.²³⁷

There may be some circumstances, however, in which the same set of facts would inadvertently result in a different outcome under a *Methanex* analysis than under DR-CAFTA. Under *Methanex*, it is clear that only specific commitments by the host state can overcome the presumption in favor of non-discriminatory government measures created for a legitimate public purpose and implemented with due process.²³⁸ Under DR-CAFTA, however, the “rare circumstances” exception leaves open the possibility that factors other than specific reliance may overcome the presumption.

Imagine, for example, that Country A bans product X, which is produced almost exclusively outside of Country A. If EFG is incorporated in Country B, also a party to the treaty, and the ban causes an unforeseen drop in EFG’s market value by half, then EFG might have a plausible claim under either DR-CAFTA or the *Methanex* analysis. However, imagine that Country A bans X in good faith because its scientists have recently discovered severe health risks as a result of its common use. Also imagine that EFG has depended on exports to Country A ever since it was initially incorporated over fifty years earlier. Under DR-CAFTA, the high economic impact on EFG, combined with the company’s reasonable, investment-backed expectations that the market would remain steady, may constitute a “rare circumstance” weighing in favor of a finding of indirect expropriation. Under the *Methanex* test, the property interest is prima facie suspect because it includes only a significant share of the market in Country B. Even if the *Methanex* analysis held the property interest to be compensable, the lack of specific representations by Country A’s government would probably lead to a decision in favor of the host state.

In a related scenario, suppose EFG manufactured a product Y that is subject to strict regulation, as in *Methanex*. Firms in Country B have been the primary manufacturer of this product for years, but recently, firms in Country A have begun to get a corner on the global market. When Country A suddenly creates stringent licensing requirements for product Y (for legitimate public health purposes and with due process), there are immediate and severe economic effects on individuals whose welfare depends on the success of Product Y manufacturing in Country B. Here, EFG’s claim may again depend on whether *Methanex*’s “specific commitments” test or DR-CAFTA’s “rare circumstances” exception applies. Under a *Methanex* analysis, assuming, again, that the alleged injury would amount to a compensable property interest, there have still been no specific commitments to EFG, and therefore, the state measure would be upheld. However, the DR-CAFTA language leaves open the possibility that an impact on a third party may be considered a “rare

²³⁷ Compare DR-CAFTA, *supra* note 2, annex 10-C(4)(a)(i) (taking into account “the economic impact of the government action”), with *id.* annex 10-C(4)(a)(iii) (taking into account “the character of the government action”).

²³⁸ *Methanex*, 44 I.L.M. at 1456 ¶7.

circumstance.”²³⁹ Although the case for the investor is weaker in this second hypothetical, both hypotheticals demonstrate how DR-CAFTA’s balancing test may allow the presence of severe economic effects to outweigh the presumption of nondiscrimination, thus affording less protection to the host state than would be afforded under the more hierarchical analysis of the *Methanex* tribunal.

CONCLUSION

DR-CAFTA has made some valuable contributions to the international law of investment treaties. The new language attempts to provide more clarity with respect to whether market share can properly be considered a protected investment on its own or only be considered in a valuation determination.²⁴⁰ It also eliminates some of the ambiguity that had plagued NAFTA tribunals regarding the term “tantamount to expropriation.”²⁴¹ By providing an annex defining “indirect expropriation,” the drafters of the agreement codified the factors that must be considered on balance in making such a determination.²⁴² The balancing factors indicate that a determination of indirect expropriation should include an analysis of the *kind* of the action, as well as an examination of the *degree* of interference with the investor’s property.²⁴³ Finally, Paragraph 4(b) of the annex deals directly with governmental regulatory action, making clear that, “except in rare circumstances,” measures serving “legitimate public welfare objectives, such as public health, safety, and the environment,” generally do not constitute indirect expropriations.²⁴⁴

However, remaining ambiguities will continue to haunt DR-CAFTA and could become problems in future litigation. First, DR-CAFTA leaves unclear whether the regulatory or expropriatory nature of a government measure is to be determined by the intent of the policy-makers or the effects of the measure.²⁴⁵ The investment provision likewise leaves vague what might constitute “rare circumstances” for purposes of the exception in Paragraph 4(b).²⁴⁶ This vagueness could lead to divergence between DR-CAFTA and NAFTA, especially considering that the tribunals hearing future cases will be constituted under different authorities.

²³⁹ There could be a third hypothetical in which the injured third party is a person or persons within Country *B*, the regulating state. In that case, the argument under DR-CAFTA is even weaker because the effects of Country *B*’s ban are felt primarily within its own jurisdiction.

²⁴⁰ See DR-CAFTA, *supra* note 2, annex 10-C(2).

²⁴¹ *Methanex*, 44 I.L.M. at 1455-56 ¶4.

²⁴² DR-CAFTA, *supra* note 2, annex 10-C(4)(a).

²⁴³ See *id.* annex 10-C (4)(a) (indicating that both the character of the government action and the economic impact on the investor should be considered).

²⁴⁴ *Id.* annex 10-C (4)(b).

²⁴⁵ *Id.* annex 10-C (4)(a)(iii).

²⁴⁶ *Id.* annex 10-C (4)(b).

In the end, despite the remaining doubt regarding a few portions of the DR-CAFTA investment provision, the Central American treaty clearly affords more protection to private investors than did previous agreements. This difference could lead to difficulties as the United States and its southern neighbors attempt to harmonize these agreements into one large Free Trade Agreement of the Americas (FTAA). Private investors may take their investments south of Mexico where there seems to be more protection for their property interests. On the other hand, if this “rare circumstances” exception creates too much uncertainty, investors may choose not to invest in those countries that are most in need of foreign capital. For developing host states, the additional protection for private investors could spell disaster as the policy-makers attempt to regulate in accordance with the specific needs of their domestic constituency. Ambiguity could similarly restrict the ability of governments to protect their own citizens because of the risk of suit by foreign private investors.

This analysis creates an anomalous result for the United States as well, since behavior considered to be indirect expropriation under one system may not be under the other, thus creating a different playing field for companies investing in different host states. Given that the context of the arbitration and the constitution of the tribunal inevitably will play roles in the interpretation of treaty terms,²⁴⁷ establishing a clear text is especially important and will lead to more international collaboration in the future.

In an effort to protect the ability of developing governments to govern with more certainty, and to ultimately encourage more foreign investment, DR-CAFTA tribunals should interpret the term “rare circumstances” restrictively. The arbitrators should make an effort in early cases to limit the use of such an exception, leaving it to policy-makers within the parties to broaden the exception if that is their intent. Although there is no precedential value to these tribunals, prior NAFTA tribunals are frequently cited for their persuasive power, and clear standards could provide the arbitral awards with concrete criteria for future arbitrators. The differing standards under the *Methanex* analysis and the text of DR-CAFTA bring to light the important role that arbitration tribunals play in international economic relations, a fact arbitrators should keep in mind when handing down future awards.

²⁴⁷ Park, *supra* note 19, at 192.