



Draft #2 Final Report on Water Policy and International Trade Law

William Waren

November 13, 2009

Short Summary of Report

- **Importance of the issue.** The question is whether international trade and investment law might thwart Maine should the state adopt new groundwater policy measures. NAFTA, the WTO and subsequent trade agreements, the so-called "post-1994 agreements," place limits on state government. The post-1994 agreements deal not only with "at the border" discrimination, but also impose strict rules related to government regulation, taxation, purchasing and economic development policies that are regarded as non-tariff barriers to trade by the drafters of the agreements.
- **Trade disputes.** The World Trade Organization (WTO) agreement on trade in goods clearly covers trade in bottled water, but there are two schools of thought on whether trade in bulk water is covered. Opinions also differ about whether the WTO agreement on trade in services covers groundwater measures, although a strong argument can be made that regulation of transportation or distribution of water is covered. WTO suits may be brought by nation-states that are parties to the agreement, and WTO tribunal decisions are effectively enforced by retaliatory trade sanctions, such as authorization of punitive tariffs on U.S. exporters.
- **Investment disputes.** Chapter 11 of the North American Free Trade Agreement (NAFTA), bilateral investment treaties (BITS), and similar international investment agreements (IIAs) cover groundwater measures. IIAs also are the most likely source for an international lawsuit. Indeed, IIA suits seeking compensation for government water policy measures are quite common. Among other reasons, this is because;
 - The definition of "investment" is so broad;
 - The standards regarding investor rights are vague; and
 - Foreign investors can directly sue the United States for money damages, without the need for another nation-state to bring suit.



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Summary of Report

- *It is important to analyze how international trade and investment agreements may impact Maine's management of groundwater resources.*

Under U.S. domestic law, Maine has authority to adopt water policy measures in order to protect the public health and the environment and to ensure sustainable supplies of water at a fair price for individual consumption and commercial use.

In pursuit of these policy goals, Maine may be asked to consider, for example, new measures to regulate groundwater extraction for export to internal and international markets.

The question is whether international trade and investment law, either already adopted or likely to be considered for adoption in the future, might thwart Maine should the state adopt such water policy measures.

It is a good question because the World Trade Organization, NAFTA, and similar international agreements are designed to limit the authority of state legislatures, agencies, and courts in the interest of maximizing the volume and value of international commerce.

NAFTA, the WTO and subsequent trade agreements, the so-called "post-1994 agreements," place limits on state government.

Prior to 1994, states had little reason to monitor the course of trade negotiations closely because they focused on tariffs, quotas and similar "at the border" discrimination against foreign products, almost always the business of the federal government.

The post-1994 agreements deal not only with "at the border" discrimination, but also

impose strict rules related to government regulation, taxation, purchasing and economic development policies that are regarded as non-tariff barriers to trade by the drafters of the agreements. Maine's policy jurisdiction is now affected by international law.

- ***Bottled water is clearly covered by the WTO General Agreement on Tariffs and Trade (GATT), which regulates international trade in goods.***

Except in unusual circumstances, it is unclear how regulation of groundwater extraction would violate "most favored nation" or other obligations under the GATT (such as export restrictions under GATT article XI).

A violation of GATT obligations would probably require strong evidence that groundwater regulation was intended to operate as a disguised or discriminatory restriction on trade in bottled water.

Even then, the groundwater regulation might be permissible under Article XX or some other exemption.

- ***It is uncertain whether bulk water is covered by GATT.*** Nonetheless, an expansive interpretation of GATT by a future tribunal, extending coverage to regulation of trade in bulk water, cannot be ruled out.

An argument for GATT coverage of bulk water might be made in circumstances:

- where governments violate article XI export restriction obligations, or
 - Where governments allow one firm to export bulk water and then change the rules to restrict or stop large-scale groundwater pumping and transfers across national borders by a second foreign firm, thus violating a GATT principle of non-discrimination, such as the "most favored nation" obligation.
- ***It is also uncertain whether the WTO General Agreement on Trade in Services (GATS) covers groundwater regulation. A strong argument, nonetheless, can be made that regulation of transportation or distribution of water is covered by GATS, even if regulation of drinking water utilities remains beyond the scope of the***

agreement. In any case, the biggest concern should be the on-going WTO negotiations on GATS obligations related to “domestic regulation,” rather than the current U.S. commitments.

The World Trade Organization secretariat strongly denies that the GATS covers public water services or public interest regulation of privately-supplied water services. But, there are several reasons to remain concerned:

- While no country has made a commitment on water services per se, the United States and other countries are free to do so in the future.
- The United States has made or in the future may make commitments on distribution services, transport services and other service sectors that might result in GATS litigation affecting regulation of groundwater pumping and transport.

In other words, the WTO statement can be read to only apply to drinking water services provided as a public utility, and to be irrelevant to the issue of whether regulation of large-scale groundwater pumping and cross-border transportation violates other GATS obligations of the United States related for example to transportation services (such as maritime transport, rail transport, road transport and pipeline transport).

- As the WTO statement makes clear, the key to any potential GATS litigation on water services would be the contract between the foreign supplier and the government.

If government taxes, regulations, or other measures change in response to new circumstances or a shift in public opinion after the signing of a contract could that constitute a breach of contract? Could the existence of the contract imply a guarantee of a “stable” legal environment for the foreign supplier?

Also a government might intentionally or unintentionally surrender its right to regulate water under a contract, as a result of:

- a cozy relationship between public officials and the foreign firm;

- as a result of being unfamiliar with international trade law; or
 - As a result of being “out-lawyered” by the foreign company.
- The WTO secretariat’s statement on water services is only the view of the secretariat and is not legally binding or even certain to be persuasive with a WTO tribunal deciding an actual case.

Regardless of the current coverage of the GATS, the biggest concern should be the on-going WTO negotiations on GATS obligations related to “domestic regulation.”

The potential intrusiveness of obligations covering domestic regulations will depend on the test for when they constitute a barrier to trade. It was originally proposed that these standards, requirements and procedures should be “not more burdensome than necessary.” Such a necessity test could have put a range of water policy measures and a range of other regulatory measures in the State of Maine and in other jurisdictions at considerable risk of conflict with GATS obligations.

The chairman’s fourth draft of proposals (January 23, 2008) for the WTO Working Group on Domestic Regulation fortunately took the “necessity test” off the table but unfortunately proposed several new disciplines. If adopted, these disciplines would apply to sectors in which the United States has made commitments under the General Agreement on Trade in Services (GATS), including distribution services.

- ***NAFTA chapter 11, bi-lateral investment treaties, and similar international investment agreements (IIAs) cover groundwater measure. Water policy measures are a frequent topic of international investment litigation.***

As state and local officials from across the country have recognized for many years, IIAs raise serious sovereignty and federalism concerns.

Also, IIAs are a more likely basis for a suit than WTO agreements.

Among other reasons, these problems arise because:

- *IIA definitions of “investment” are very broad;*
- *IIA standards regarding what constitutes a violation as a result of an “indirect expropriation” or a failure to meet the “minimum standard of treatment under international law” including “fair and equitable treatment” are vague and are interpreted broadly by some international tribunals; and*
- *Foreign investors can sue the United States directly, without the need for another nation-state to bring suit.*

Despite the fervent support for international investment agreements by corporate lobbyists in Washington D.C., state and local officials across the country have for many years been concerned about the potential for NAFTA chapter 11 and similar international investment agreements to intrude on state sovereignty and inappropriately constrain state legislative, regulatory, and judicial authority.

Given the broad definition of investment in IIAs, these sovereignty concerns clearly apply to water policy issues, and not surprisingly water policy measures are a frequent topic of international investment litigation.

Most of these cases deal with challenges to governmental authority to regulate threats to health and safety resulting from pollution of groundwater or surface water (for example *Methanex v. United States* and *Metalclad v. Mexico*) or water utility privatization (for example *Azurix v. Argentina*, *Aguas del Tunari v. Bolivia*, and *Biwater v. Tanzania*). There is at least one example of bulk water transport case being filed under NAFTA chapter 11, although that claim has been alleged to be frivolous and never went to arbitration (*Sun Belt Water v. Canada*).

So a challenge under an international investment agreement or bilateral investment treaty to Maine’s authority to regulate its water resources is always possible. Such an international investment claim might be made even if Maine regulates in the public interest and without the intent to discriminate against a foreign firm.



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Preface:

What is the scope of this analysis?

With respect to the risk of an international trade or investment law challenge to Maine's authority to adopt policies and legal measures related to groundwater, this paper provides a general analysis of how the World Trade Organization agreement on trade in goods (GATT), the WTO agreement on trade in services (GATS), and international investment agreements (NAFTA chapter 11 and similar agreements) might apply.

The first step in such an analysis is to determine whether a groundwater measure is even covered by the agreement. Much of the analysis in this paper focuses on the coverage issue because some conclusions can be reached at least in general terms without reference to the facts of a particular case and to the detailed language of the specific law, regulation, administrative decision, or domestic court opinion that is being challenged.

The next two steps in analyzing the potential risk of a successful international lawsuit are to determine whether a specific rule or "obligation" has been violated and even if there is a violation whether an exclusion, an exception, or an annex reservation (grandfathering particular existing measures) applies regardless of the violation of an obligation. It is difficult or more often even impossible to determine whether an obligation has been violated or whether an exception applies without reference to the facts of a specific case or the detailed language of the government regulation or other government measure being challenged. Nonetheless, this paper includes some limited discussion of general and hypothetical situations where an obligation is violated or an exclusion applies.

Finally, this paper provides no analysis of Maine water law. The Maine Attorney General's office is preparing such an analysis. Any hypothetical scenarios regarding future groundwater regulation are included strictly for purposes of illustrating points of international trade law, and are not intended to imply support for or opposition to any new water law or regulation. Keep in mind that international trade and investment

tribunals do not apply United States or Maine domestic law when making a decision. Although of course, domestic law may be part of the factual background of a case, and may be analyzed for its conformity to international law. But, international tribunals decide cases based on the text of the relevant international agreement and international law.¹

¹ For example, NAFTA chapter 11 on investment provides at article 1131 that “ A Tribunal established under this Section shall decide the issues in dispute in accordance with this Agreement and applicable rules of international law,” available at <http://www.nafta-sec-alena.org/en/view.aspx?x=343>; Article 38 of the Statute of the International Court of Justice identifies the following sources of international law: (a) international conventions, whether general or particular, establishing rules expressly recognized by the contesting states; (b) international custom, as evidence of a general practice accepted as law; (c) the general principles of law recognized by civilized nations; (d) subject to the provisions of Article 59, judicial decisions and the teachings of the most highly qualified publicists of the various nations, as subsidiary means for the determination of rules of law. Available at, <http://www.icj-cij.org/documents>.



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- 1. Why is it important to analyze how international trade and investment agreements may impact Maine's management of groundwater resources?** Under U.S. domestic law, Maine has authority to adopt water policy measures in order to protect the public health and the environment and to ensure sustainable supplies of water at a fair price for individual consumption and commercial use. In pursuit of these policy goals, Maine may be asked to consider, for example, new measures to regulate groundwater extraction for export to internal and international markets.

The question is whether international trade and investment law, either already adopted or likely to be considered for adoption in the future, might thwart Maine should the state adopt such water policy measures. It is a good question because the World Trade Organization, NAFTA, and similar international agreements are designed to limit the authority of state legislatures, agencies, and courts in the interest of maximizing the volume and value of international commerce.

NAFTA, the WTO and subsequent trade agreements, the so-called "post-1994 agreements," place limits on state government. Prior to 1994, states had little reason to monitor the course of trade negotiations closely because they focused on tariffs, quotas and similar "at the border" discrimination against foreign products, almost always the

² Policy Director, Forum on Democracy & Trade; Adjunct Professor, Georgetown University Law Center. 111 F Street N.W. #102, Washington D.C. 20001; (202) 662-4236; wtw2@law.georgetown.edu.

business of the federal government. The post-1994 agreements deal not only with "at the border" discrimination, but also impose strict rules related to government regulation, taxation, purchasing and economic development policies that are regarded as non-tariff barriers to trade by the drafters of the agreements. In other words, a large number of measures within state policy jurisdiction are now affected by international law.

In addition, the pre-1994 agreements had no effective enforcement mechanism. But NAFTA, the WTO agreements and other post-1994 agreements (in combination with federal implementing legislation) do. International tribunals created by these agreements have the power to enforce the obligations of the agreement against parties through retaliatory trade sanctions³ or in the case of investment disputes through awards of uncapped money damages for any state or local government measure⁴, including any

³ WTO tribunal decisions can be effectively enforced even though under U.S. implementing legislation for the Uruguay Round agreement private parties do not enjoy a private right of action to in U.S. courts to enforce WTO tribunal decisions. The effectiveness of retaliatory trade sanctions as an enforcement mechanism is illustrated by the dispute over the 2002 U.S. steel tariff. President George W. Bush on March 5, 2002 imposed temporary tariffs on imported steel of 8 to 30 percent. No tariffs were imposed on Mexican and Canadian steel imports because of the threat of retaliatory trade sanctions under NAFTA. The European Union and most other major trading partners filed a complaint with the WTO. In 2003, the WTO ruled against the U.S., authorizing \$2.2 billion in retaliatory trade sanctions potentially including higher tariffs on imports on Florida citrus, on rice, tobacco, clothing, paper, and pleasure boats produced in the South, and steel products, watches, and hand tools produced in the Midwest (Florida and Midwestern states were very much in play in the upcoming U.S. presidential elections). President Bush ultimately backed down and withdrew the steel tariffs well before the 2005 expiration date. BBC News, "Q & A: US-EU Steel Dispute, December 4, 2003, *available at* <http://newsvote.bbc.co.uk/2/hi/business/3391675.stm>.

⁴ International investment tribunals can also effectively enforce their judgments in most cases by demanding payment of money damages to compensate the foreign investor. Nonetheless it must be kept in mind that even if the foreign investor is awarded damages, the NAFTA panel ruling does not automatically result in preemption of state or local law. Nor is there any right of action for private parties to enforce panel rulings in U.S. courts. 19 U.S.C. §3312(c). If U.S. state or local officials are unwilling to amend policies that are popular with the public, federal officials may simply leave the local policy in place, pay damages to the investor, and hope the issue never arises again as an IIA case. In the alternative, the federal government may seek to quietly resolve the issue. For example, federal officials acting behind the scenes might apply political or economic pressure on state officials to "voluntarily" bring state policy in line with the panel ruling. If the investor wins, the United States also has the option of suing to preempt the state law. Unlike private investors, the federal government can sue a state or locality at any time and seek the preemption of state or local measures that do not comply with an international investment agreement. In this connection, state law is in an inferior position to federal law under NAFTA chapter 11 and similar IIAs. If a dispute resolution panel finds that a federal law violates NAFTA's investment chapter, an act of Congress is required to comply with the ruling. North American Free Trade Agreement Implementation Act, Title I, §102 (a), 19 U.S.C. §3312 (1993). In addition to that, state and local governments have repeatedly asked for assurances from Congress and several presidential administrations that if money damages are assessed against the U.S. Treasury as a result of an international investment judgment in which a state and local measure is found to be in violation of international law, the federal government would not seek to directly or indirectly recoup those costs from the state or locality. Neither the Clinton nor the Bush Administration would promise not to try to recoup the cost of an IIA money damages award from state or localities.

groundwater policy measure, deemed to violate international trade and investment law.

As a policy resolution adopted by the National Conference of State Legislatures states, “NCSL also believes that these [trade] agreements must be harmonized with traditional American values of constitutional federalism...[measures] are necessary to ensure that international trade agreements do not adversely impact state budgets or constrain state regulatory authority.”⁵ Certainly, NCSL’s principle applies to state groundwater regulation in Maine and across the country.

2. Why should Maine closely monitor the WTO General Agreement on Tariffs and Trade (GATT) as it applies to trade in water?

Bottled water: Trade in bottled water is covered by the GATT.⁶ According to Howard Mann, a leading expert on trade and the environment, “It is well understood that bottled water, for example, is covered by trade law, and that restrictions on exports of bottled water are, therefore, significantly limited.”⁷

Given that bottled water is covered by the GATT and similar agreements on trade in goods (or products), the next question is what “disciplines” or limitations on government action are imposed. For example, in the case of the GATT, the “most favored nation” discipline at article I requires governments that accord “any advantage, favor, privilege or immunity” to any product destined for one country must accord that same benefit to like

⁵ NCSL policy on Free Trade and Federalism (policy resolutions under the jurisdiction of the Labor and Economic Development Committee, *available at* , <http://www.ncsl.org>.

⁶ *For general background*, Edith Brown Weiss, *Water Transfers in International Trade Law*, in Edith Brown Weiss, Laurence Boisson de Chazournes, & Nathalie Bernasconi-Osterwaler, *Fresh Water and International Economic Law*. Oxford University Press, 2005.

⁷ Howard Mann, “Implications of International Trade and Investment Agreements for Water and Water Services: Some Responses from Other Sources of International Law,” a paper prepared for Agua Sustentable and funded by the International Development Research Center, Ottawa, Canada, May 2006, p. 9 (on file); According to Alix Gowlland Gualtieri, “The most common form in which water can be traded occurs after its transformation or removal from a natural or bulk state. This concerns most prevalently bottled water¹³ and other drinks containing water such as soft drinks and juices. An increasingly lucrative international market in bottled water has emerged as a consequence of growing demand for the good, with Nestlé, Danone, Coca Cola and Pepsi Cola as leading corporations in the field.”*Legal Implications of Trade in ‘Real’ and ‘Virtual’ Water Resources*, IELRC Working Paper 2008-02, International Environmental Law Research Center, Geneva, Switzerland, p.2., *available at* <http://ielrc.org.content/w0802.pdf>.

products destined to all countries belonging to the World Trade Organization. Similarly, article XI of the GATT bars governmental measures, other than taxes, duties, or similar charges, on the “exportation or sale for export of any covered product, absent an exemption.”

So, what exemptions in the GATT would allow application of a government measure to a covered good or product such as bottled water in spite of the disciplines imposed by article XI⁸ and/or article I⁹? Article XX, for example, allows governments to impose measures that would otherwise be prohibited that are “necessary to protect human, animal, or plant life or health” or that relate to “the conservation of exhaustible natural resources if such measures are made effective in conjunction with restrictions on domestic production or consumption.” These two exceptions in article XX, however, are available only where governmental measures “are not applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade.” In parsing the text of article XX, it becomes clear that its exceptions are narrow and subjective in many respects. For example, a WTO tribunal will decide when a measure to protect human, animal, or plant life is “necessary.” Does that mean the measure must be no more trade restrictive than necessary? Similarly, a tribunal will make the subjective judgment about when a measure is a disguised restriction on international trade. Also, governmental measures, to retain exempt status, must apply to goods consumed domestically in the same way they are applied to goods for export. And, measures must be applied to all countries in the same way.

In summary, bottled water is clearly covered by the GATT. What is unclear is how a groundwater measure would violate “most favored nation” or other obligations under the GATT (such as export restrictions under GATT article XI) with respect to trade in bottled water. It might well require strong evidence that groundwater regulation was intended to

⁸ GATT article XI provides that, “No prohibitions or restrictions other than duties, taxes or other charges, whether made effective through quotas, import or export licences or other measures, shall be instituted or maintained by any contracting party on the importation of any product of the territory of any other contracting party or on the exportation or sale for export of any product destined for the territory of any other contracting party.”

⁹ GATT article I provides that, “... article any advantage, favour, privilege or immunity granted by any contracting party to any product originating in or destined for any other country shall be accorded immediately and unconditionally to the like product originating in or destined for the territories of all other contracting parties.”

operate as a disguised or discriminatory restriction trade in bottled water. And even then, the groundwater regulation might be permissible under an Article XX general exemption.

Bulk Water: Commentators disagree about whether bulk water exports are covered by GATT and by trade in goods chapters in free trade agreements such as NAFTA. One school of thought is that bulk water is not a covered good or product. The other school of thought is that while the language of the agreements may not be specific about whether bulk water is covered, given the modern commercial practice of treating water as a commodity, the logic of the GATT agreement leads to the conclusion that bulk water is covered.

The traditional view is that bulk water, in its “natural state,” is not a good or product. For example, with respect to trade --but not investment issues--the parties to NAFTA (Canada, Mexico, and the United States) issued a joint statement in 1993 declaring that “water in its natural state...is not a good or product, is not traded, and therefore is not and never has been subject to the terms of any trade agreement.”¹⁰ With respect to the GATT, the argument is that bulk water does not fit under that agreement’s definition of a product. The GATT defines a product as a “substance produced during a natural, chemical, or manufacturing process.”¹¹ Water in its natural state, it is argued, is not “produced” under this definition. As one commentator notes, the GATT definition implies that “something must be done to water to make it a product, and that mere diversion, pumping, or transfer does not suffice.”¹² Mere water use rights, by this view, do not confer ownership of a product.

Dissenters from this view ask how is it that water does not fit under the GATT definition of a product, when the common practice is to regard other unrefined natural resources as products and goods in international trade.¹³ They also argue that as a matter of recent commercial practice water is being exported as a commodity, just like crude oil, and that tribunals could find this to be a commercial reality that must be recognized. As a report

¹⁰ 1993 Statement by the Governments of Canada, Mexico, and the United States.

¹¹ Bryant Walker Smith, “Water as a Public Good: The Status of Water Under The General Agreement on Tariff and Trade, 2009, available at : http://works.bepress.com/bryant_walker_smith/2_pp.4-6

¹² Smith, pp.4-6.

¹³ Smith, pp.4-6.

of the International Environmental Law Research Centre notes, “New bulk storage and transfer technologies have now been developed to make it possible to move large volumes of water across long distances for commercial purposes, including through massive pipelines, supertankers, or giant sealed water bags.”¹⁴ In other words, a distinction must be made by an international tribunal between “water in its natural state” and “bulk water.” The process of transferring or transporting bulk water in large containers like tanker trucks, rail cars, ships, or maybe even pipelines might be regarded as the equivalent of a production process, with the result that bulk water that is in the stream of commerce and that has been transported in this way is a product covered by GATT. According to Matthew Porterfield, Senior Fellow at Georgetown’s Harrison Institute, it is significant that “water is included within the tariff classification system used by the WTO.”¹⁵ And if water is a “product,” then government groundwater regulation in certain fact situations might violate GATT obligations related to nondiscrimination and export restrictions, unless article XX or some other exception applies.

As Howard Mann explains, “while common sense and some history indicates trade law cannot compel the trade in freshwater resources, the matter is not without doubt, doubt created at least in part by the trade lawyers themselves. This doubt can be compounded if a first export is allowed to occur, as additional limitations or conditions on exports subsequent to a first export may become more difficult to apply due to non-discrimination requirements under trade law.”¹⁶

In summary, it is uncertain whether bulk water is covered by GATT. Nonetheless, a more expansive interpretation of GATT coverage by a future tribunal cannot be ruled out, particularly in circumstances where governments violate article XI export restriction

¹⁴ Gualtieri, p.4; the author also notes on p.6, that “There is no information on the intent of the parties when negotiating the GATT relevant to the applicability of the [GATT] Agreement to bulk transfers of water, and this question has indeed never been discussed in the framework of the WTO. Indeed, the absence of an explicit exclusion of water from the GATT has been read as arguing for the applicability of the Agreement to trade in this resource. On the other hand, water might not be mentioned because trading large amounts of water between states was not envisaged until recent years.”

¹⁵ “The General Agreement on Tariffs and Trade is the centerpiece of the WTO system. It covers trade in goods. There’s been a vigorous debate whether water in its “natural state” -- lakes, streams, aquifers -- constitutes a good or “product” and is therefore covered under the GATT. Water is included within the tariff classification system used by the WTO.”, *available at, <http://forumdemocracy.net/article>.*

¹⁶ Mann, *above*, p. 10.

obligations or allow one firm to export bulk water and then change the rules to restrict or stop large-scale groundwater pumping and transfers across national borders by a second foreign firm, thus violating a GATT principle of non-discrimination, such as the article I “most favored nation” obligation.

- 3. Why should Maine closely monitor water services issues raised by the General Agreement on Trade in Services (GATS)?** Maine should be concerned about the potential for GATS coverage of water services because of the potential effect on state regulatory authority over natural resources and the environment and also because access to water is a human right.¹⁷ Despite the protestations of the WTO secretariat, the General Agreement on Trade in Services (GATS) is relevant to these concerns because the distribution of water is a service. And, the transportation of water is a service.

The secretariat of the World Trade Organization strongly denies that GATS restricts public water services or public interest regulation of privately-supplied water services: “The number of Members which have so far made GATS commitments on water distribution services is zero. If such commitments were made, they would not affect the right of governments to set levels of quality, safety, price, or any other policy objectives as they see fit, and the same regulations would apply to foreign suppliers as to nationals. A foreign supplier which failed to respect the terms of its contract or any other regulation would be subject to the same sanctions under national law as a national company, including termination of the contract...It is of course inconceivable that any government would agree to surrender the right to regulate water supplies...”¹⁸

The WTO statement, itself, reveals reasons not to be reassured.

First, while no country has made a commitment on water distribution services per se, they

¹⁷ Several respected commentators and even the United Nations High Commissioner for Human Rights have expressed concern that liberalization of trade in services could pose challenges to governments’ obligation to promote a right to health, including access to an adequate supply of safe and potable water.¹⁷ United Nations, Economic and Social Council, Report of the High Commissioner, “Liberalization of Trade in services and Human Rights,” June 25, 2002 p. 17, 21(Given that FDI [foreign direct investment] is primarily driven by commercial objectives, the promotion of FDI in areas such as the health, water, and education sectors will not necessarily be the most effective means of ensuring universal access to entitlements that at times can be unprofitable. Further, privatization that is leading to an increasingly large and powerful private sector can also threaten the Government’s role as a primary duty bearer for human rights.” para. 44.)

¹⁸ WTO, “GATS: Fact and Fiction: The WTO is not after your water,” *available at*, http://www.wto.org/english/tratop_e/serv_e/gats_factfiction8_e.htm.

may choose to do so in the future.

Second, the United States has made or in the future may make commitments on general distribution services, transport services and other service sectors that might result in GATS litigation affecting regulation of groundwater pumping and transport. In other words, the WTO statement can be read to only apply to drinking water services provided as a public utility, and to be irrelevant to the issue of whether regulation of large-scale groundwater pumping and transportation violates other GATS obligations of the United States related for example to transportation services (such as maritime transport, rail transport, road transport and pipeline transport).

Third, as the WTO statement makes clear the key to any potential GATS litigation on water services would be the contract between the foreign supplier and the government. Does that mean that government regulations responding to changed circumstances or a shift in public opinion after the signing of the contract could themselves be a breach of contract? Could the existence of the contract imply a guarantee of a stable legal, tax, or regulatory environment for the foreign supplier?

Fourth, it is entirely conceivable, contrary to the WTO secretariat's expectation, that a government might intentionally or unintentionally surrender its right to regulate water supplies, as a result of a cozy relationship between government officials and the foreign suppliers or simply as a result of being unfamiliar with international trade law or of being "out-lawyered" by the foreign supplier.

Finally, the WTO statement on water services is only the view of the secretariat and is not legally binding or even certain to be persuasive with a WTO tribunal deciding an actual case.

Andrew Lang, a GATS scholar at Cambridge University in England, observes, " ...one can attempt the difficult task of assessing the risk of claims against water sector regulation will be successful. There is no doubt that, at times, this risk has been overstated by GATS critics. But, this analysis suggests that one must approach with caution claims that the risk is nothing more than minimal."¹⁹

¹⁹ Andrew Lang, "The GATS and Regulatory Autonomy: A Case Study of Social Regulation of the Water Industry," *Journal of International Economic Law*. 2004 7(4), Oxford University Press, pp. 836-837, Available at, <http://jiel.oxfordjournals.org/cgi/reprint/7/4/801>.

At the very least, the capacity of Maine to adopt groundwater measures and manage water resources in light of potential conflicts with the GATS bears watching. In particular, any resumption of GATS negotiations on domestic regulation and the future interpretations of U.S. commitments on water related to distribution and transportation services should be monitored closely.

This is despite the European Union's decision not to seek inclusion of "water for human use" as a sector of economic activity that should come under the scope of GATS regulation and despite the fact that the United States has not made a commitment to subject drinking water services to GATS disciplines, up to this point.²⁰ The United States Trade Representative (USTR) has assured states that the United States has no current plans to make such a commitment. But, could those plans change if such a compromise could restart Doha Round negotiations in ways that would be favorable to the United States in other sectors? Moreover as noted above, "water for human use" may be understood narrowly to cover drinking water utilities, not other groundwater measures, such as those relating to or affecting cross-border transportation of large quantities of bulk water.

Of even greater concern to Maine should be the on-going WTO negotiations on GATS obligations related to "domestic regulation." The potential intrusiveness of obligations covering domestic regulations will depend on the test for when they constitute a barrier to trade. It was originally proposed that these standards, requirements and procedures should be "not more burdensome than necessary."²¹ Such a necessity test could have put a range of water policy measures and a range of other measures in the State of Maine and

²⁰ According to the European Federation of Public Service Unions, "In its recent plurilateral requests on environmental services, EC [European commission] and other demandeurs have categorically excluded "water for human use" as a result of strong civil society pressure. However water is still involved in many other areas of WTO negotiations that can be of equal threat to our demand for access to water as a basic human right. This is of concern to waste water treatment for example." Available at, <http://www.epsu.org/a/1865>.

²¹ "The chairman's fourth draft continues to leave out the proposal from Australia, Hong Kong and New Zealand that requires domestic regulations to be "no more burdensome than necessary to ensure the quality of a service." This is no doubt due to resistance from the United States, Brazil and other nations who view the necessity test as incompatible with domestic regulatory authority. The strongest statement to date on this issue has been the March 2007 outline of negotiating principles by the United States Trade Representative (USTR)." Memorandum to Kay Wilkie, Chair, Intergovernmental Policy Advisory Committee (IGPAC) from: Robert Stumberg, February 12, 2008, re: WPDR chairman's fourth draft on domestic regulation, dated 23 January 2008, p3, available at, <http://www.forumdemocracy.net/downloads/Stumberg/WPDRdraftJan-08>.

in other jurisdictions at considerable risk of conflict with GATS obligations.²²

The chairman's fourth draft of proposals (January 23, 2008) for the WTO Working Group on Domestic Regulation²³ fortunately took the "necessity test" off the table but "[i]n place of ensuring "necessity," the fourth draft states that one purpose is to ensure that regulations "do not constitute disguised restrictions on trade in services." This purpose would inform how dispute panels interpret the disciplines. In recent disputes, the WTO has found disguised restrictions when countries have failed to consult and seek less-trade-restrictive alternatives in response to complaints that measures violate trade rules. In other words, avoiding "disguised barriers" has a meaning that is similar to the necessity test."²⁴

"Like prior versions, the chairman's fourth draft recognizes the "right to regulate ... in order to meet national policy objectives." However, the fourth draft deleted language that referred to subnational governments, and the third draft had weakened the previous version, which was the right to regulate in order to meet "domestic" policy objectives. To come within the GATS right to regulate, states would have to seek an endorsement of state policy from the federal government."²⁵

²² If something similar to the necessity test is agreed upon in Geneva, the Center for International Environmental Law identified several areas where water policy could be threatened, including among others: qualifications of water service providers; the use of licenses, permits, and technical regulations and standards related to pollution discharges, operating permits, and other water policy measures; the use of environmental criteria related to water services in awarding concession contracts or assessing licensing fees; and requirements for water sustainability impact assessments before issuing licenses. CIEL (document on file, Harrison Institute for Public Law, Georgetown University Law Center) p. 2.

²³ Working Party on Domestic Regulation (WPDR), Revised Draft, Disciplines on Domestic Regulation Pursuant to GATS Article VI:4, Informal Note by the Chairman, 23 January 2008 (Room Document), available at <http://www.tradeobservatory.org/library.cfm?refID=101417> .

²⁴ Memorandum to Kay Wilkie, p.3. "Another change in the fourth draft is where it defines an obligation on governments to publish 'detailed information' on regulations. Mandatory details include applicable technical standards, appellate process, monitoring, public involvement, exceptions and normal time frames." *Id.*

²⁵ Memorandum to Kay Wilkie, p.3. Also, "The fourth draft retains 48 paragraphs of substantive and procedural disciplines from the prior drafts. ...Among the most significant proposals, several create a spectrum of possible meanings. These meanings *could be* consistent with constitutional authority to regulate in the United States, but they *could also be* interpreted as an obligation to regulate in the least-burdensome way. For example:

o *A relevance test* ... could exclude criteria that are external to the quality of a service being supplied, criteria such as environmental, historical or aesthetic impacts.

As Stumberg notes, the disciplines proposed in the chairman's fourth draft, "would cover U.S. commitments and offers in over 90 service sectors, many of which are regulated by states or operated by local governments ... [including distribution and transportation services, among many others]... Many of the proposed GATS disciplines reflect best practices. Yet neither Congress nor state legislatures have imposed such disciplines on regulatory agencies, primarily owing to the complexity of regulating service industries. If proposed as domestic law, the disciplines as proposed by the chairman would be controversial. Lawyers will recognize some proposed disciplines as variations on substantive due process, one of the most contentious areas of constitutional law. Other disciplines, if adopted as domestic law, would be changes in the federal or state administrative procedure acts."²⁶

The outcome of negotiations within the Working Group on Domestic Regulation will be vital for Maine and all other U.S. states and localities engaged in water policy and other forms of natural resources, public health, and public utility policy.²⁷

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- o *Pre-established test* ... could affect the law of when development rights or property rights vest, meaning at what point in time regulatory changes are applicable.
 - o *An objectivity test* ... could exclude subjective standards such as "just and reasonable" authority that legislatures delegate to public utility commissions to regulate in the public interest. See page
 - o *Simplicity test* ... could affect licensing and standards of operation in the most complex service industries, where typically, procedures reflect a balance of regulator vs. industry needs.

WTO dispute panels would have to interpret this array of tests, which are neither simple nor objective. Not only are they novel, thus lacking in precedents, but one test is likely to influence interpretation of another." *Id. p. 4.*

²⁶ Memorandum to Kay Wilkie. p. 1-2.

²⁷ The Intergovernmental Policy Advisory Committee (IGPAC) Services Working Group (representing state and local governments in the USTR advisory process) has highlighted several of these disciplines as posing a significant risk of conflict with state regulations that neither discriminate nor limit market access. For example, the IGPAC group expressed:

- (1) "Serious concern [about disciplines that require domestic regulations to be] 'pre-established, based on objective criteria and relevant...' given the potential for unacceptable constraints on the scope and exercise of state/local regulatory authority, particularly related to complex and emerging industries." IGPAC is referring to the fact that a term like "objective" has been interpreted by the WTO in ways that are inconsistent with regulatory practice in the United States, and
- (2) "Active opposition to the extremely objectionable omission of any mention of sub-federal policy objectives from [the section that states a principle of deference to legitimate national policy objectives]." Instead, the IGPAC services working group recommends the following language: "National policy objectives include objectives identified at national or sub-national levels."

In summary, whether groundwater regulation and related water policies are covered by GATS is uncertain. Rebecca Bates, an Australian trade law scholar observes that, “The existence...of continuing debate and uncertainty as to the interpretation of the agreement means that the power and impact of GATS will not be wholly known until it is applied to the water and sanitation market in a real world situation...greater certainty may be achieved through specifically excluding water and sanitation services from the scope of the agreement. The essential nature of water and sanitation for human health and survival sets this service area apart from many others when discussing liberalization of a service area, and the existence of a human right to water means that extra care must be taken before water in any form is subject to free trade obligation.”²⁸

4. Why should the Maine Commission closely monitor international investment litigation? Despite the fervent support for international investment agreements by corporate lobbyists in Washington D.C.²⁹, state and local officials across the country have

Memo from Kay Wilkie, chair of the Intergovernmental Policy Advisory Committee, Services Working Group, to Daniel Watson, Office of the U.S. Trade Representative (February 12, 2008).

²⁸ Rebecca Bates, 31 Sydney Law Review, 121, 142 (2009).

²⁹ Business groups that want to expand investor rights include:

U.S. Council for International Business. USCIB is the American affiliate of the International Chamber of Commerce (ICC), the Business and Industry Advisory Committee (BIAC) to the OECD, and the International Organisation of Employers (IOE). USCIB now supports expansion of investor-state arbitration to Brazil, India and China, and in the Korea FTA negotiations, urged U.S. negotiators to “return to the provisions of the model BIT,” rather than crafting exceptions to deal with sensitive sectors such as government services. USCIB, Recommendations on Objectives for the U.S.-Korea FTA (March 24, 2006) 9, available at <http://www.uscib.org/index.asp?documentID=829> (viewed May 10, 2009).

National Association of Manufacturers. NAM supports a multilateral agreement on investment under the OECD and expansion of BITs to include Russia, China, Brazil, India, the EU and Japan. NAM, 2.01 International Investment, available at <http://www.nam.org/policypositions/> (viewed May 10, 2009).

U.S. Chamber of Commerce. The Chamber also supports trans-Atlantic investment negotiations through the OECD. Its goals are to limit “increasingly burdensome” investment regulations and standards on technology, environment, health and safety. U.S. Chamber of Commerce, Unleashing Our Economic Potential: A Primer on the Transatlantic Economic Council (2008), Appendix II.E, available at http://www.uschamber.com/publications/reports/0804econ_potential.htm (viewed September 7, 2008); U.S. Chamber of Commerce, Global Regulatory Cooperation Project, available at <http://www.uschamber.com/grc/default> (viewed September 7, 2008).

Emergency Committee for American Trade. In principle, ECAT supports the negotiating objective of “no greater substantive rights” for foreign investors. However, it opposes interpretive notes or congressional action to clarify open-ended language on expropriation and the minimum standard of treatment, saying that these terms “should properly be an issue for the investor-state tribunal.” About ECAT, available at <http://www.ecattrade.com/about/> (viewed May 10, 2009); ECAT, Bulletin #15: Bipartisan TPA Act v. Kerry Amendment (2002).

for many years been concerned about the potential for NAFTA chapter 11 and similar international investment agreements³⁰ to intrude on state sovereignty and inappropriately constrain state legislative, regulatory, and judicial authority.³¹ Given the broad definition of investment in IIAs, these sovereignty concerns clearly apply to groundwater policy issues. Not surprisingly water policy measures are a frequent topic of international investment litigation.³²

³⁰ The modern model for protecting foreign investments, embodied in NAFTA chapter 11, has its origins in the 1970s when the United States concluded bi-lateral investment treaties (BITS) with several developing countries. Among the distinguishing features of BITS are: (1) broad and largely undefined provisions for protecting the property rights of foreign investors, such as “indirect expropriation,” (2) an investor-to-state dispute resolution mechanism, which provides standing for an individual foreign investor to invoke international arbitration against a nation-state, based on allegations that a governmental measure violates treaty provisions protecting foreign property rights, and (3) enforcement of international tribunal decisions with awards of money damages to foreign investors in compensation for such treaty violations. See, Matthew C. Porterfield, “International Expropriation Rules and Federalism,” *Stanford Environmental Law Journal*, Vol. 23, No. 1, January 2004, pp.36-39.

³¹ State government groups that call for reform of international investment agreements in order to protect state sovereignty, include:

Intergovernmental Policy Advisory Committee. IGPAC, the state and local advisory committee to USTR, filed its most recent comments on investment under the pending Colombia FTA. IGPAC urges U.S. negotiators to codify the holding of the *Methanex* panel to limit expropriation, limit the minimum standard of treatment to procedural due process and reject substantive due process, require investors to exhaust judicial remedies, and reimburse the states (CA, MA, MS, VA) that have been “heavily taxed” in defending investor-state disputes. IGPAC, *Advisory Committee Report to the President, the Congress and the United States Trade Representative on the US-Colombia Trade Promotion Agreement*, September 15, 2006, 3 and 20-22.

National Conference of State Legislatures. NCSL opposes investor-state arbitration: “Trade agreement implementing language must include provisions that deny any new private right of action in U.S. courts or before international dispute resolution panels based on international trade or investment agreements.” NCSL also calls for U.S. negotiators to: (1) “carve out” state laws that might be subject to challenge, (2) use a “positive list” approach to defining the scope of covered investments, and (3) enable states to “make adjustments” to limit coverage of state policies. NCSL, *Free Trade and Federalism, 2008 - 2009 Policies for the Jurisdiction of the Labor and Economic Development Committee*, available at http://www.ncsl.org/standcomm/sclaborecon/sclaborecon_Policies.htm#FreeTrade.

Conference of Chief Justices. CCJ is concerned that investor-state arbitration “can undermine the enforcement and finality of state court judgments.” CCJ, Resolution 26, adopted as proposed by the International Agreements Committee at the 56th Annual Meeting on July 29, 2004.

Cities, mayors CSG. National League of Cities, U.S. Conference of Mayors, Council of State Governments and National Conference of State Legislatures, joint letter to Ambassador Robert Zoellick (September 23, 2003).

National Association of Attorneys General. NAAG asked Congress to “ensure that ... foreign investors shall receive no greater rights to foreign compensation than those afforded to our citizens.” NAAG, Resolution, Spring Meeting, March 20-22, 2002, Washington, DC.

Association of Towns and Townships. Tom Haliki, Executive Director, NATaT, letter to U.S. Senators (April 4, 2002).

³² Argentina alone has been sued in at least 8 different water cases: (1) *Compañía de Aguas del Aconquija S.A. and Vivendi Universal v. Argentina Republic* (ICSID Case No. ARB/97/3); (2) *Azurix Corp. v. Argentine Republic* (ICSID Case No. ARB/01/12); (3) *Azurix Corp. v. Argentine Republic* (ICSID Case No. ARB/03/30); (4) *SAUR International v. Argentine Republic* (ICSID Case No. ARB/04/4); (5) *Suez, Sociedad General de Aguas de Barcelona S.A. and Interagua Servicios Integrales de Agua S.A. v. Argentine Republic* (ICSID Case No. ARB/03/17); (6) *Suez, Sociedad General de Aguas de Barcelona S.A. and Vivendi Universal S.A. v. Argentina Republic* (ICSID Case No. ARB/03/19) consolidated with *AWG Group plc v. Argentina* (UNCITRAL); (7)

Most of these cases deal with challenges to governmental authority to regulate threats to health and safety resulting from pollution of groundwater or surface water (for example *Methanex v. United States* and *Metalclad v. Mexico*³³) or water utility privatization (for example *Azurix v. Argentina*, *Aguas del Tunari v. Bolivia*, and *Biwater v. Tanzania*³⁴). There is at least one example of bulk water transport case being filed under NAFTA chapter 11, although that claim has been alleged to be frivolous and never went to arbitration (*Sun Belt Water v. Canada*³⁵).

So a challenge under an international investment agreement or bilateral investment treaty to Maine's authority to regulate its water resources is always possible.

Such an international investment claim might be made even if Maine adopts measures in the public interest and without the intent to discriminate against a foreign firm. For example, in *Metalclad v. Mexico*, an international tribunal found a violation of NAFTA's chapter 11 on investment when state and local governments took regulatory action to stop operation by U.S.-based Metalclad Corporation of a hazardous waste disposal facility believed to be a threat to drinking water safety and the environment. *See appendix II.*

This suggests that Maine may want to work with the U.S. Trade Representative's office and with the Maine congressional delegation to seek an official interpretation of NAFTA chapter 11 and clear language in future agreements and treaties that will codify parts of

Impregilo S.p.A. v. Argentine Republic (ICSID Case No. ARB/07/17) ; (8) *Urbaser S.A. and Consorcio de Aguas Bilbao Biskaia, Bilbao Biskaia Ur Partzuergoa v. Argentine Republic* (ICSID Case No. ARB/07/26) . Information on ICSID cases available at, <http://icsid.worldbank.org/ICSID/Index.jsp>.

³³ *Metalclad v. Mexico*, available at, <http://naftaclaims.com/Disputes/Mexico/Metalclad/Metalcladfinalaward.pdf>; Award, *Methanex v. United States*, available at, http://naftaclaims.com/disputes_us_methanex.htm. *See appendix II.*

³⁴ *Azurix*, above. Investment Treaty News, 'Azurix Wins Claim Against Argentina,' International Institute for Sustainable Development, July 26, 2006, available at <http://www.iisd.org/investment/itn>.; Jim Schultz, "Bechtel v. Bolivia: The People Win" (Bechtel settles for only symbolic damages), Latin America Solidarity Centre, January 19, 2006, available at, <http://www.lasc.ie/news/bechtel-vs-bolivia.html>.; Award, *Biwater Gauff Ltd. v. Republic of Tanzania*, available at <http://www.worldbank.org/icsid/cases/awards.htm#awardarbo0522>; [Epaminontas E. Triantafilou](http://www.whitecase.com/whitecase/epaminontas), "No Remedy for an Investor's Own Mismanagement: The Award in the ICSID Case *Biwater Gauff v. Tanzania*," International Disputes Quarterly, White & Case, Winter 2009, available at, http://www.whitecase.com/idq/winter_2009_4/.

³⁵ Notice of Intent to Submit a Claim to Arbitration, November 27, 1998 and Notice of Claim and Demand for Arbitration, *Sun Belt Water v. Canada*, October 12, 1999, available at, <http://sunbeltwater.com/docs.shtml>.

the *Methanex* and *Glamis Gold* decisions and otherwise protect bona fide government regulations, including water regulations, from any *Metalclad*-type claim that might be based on the actions of the State of Maine. Codification of the favorable decisions in *Methanex* and *Glamis Gold* is essential because there is no rule of precedent or *stare decisis* in customary international investment law.³⁶ Nor is there even an authoritative appellate body to reconcile conflicts between different tribunal rulings. Unfortunately powerful business lobbies and corporate lawyers in Washington D.C. oppose such reform measures and codification of the rules in *Methanex* and *Glamis Gold* in particular.³⁷

The problem with international investment treaties and agreements is fundamentally structural. International investment treaties and agreements allow foreign investors to file claims against national governments seeking money damages in compensation for regulation at the national, state, or local level. Investors no longer have to work through trade ministries to pursue a claim. As a result, the volume of cases increases. Generally lacking a diplomatic screen, the claims may be brought without the restraint that nation-states exercise when dealing with issues of international relations.³⁸ And, international investment tribunals can effectively enforce their decisions by ordering the national

³⁶For example, article 1136(1) NAFTA provides that: “An award made by a Tribunal shall have no binding force except between the disputing parties and in respect of the particular case.” available at <http://www.nafta-sec-alena.org/en/view.aspx?x=343>. Moreover, case law is not supposed to be a source of customary international law. “Customary international law results from a general and consistent practice of states followed by them from a sense of legal obligation.” Restatement (Third) of the Foreign Relations Law of the United States § 102(2) (1987).

³⁷ Objecting to the proposal to codify the rule in *Methanex*, Linda Menghetti, from the Emergency Committee for American Trade writes, “Professor Stumberg proposes that the U.S. should “[n]arrow indirect expropriation so that it does not apply to nondiscriminatory regulations as explained in the *Methanex* award.” *Methanex* provides, in pertinent part, that “a non-discriminatory regulation for a public purpose, which is enacted in accordance with due process and which affects, *inter alia*, a foreign investor or investment is not deemed expropriatory and compensable” Professor Stumberg’s proposal would significantly narrow an investor’s rights and would be inconsistent with international law.” Additional Views Submitted on Behalf of the Emergency Committee for American Trade, Hearing on “Investment Protections in U.S. Trade and Investment Agreements,” held by the Subcommittee on Trade of the House Committee on Ways and Means on May 14, 2009, available at, <http://waysandmeans.house.gov/hearings>. ;For objections from the international business community and bar regarding the award in *Glamis Gold v. United States*, see Report of the Advisory Committee on International Economic Policy Regarding the Model Bilateral Investment Treaty, U.S. Department of State, September 30, 2009, pp. 3-4, pp.18-19; statement appended to the Report from Steven Canner, U.S. Council for International Business, Jennifer Haworth McCandless, Sidley Austin LLP, and Linda Menghetti, Emergency Committee for American Trade, pp.19-20; statement appended to the Report from Shaun Donnelly, National Association of Manufacturers, p. 20; statement appended to the Report from Sean Heather, U.S. Chamber of Commerce ; statement appended to the Report from Judge Stephen Schweibel, independent arbitrator p. 34. (on file Forum on Democracy & Trade).

³⁸ NAFTA provides for diplomatic screens for cases involving tax measures at article 2103(6), financial services regulation at article 1419, and interpretation of annexes at article 1132, available at <http://www.nafta-sec-alena.org/en/view.aspx?x=343>.

government to pay money damages to the foreign investor.³⁹

By its very nature international investor-state dispute resolution grants greater procedural rights to foreign corporations and investors than those enjoyed by Americans. International investment treaties and agreements provide a private right of action for foreign corporations to initiate claims for economic damages against the national government where the investment is located. Multinational corporations and other investors are placed on an equal footing with nation-states. This by itself is a significantly greater procedural right.

Provisions for the selection of arbitrators similarly provide greater procedural rights. Arbitrators in these cases are typically international commercial lawyers who may alternately serve as arbitrators in one case and plaintiff's counsel in the next, thus raising questions of conflict of interest.

International investment agreements also grant foreign investors greater substantive rights than those accorded U.S. investors under the U.S. constitution. The definition of investment, expropriation rules, and rules on the minimum standard of treatment under international law all potentially sweep more broadly than comparable concepts in U.S. constitutional law.

The current US model for international investment treaties and agreements contains a sweeping definition of investment. For example, the definition includes the expectation of gain or profit and the assumption of risk. And, any interests resulting in the commitment of capital also might be considered an investment.⁴⁰

In contrast to the narrow construction by U.S. courts of analogous property rights protections in the Fifth Amendment "takings" clause and the even more narrow

³⁹ If state officials are unwilling to amend policies that are popular with the public, federal officials may simply leave the state policy in place, pay damages to the investor, and hope the issue does not arise again as a NAFTA case. In the alternative, the federal government may seek to quietly resolve the issue. For example, federal officials acting behind the scenes might apply political or economic pressure on state officials to "voluntarily" bring state policy in line with the panel ruling. If the investor wins, the United States also has the option of suing to preempt the state law. Unlike private investors, the federal government can sue a state or locality at any time and seek the preemption of state or local measures that do not comply with NAFTA, 19 U.S.C. §3312(c); 19 U.S.C. §102(c).

⁴⁰ *For example, look at section C., article 10.28, U.S./Peru Free Trade Agreement.*

construction of constitutional property clauses in other legal systems,⁴¹ international arbitrators have room to read the vague expropriation language of international investment treaties and agreements broadly or narrowly. The arbitrators in *Methanex v. United States* interpreted NAFTA's expropriation rule narrowly, but the tribunal in the earlier case of *Pope & Talbot* gave the same language a broad construction.⁴² Accordingly, the construction of the expropriation article of IIAs in future cases is unpredictable, particularly given that there is no rule of precedent or *stare decisis* in international investment law. Unless IIA expropriation articles are reformed by codifying the *Methanex* rule or by otherwise reflecting the international legal norm that police-power regulations are not compensable, some IIA tribunals will bestow greater rights to foreign investors than U.S. investors enjoy under one of the more 'property-rights friendly' constitutions in the world (and thereby radically depart from the norm under domestic law in legal systems around the world).

The obligation on parties to provide a minimum standard of treatment (MST) including "fair and equitable treatment" under international law is also vague and subject to being read broadly or narrowly.⁴³ International investment tribunals are not in agreement on the scope of MST rules. In contrast to the consistently narrow construction by modern

⁴¹ While U.S. constitutional case law construes the analogous Fifth Amendment Takings Clause narrowly compared to the construction of "expropriation" by many international investment tribunals, U.S. courts do recognize "regulatory takings" when the regulation eliminates all or substantially all economic value, *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003 at 1019 n.8, (1992) ("It is true that in at least some cases the landowner with 95% loss will get nothing, while the landowner with total loss will recover in full"), thereby providing in the U.S.A. greater protection of property rights than is the norm in other legal systems around the world. See A.J. Van der Walt, *Constitutional Property Clauses: A Comparative Analysis*, (1999) p.17 ("the distinction between police-power regulation of property and eminent-domain expropriation of property is fundamental to all [constitutional] property clauses, because only the later is compensated as a rule. Normally, there will be no provision for compensation for deprivations or losses caused by police-power regulation of property.").

⁴² The NAFTA tribunal decision in *Methanex v. United States* reads the rule relatively narrowly, concluding that: "as a matter of international law, a nondiscriminatory regulation for a public purpose, which is enacted in accordance with due process and which affects...a foreign investor or investment is not deemed expropriatory or compensatory," unless specific commitments to refrain from regulation were made to the investor. *Methanex v. United States*, Final Award, part IV, chapter D, paragraph 7 (2005). In sharp contrast, the NAFTA panel in *Pope & Talbot*, although it ultimately rejected Pope and Talbot's expropriation claim, said economic regulation, even when it is an exercise of the state's traditional police powers, can be a prohibited indirect or "creeping" expropriation under customary international law if it is "substantial enough." *Pope & Talbot v. Canada*, Interim Award by Arbitral Tribunal, In the Matter of an Arbitration Under Chapter Eleven of The North American Free Trade Agreement Between Pope & Talbot Inc. and The Government of Canada (April 10, 2001), pp. 33-34, available at <http://www.naftaclaims.com>.

⁴³ See generally Matthew C. Porterfield, *An International Common Law of Investor Rights?* 27 U. Pa. J. Int'l Econ. L. 79 (2009).

U.S. courts of analogous “substantive due process” obligations, many international investment tribunals give a broad construction to the minimum standard of treatment obligation. On the other hand, a NAFTA tribunal in the recently decided case of *Glamis Gold v. United States* read it more narrowly.

One line of tribunal decisions, for example, has indicated that the minimum standard of treatment imposes a duty on governments to change maintain a stable and predictable legal environment.⁴⁴ By contrast, under U.S. substantive due process analysis and presumably under due process principles embodied in other legal systems, governments are generally free to change regulatory standards in response to changed circumstances or priorities. Some tribunals have also noted that the minimum standard of treatment is continuing to “evolve,” suggesting that the scope of protection that it provides to foreign investors will continue to expand.⁴⁵

This expansive reading of the MST obligation, however, was rejected by the tribunal in *Glamis Gold*. The tribunal ruled for the United States in this landmark case,⁴⁶ in which Glamis, a Canadian corporation, sued under NAFTA’s chapter 11, seeking \$50 million in compensation for actions taken by the U.S. Department of Interior and the State of California, imposing environmental and land use regulations on Glamis’s proposed open-pit gold mine in the Imperial Valley of California. The tribunal decision in *Glamis* may represent an important advance when it comes to preserving

⁴⁴For example, Azurix, a U.S. water services company won a multi-million dollar award against Argentina under the US-Argentina Bilateral Investment Treaty (BIT), based on the finding of the arbitral tribunal that Argentine water regulators had violated the “fair and equitable treatment” provisions of the minimum standard of treatment article in the U.S./Argentine BIT. Other examples include *Saluka Investments BV v. Czech Republic*, UNCITRAL, Permanent Court of Arbitration, Award (Mar. 17, 2006), available at <http://ita.law.uvic.ca/documents/Saluka-PartialawardFinal.pdf>; and *Occidental Petroleum Exploration and Production Co. v. Ecuador*, para. 191 (UNCITRAL Arb.) (2004). According to the United Nations Conference on Trade and Development: “*On fair and equitable treatment*, several recent decisions have upheld and reinforced a broad acceptance of the FET standard in line with the often-cited *Tecmed* award in 2003. In *LG&Ev. the Argentine Republic*, for example, the tribunal affirmed that the “*fair and equitable standard consists of the host State’s consistent and transparent behaviour, free of ambiguity that involves the obligation to grant and maintain a stable and predictable legal framework necessary to fulfill the justified expectations of the foreign investor.*” This reading is in line with the other awards rendered in 2006 in *Azurix v. The Argentine Republic* and *Saluka v. The Czech Republic.*” UNCTAD, Latest Developments In Investor-State Dispute Settlement, IIA Monitor No. 4, United Nations, New York Geneva, 2006, p. 4.

⁴⁵ Award *Mondev Int’l Ltd. V. United States*, Case No. ARB(AF)/99/2, para. 116, ICSID (W. Bank) (Oct.11, 2002).

⁴⁶The United States was the ‘defendant’ in this case, even though the case concerns California state law and regulation, by virtue of the fact that the US federal government, and not California, is the signatory of the NAFTA treaty.

governmental regulatory authority in the face of property rights claims based on minimum standard of treatment obligations, depending on the outcome of future cases.⁴⁷ Again, the problem is that *Glamis* is not controlling precedent.

Professor Stumberg nicely summarizes the general state sovereignty problems with international investment agreements and the politically-possible IIA reforms that would substantially mitigate those problems,⁴⁸ “To date, the U.S. defense team has successfully defended against NAFTA investor-state claims. Yet behind closed doors, there is significant concern that NAFTA panels will begin to rule against the United States.”⁴⁹ For example, Abner Mikva, a former congressman and retired federal circuit court judge, was the U.S. government’s appointed arbitrator in *Loewen v. United States*. Judge Mikva recounted a meeting with U.S. officials prior to the panel being constituted. ‘You know, judge,’ they said, ‘if we lose this case we could lose NAFTA.’ ‘Well, if you want to put pressure on me,’ Mikva replied, ‘then that does it.’⁵⁰ As BITS and FTAs multiply, more

⁴⁷ Transcripts, submissions, and tribunal orders in *Glamis Gold v. United States* may be found at <http://www.state.gov/oc/s/1/c10986.htm>. The *Glamis* tribunal rejected the plaintiff’s broad reading of MST, finding that none of the actions of the United States or the State of California violated the obligation to provide “fair and equitable treatment,” a standard that must be understood as “customary international law,” under the official interpretation of MST by the NAFTA Free Trade Commission. “Custom,” the tribunal concluded, is a question of fact that must be found in the “practice of states.” The baseline for understanding the customary international law standard for fair and equitable treatment, the tribunal said, was established in the 1926 *Neer* arbitration. The tribunal further determined that no convincing evidence based on the practice of states had been presented by Glamis Gold to show that the *Neer* standard has evolved to encompass a right to a “stable regulatory and business climate” and similar concepts. In other words, just as in 1926 a violation of the standard of “fair and equitable treatment” requires that an act by a nation-state must be: (1) “sufficiently egregious and shocking—a gross denial of justice, manifest arbitrariness, blatant unfairness, a complete lack of due process, evident discrimination, or a manifest lack of reasons,” or (2) “creation by the State of objective expectations in order to induce investments and the subsequent repudiation of those expectation.” Based on its application of the *Neer standard*, the tribunal concluded that none of the acts of the United States and the State of California about which Glamis Gold complained violated the customary international law standard.

⁴⁸ Robert Stumberg, “Reforming Investor Rights,” testimony before the U.S. House Ways and Means Committee, Subcommittee on Trade, May 14, 2009. (on file).

⁴⁹ There is considerable speculation about why the United States has not lost any NAFTA cases, including open discussion by arbitrators about the pressures of deciding claims against the United States. See, e.g., David Schneiderman. “Judicial Politics and International Investment Arbitration: Seeking an Explanation for Conflicting Outcomes” ExpressO, (2009), available at: http://works.bepress.com/david_schneiderman/1 (viewed May 10, 2009) (“Not so easily explained are conflicting tribunal awards drawing on virtually identical facts, invoking the same treaty text, where arbitrators seemingly change their mind from one case to the next without any explanation.”)

⁵⁰ Remarks of Judge Abner Mikva, Symposium: The Judiciary and Environmental Law, Panel on Trade, the Environment and Provincial/State Courts, Pace University School of Law, White Plains, New York, (December 7, 2004) (transcript on file).

investors have arbitration rights. The risk grows that arbitrators will start to interpret the ambiguity of investor protections in ways that are unfavorable to the United States. ‘No greater rights’ is still the right mandate for negotiators. But the language in BITs and FTAs needs to be revised to ensure that it conforms to the conservative interpretation that the United States has used to defend against the investor claims.”

Appendix I: Selected Policy Options Worthy of Further Debate

General Water Policy Reforms for International Trade and Investment Agreements

- *Maine may want to consider the pros and cons of petitioning Congress and the President to ensure that all international trade and investment agreements entered into by the United States include the following provisions:*
 - Water, including bottled water, shall not be regarded as a good or a product and shall be excluded from coverage in all international trade and investment agreements;
 - Any bona fide and non-discriminatory regulation adopted in the public interest related to or affecting the drilling for, pumping or extraction of water or related to or affecting the distribution or transportation of water, whether by pipeline, marine, land, or other transport, is excluded from coverage in all international trade and investment agreements;
 - No international trade or investment agreement shall require the privatization of drinking water or sanitation services (or services related to those sectors) or to require the payment of damages or the authorization of retaliatory trade sanctions as a result of either the regulation or the total or partial exclusion of private investors or companies from drinking water and sewerage markets (or by the de-privatization of drinking water and sanitation services).

General Federalism Reforms for International Trade and Investment Agreements

- *Maine may want to reiterate its call to Congress and the President for greater state-federal consultation on trade and federalism issues and for additional protections against federal preemption and unfunded federal mandates resulting from trade and investment disputes. For example, Congress could enact legislation to forbid U.S. federal agencies from taking any of the following actions on grounds that a state, tribal, or local government measure (or its application) is inconsistent with an international agreement or treaty or award:*
 - Initiate legal action to preempt or invalidate a sub-national law or its enforcement or application;
 - Directly or indirectly shift costs to a state or local government in response to an international tribunal decision that the United States must pay compensation to a foreign investor.

Reform of International Services Agreements

Maine may want to reiterate its call for Congress and the President to limit the coverage of state and local measures in international services agreements, in ways that specifically reference water policy. For example:

- All international services agreements entered into by the United States could include provisions that:
 - Preserve the right of federal, state, and local governments to provide and regulate services in the public interest, including water and sewer services, on a non-discriminatory basis;
 - Provide that nothing in any services agreement shall bar measures rolling back service privatization or require the privatization of public services, even when such services are provided on a commercial basis and/or are already partially privatized;
 - Provide that services disciplines shall be based exclusively on a positive list of commitment, each of which is defined in detail;
 - Provide a general exclusion from the agreement for distribution and transportation of water and for drinking water and sanitation services.
- The United States by legislation or executive directive could adopt a policy that:
 - It will never accept a GATS agreement on domestic regulation that requires domestic regulations to meet a “necessity test” even if drafted in language addressing a “disguised barrier to trade,” to be “pre-established, based on objective criteria, or relevant;”
 - The section in the proposed agreement on domestic regulation providing for a principle of deference to legitimate national policy objectives shall explicitly state that national policy objectives include objectives identified at both national or sub-national levels.

Reform of International Investment Agreements and Treaties

Maine may want to consider the pros and cons of reiterating its call for Congress and the President to limit the coverage of state and local measures in international services agreements, in the following respects among others:

- *Minimum standard of treatment* – Narrow the minimum standard treatment to the elements of customary international law as explained in the U.S. brief in *Glamis*, in which the State Department argued for a reading of MST confined to three elements: (1) compensation for expropriation, (2) “internal security,” and (3) “denial of justice” where domestic courts or agencies (not legislatures) treat foreign investors in a way that is “notoriously unjust” or “egregious” such as a denial of procedural due process.⁵¹ Further,

⁵¹ Counter-Memorial of Respondent United States of America, in *Glamis Gold v. USA* (September 19, 2006) 221.

the expectation of a stable or unchanging legal environment is not to be understood as part of customary international law.⁵²

- *Indirect expropriation* – Narrow indirect expropriation so that it does not apply to nondiscriminatory regulations as explained in the *Methanex* award. In other words, establish that the adoption or application by any national or sub-national government of any bona fide and non-discriminatory measure intended to serve a public purpose shall not constitute a violation of an expropriation article of an investment agreement or treaty.⁵³
- *Protected investments* – Narrow the definition of investment to include only the kinds of property that are protected by the takings clause of the U.S. Constitution. Exclude from the definition of investment the expectation of gain or profit, the assumption of risk, and intangible property interests other than intellectual property. Acknowledge that property interests are limited by background principles of domestic property, water, and nuisance law.
- *Exhaustion of remedies* – Follow international law and require investors to exhaust domestic remedies before using investor-state arbitration. This recognizes that international investor-to-state arbitration is to be used as a last resort and should not be invoked routinely as a means of circumventing the domestic administrative and judicial processes. This also allows domestic courts and administrative bodies to resolve disputed facts and disputed points of domestic law prior to review by international arbitrators.
- *Waiver of right to file an international investment claim* – Clarify that no international investment tribunal shall find a contract provision in which a foreign investor waives its right to pursue an international investment claim to be unenforceable. *See Appendix III.*

Measures That Might Be Taken By State And Local Governments In Maine

The State of Maine and its subdivisions may want to consider the pros and cons of a:

- *Waiver of right to file an international investment claim* – Require that contracts between governmental units in Maine and private investors include a waiver of any right by investors to seek compensation through international investment arbitration. *See appendix III.*

⁵² Counter-Memorial... at 226, 232.

⁵³ The Intergovernmental Policy Advisory Committee, which is the formal state and local government advisory body to the U.S. Trade Representative, has recommended codifying the rule in *Methanex v. United States*, “The recent ruling in the *Methanex* dispute established an important precedent for safeguarding important principles of federalism and state sovereignty of concern to this Committee. However, since such tribunal judgments are not formally precedential, IGPAC members recommend that the case’s finding that ‘as a matter of general international law, a non-discriminatory regulation for a public purpose, which is enacted with due process and which affects...a foreign investor or investment is not deemed expropriatory and compensable...’ be codified as a formal Interpretive Note in NAFTA and other existing FTAs, and that corrected language be added to this TPA and future trade agreements.”The US-Peru Trade Promotion Agreement: Report of the Intergovernmental Policy Advisory Committee,” February 1, 2006, *available at*, http://www.citizen.org/documents/IGPAC_Peru_Report.pdf.

Appendix II:

Metalclad v. Mexico

What were the facts in Metalclad?[4]

This dispute arose over the use of a plot of land, located near the municipality of Guadalcazar, in the state of San Luis Potosi, Mexico. This plot of land was originally owned originally by a Mexican company, COTERIN. In 1990, the Mexican federal government granted COTERIN a permit to build and operate a hazardous waste landfill on the land. Thereafter, COTERIN applied to the municipality of Guadalcazar for a building permit to construct the landfill. In both 1991 and 1992, the municipality denied COTERIN such a building permit. Despite the municipality's denial, in 1993 COTERIN received three building permits to construct and operate the landfill: two from the Mexican federal government's Secretariat of the Environment, and one land use permit from the state government of San Luis Potosi. But COTERIN still had not received a municipal building permit.

In 1993 the U.S. corporation Metalclad contracted for an option to buy COTERIN and its permits[5] . Then—after receiving assurances from federal government officials as well as the Governor of San Luis Potosi[6] that all necessary permits for the landfill had been obtained—and that the federal government would secure any further support required from the state of San Luis Potosi and the municipality of Guadalcazar—Metalclad purchased COTERIN, the landfill site, and COTERIN's state and federal building permits.[7]

Shortly after Metalclad purchased COTERIN, the Governor of San Luis Potosi publicly denounced the landfill project. Nevertheless, in May 1994, upon securing an extension of the federal building permit, Metalclad began construction of the landfill.[8] Then, in October, 1994, the City of Guadalcazar ordered a halt to construction because Metalclad had not obtained proper municipal building permits. Federal officials advised Metalclad to apply for the municipal permit merely “to appease the municipality,” allegedly assuring Metalclad that Guadalcazar could not deny the permit. Metalclad therefore applied again for the municipal permit. Immediately thereafter Metalclad resumed construction, and in March 1995 completed the landfill building project.

That same month, Metalclad attempted to open its new facility for operations. But angry local

protestors, allegedly with the aid of state troopers, blocked the opening of the new facility. The landfill remained closed until November 1995.

In November, Metalclad entered into an agreement with two federal agencies, and the facility began to operate. The Guadalucazar city council responded in December 1995 by denying Metalclad's last petition for a municipal building permit. Allegedly, the city council acted without granting the Metalclad corporation any notice or opportunity to be heard.

Soon thereafter, Guadalucazar brought action against the federal government to challenge the agreement the federal agencies entered into with Metalclad. Pending resolution of this suit, Guadalucazar successfully obtained a preliminary injunction barring further operations at the landfill site. While the action was pending, the same federal agencies granted Metalclad a further permit which authorized a substantial expansion of the landfill site.

Finally, in September 1997, the Governor of San Luis Potosi issued a state-level decree which established the landfill site as a protected natural area. Thus, without any reference to the lack of a municipal building permit, the state government entirely prevented the landfill from operating.

What is the history of the Metalclad proceedings?



Nine months earlier, on January 2, 1997, Metalclad had already demanded arbitration under NAFTA's Chapter 11. In its claim against the Mexican federal government, Metalclad argued that the nation of Mexico was responsible under international law for the conduct of its governmental subdivisions, and that both the state of San Luis Potosi and the municipality of Guadalucazar had violated NAFTA section 1105's "minimum treatment" standard, and NAFTA section 1110's "expropriation" prohibition.

As provided for in NAFTA, Article 1120, Metalclad filed its Notice of Claim with the Additional Facility of the International Centre for Settlement of Investment Disputes (ICSID). On January 13, 1997, the Secretary-General of ICSID informed the parties that the requirements for accessing an ICSID tribunal had been fulfilled, and issued a Certificate of Registration of the Notice of Claim. On May 19, 1997 the ICSID Tribunal was constituted, and it held its first session on July 15, 1997.

After extensive review of Metalclad's claims during a period of over three years, in August 2000 the ICSID Additional Facility tribunal issued a two-part decision: (1) Mexico's conduct violated Article 1105(1) of NAFTA, which was intended to ensure the fairness, equity, and "transparency" of domestic investment rules for foreign investors, and (2) Mexico's conduct was deemed to be "a measure tantamount to expropriation" under the language of NAFTA section 1110. For these two violations, the Tribunal found that Metalclad was entitled to monetary relief in the amount of \$16.9 million from the nation of Mexico.

Following the August 2000 decision of the arbitration panel, Mexico sought domestic court review in the British Columbia Supreme Court. "Because the parties had designated the place of

arbitration to be Vancouver, B.C., the International Commercial Arbitration Act allowed the Supreme Court of British Columbia to [have jurisdiction to] set aside the Tribunal's award under certain limited circumstances"—should the proceeding move to that stage.[9]

On May 2, 2001, the British Columbia Supreme Court resolved the question of whether the Metalclad tribunal had exceeded its authority under the B.C. international arbitration statute.[10] The decision came down in favor of Metalclad, as the British Columbia Supreme Court agreed with the Tribunal that the Mexican federal government owed Metalclad nearly \$16 million US dollars.[11]

- Specifically, in his British Columbia Supreme Court opinion, Judge Tysoe delivered a two-part decision which (1) agreed with the ICSID Tribunal's finding that the decree passed by the State government of San Luis Potosi was an expropriation of Metalclad's property; (2) agreed that compensation to Metalclad was thus required by the federal government of Mexico under NAFTA Chapter 11; and (3) disagreed with the Tribunal's finding that the refusal of Guadalcázar to grant a municipal building permit was a violation of NAFTA obligations of "fair and equitable treatment" under article 1105(1) on minimum treatment under international law and therefore also a violation of article 1110 on expropriation. (Judge Tysoe reached this conclusion because the violation alleged was based on the wrong section of NAFTA[12].)

Soon after the British Columbia court reached its result, the Mexican federal government announced that "Mexico's Ministry of the Economy has paid over \$16 million U.S. dollars to the United States corporation Metalclad in order to comply with a ruling by a North American Free Trade Agreement (NAFTA) arbitration panel." [13]

In sum, following the NAFTA Tribunal decision and the British Columbia Supreme Court decision, the Mexican federal government was required to pay – and did pay – the full costs of the tribunal award.[14]

What was the basis for the tribunal and appellate court decisions?

The Tribunal decision: The Metalclad tribunal found that Mexican authorities had violated two important investor rights protected by NAFTA: article 1110 on expropriation and article 1105 on minimum treatment under international law.

- **Compensation for expropriation.** NAFTA requires member nations to compensate investors if national or subnational governments "directly or indirectly nationalize or expropriate" an investment of the other countries' investors in its territory. Expropriation includes measures "tantamount to nationalization or expropriation." [15] The Metalclad tribunal had to decide not only the scope of expropriation, but also what the open-ended references to "tantamount to expropriation" and "indirect" expropriation meant.

The Metalclad tribunal broadly read the term "tantamount to expropriation" and "indirect expropriation" in NAFTA's article on expropriation. This broad reading granted to investors a set of property rights protections that extend beyond the

protections granted to property owners under the Fifth Amendment to the U.S. Constitution.

In interpreting the Fifth Amendment “takings” clause, the U.S. Supreme Court “usually has applied the regulatory takings analysis only to regulations of specific interests in property.”[16] Expected or future economic benefits are not considered property under the Takings Clause.[17] By way of contrast, the Metalclad tribunal read NAFTA’s expropriation article to include not merely the seizure of property or its regulation to the point that its economic value is extinguished, but also “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...”[18] In its Metalclad opinion, the “tribunal made it clear...that the relevant ‘investment’ for purposes of its expropriation analysis was Metalclad’s broader interest in operating a particular type of business, not merely its interest in its real property.”[19]

- **Minimum treatment under international law.** NAFTA article 1105(1) requires member nations to provide other members' investors with treatment in accordance with customary international law, including fair and equitable treatment and full protection and security. Article 1105 is intended to serve roughly the same purpose as “due process” norms in U.S. constitutional law, but because article 1105’s terms are largely undefined, especially when compared with the extensive U.S. case law on procedural and substantive due process, international investment tribunals exercise great discretion when they make inherently subjective judgments about when government action violates fundamental principles of procedural or substantive justice.[20]

According to the Metalclad tribunal, Mexico breached article 1105(1) because it “failed to ensure a transparent and predictable framework for Metalclad’s business planning and investment.”[21] The tribunal noted the lack of an “orderly process” in at least three circumstances:[22]

No clear rule or established practice: The tribunal concluded that Mexico did not accord Metalclad “fair and equitable treatment.” Fair and equitable treatment was understood to incorporate principles of transparency in NAFTA chapter 18, because there was no clear rule and no established practice with respect to whether Metalclad was required to obtain a municipal permit prior to constructing and operating its hazardous waste facility in San Luis Potosi.[23]

Detrimental reliance on assurances of federal officials: The tribunal similarly concluded that Mexico did not accord Metalclad “fair and equitable treatment” (as interpreted to require transparency and a predictable regulatory environment) because the company relied on representations of federal officials that a municipal permit was not required. But Guadalcazar officials later refused that permit.[24] A finding that Mexico had failed to provide Metalclad with “fair and equitable treatment,” because of statements made by Mexican federal officials, would be an astonishing conclusion in a U.S. court—where businesses have an obligation to take due diligence in researching the laws and regulations that regulate their economic activities.

Notice and opportunity to be heard: The tribunal finally concluded that Mexico did not accord Metalclad “fair and equitable treatment” because the municipality of Guadalupe did not meet its obligation to conduct a transparent regulatory process, when it failed to give Metalclad adequate notice of the meeting where its construction permit application was denied and failed to provide adequate and credible reasons for denying the permit.[25]

Certainly, a U.S. court might find an authentic failure to provide notice and opportunity to be heard to be a violation of procedural due process. The question here is why the Metalclad panel felt competent to apply Mexican law and make its own findings of fact— rather than requiring Metalclad to pursue its claims using domestic judicial remedies.

- **The appellate court decision.** Because *Metalclad v. Mexico* was arbitrated under ICSID Additional Facility rules, domestic courts could review the tribunal decision. Those rules allow a party to ask the domestic courts at the “seat” of the arbitration, in this case British Columbia, to set aside an award because of a violation of that jurisdiction’s international arbitration statute.[26] On this basis Mexico petitioned a British Columbia court to review the award in the Metalclad case to determine its conformity with the B.C. statute governing such arbitrations (which is based on the International Commercial Arbitration Act). The grounds for review under the B.C. statute are: improper constitution of the tribunal, actions taken beyond the jurisdiction of the tribunal, and violations of public policy.[27]

As noted above, the British Columbia Supreme Court in an opinion by Judge David Tysse agreed with the Metalclad tribunal’s finding that the decree issued by the state government of San Luis Potosi, creating an ecological zone and barring Metalclad’s waste disposal facility from operating, was an expropriation of Metalclad’s property, but it disagreed with the tribunal’s findings that the refusal of City of Guadalupe to grant a municipal building permit for the Metalclad facility was a denial of fair and equitable treatment under international law and an expropriation.[28]

Recall that the Metalclad tribunal interpreted the concept of “fair and equitable treatment” under article 1105(1) in light of the transparency requirements in NAFTA article 102(1), a section of the agreement not located in chapter 11 on investment, but in chapter 18 of the agreement. But, Metalclad’s right to arbitrate a claim against Mexico, Judge Tysse reasoned, is confined to alleged breaches of obligations under section A of NAFTA chapter 11 and two articles found in chapter 15 and do not extend to the transparency obligation in chapter 18 (an obligation that might be the basis of state-to-state arbitration, but not investor-to-state arbitration). Therefore, Tysse concluded that the Metalclad tribunal was acting beyond the scope of its authority to arbitrate under B.C. international arbitration act, because the tribunal found that the municipality of Guadalupe—which required, but then refused to issue, a building permit—violated Mexico’s article 1105(1) obligation related to “fair and equitable treatment.” Also, the tribunal’s finding that Guadalupe’s non-transparent permitting process amounted to an

expropriation under article 1110, Tysoe concluded, was beyond the scope of its authority under the B.C. arbitration statute.

In other words, the tribunal's finding of an article 1110 expropriation violation was also beyond the scope of the tribunal's authority under the B.C. statute because it was based entirely on the previous finding of an article 1105(1) violation that inappropriately incorporated transparency obligations from NAFTA chapter 18.[29]

Nonetheless, Judge Tysoe let stand the Metalclad tribunal's finding that the ecological decree of the state of San Luis Potosi was a violation of article 1110 on expropriation, because that finding was based on neither a lack of transparency nor a flawed finding of an article 1105(1) violation.[30]



What are the legal and policy implications of the Metalclad decisions?

The Tribunal decision. State and local officials should be concerned about the Metalclad tribunal decision for at least three reasons:

- **A successful challenge to core functions of state and local government:** The Metalclad case illustrates how NAFTA's investment chapter allowed a transnational corporation to successfully bring a complaint based on state and local governments performance of core governmental functions: protecting public health and regulating land use.
- **A broad reading of NAFTA's investor protection against expropriation:** The Metalclad tribunal read article 1110 on expropriation very broadly to include "covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use or reasonably-to-be expected economic benefit of the property." [31] This broad reading of article 1110 would provide foreign investors with greater rights than U.S. investors in property enjoy under the U.S. regulatory takings doctrine. This broad reading would substantially diminish state and local regulatory authority related to land use and environmental protection. As the U.S. Supreme Court explained in its recent decision in *Lingle v. Chevron* 125 S. Ct. 2074 (2005), which rejected Chevron's "takings" arguments, the touchstone of regulatory takings doctrine is "to identify regulatory actions that are functionally equivalent to the classic taking in which the government directly appropriates private property or ousts the owner from his domain." [32]
- **A broad reading of NAFTA investor protection related to minimum treatment under international law:** The Metalclad panel's finding that transparency requirements should be read into the concept of "fair and equitable treatment" parallels the expansive reading of the text of article 1105 by other NAFTA tribunals. For example, a NAFTA tribunal in *Waste Management II* concluded that "fair and equitable treatment" is violated by government conduct "leading to an outcome which offends judicial propriety—as might be the case with a manifest failure of natural justice in judicial proceedings or a complete lack of transparency and candor in an administrative

process.”[33] No responsible U.S. court would presume to divine natural law in this way.

ENDNOTES

[1] Metalclad Corp. v. The United Mexican States, ICSID Case No. ARB(AF)/ 97/1, Award (Aug. 30, 2000) (hereinafter Metalclad v. Mexico), at <http://www.worldbank.org/icsid/cases/mm-award-e.pdf>.

[2] Metalclad Corp. , supra, para. 30

[3] Vicki Been, NAFTA’s Investment Protections and the Division of Authority for Land Use and Environmental Controls, 32 Env’tl. L. Rep. 11001 (Sept. 2002) [hereinafter ‘Vicki Been I’].

[4] Metalclad Corp., supra. See Vicki Been and 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, 72 (April, 2003) [hereinafter ‘Vicki Been II’].

[5] Stephen L. Kass and Jean M. McCarroll, The ‘Metalclad’ Decision Under NAFTA’s Chapter 11, New York Law Journal, October 27, 2000, available at http://www.clm.com/pubs/pub-990359_1.html (last visited July 10, 2003).

[6] Vickie Been I, at FN 108.

[7] http://www.rmalc.org.mx/CIADI/reasons_for_judgment.pdf

[8] NAFTA Summary Reasons of Judge Tysoe on Review of Metalclad v. Mexico BCSC. http://www.canadianliberty.bc.ca/nafta/nafta_summary.html

[9] Id.

[10] Mexico Pays \$16 Million to Metalclad, Ending First NAFTA Chapter 11 Dispute (Oct. 30, 2001), <http://www.wtowatch.org/News/index.cfm?ID=2963>

[11] The payment for over \$16 million was very good news for Metalclad in an otherwise lackluster year. According to its SEC filings, Metalclad made a \$7.1 million profit in 2001, but this number was possible only because of the over \$16 million payment received from the Mexican federal government. See Metalclad Corporation (MTLC) Annual Report (SEC form 10-K), Item 7: Management’s Discussion and Analysis of Financial Condition and Results of Operations (March 29, 2002), <http://biz.yahoo.com/e/020329/mtlc.html>

[12] NAFTA article 1110.

[13] See, Matthew C. Porterfield. “International Expropriation Rules and Federalism,” Stanford Environmental Law Journal, Vol. 23, No. 1, January 2004, pp.11-12;E. Enters v. Apfel, 524 U.S. 498,541 (1998).

[14] Id. Also see, Andrus v. Allard,444 U.S. 51,66 (1979) (“[L]oss of future profits – unaccompanied by any physical property restriction – provides a slender reed upon which to lay a takings claim.”)

[15] Metalclad v. Mexico supra, para. 103.

[16] Porterfield, supra, at p 47.See Metalclad v. Mexico, supra, at para 104.

[17] For example, without being totally subjective, the standard of review applied in two NAFTA chapter 11 cases Loewen v. United States (available at <http://www.naftaclaims.com>) and Mondev v.United States (available at <http://www.naftaclaims.com>), echoes the Elettronica tribunal’s understanding of a violation of minimum treatment under international law, as encompassing “a willful disregard of due process of law...which shocks or at least surprises a

sense of judicial propriety.” *Electronica Sicula S.P.A. (SLSI) (U.S. v. Italy)*, I.C.J. 15 at 76 (July 20). A simple “surprise to judicial propriety” would seem to be subjective and only moderately deferential, at best.

[18] *Metalclad v. Mexico* supra, para. 99.

[19] *Id.*

[20] *Metalclad v. Mexico* supra, para. 88 (“The absence of a clear rule as to the requirement or not of a municipal construction permit, as well as the absence of any established practice or procedure as to the manner of handling applications for a municipal construction permit, amounts to a failure on the part of Mexico to ensure the transparency required by NAFTA.”)

[21] *Metalclad v. Mexico* supra, para. 89 (“*Metalclad* was entitled to rely on the representations of federal officials and to believe that it was entitled to continue its construction of the landfill. In following the advice of these officials, and filing the municipal permit application on November 15, 1994, *Metalclad* was merely acting prudently and in the full expectation that the permit would be granted.”)

[22] *Metalclad v. Mexico* supra, para. 91.

[23] See *United Mexican States v. Metalclad Corp.*, 2001 B.C. Sup.Ct. 664 (2001), paras. 39-49 [hereinafter *Metalclad Appeal*].

[24] See *Metalclad Appeal*, para. 50.

[25] See *Metalclad Appeal*, paras. 66-76.

[26] See *Metalclad Appeal*, paras. 57-80.

[27] See *Metalclad Appeal*, paras. 81-105.

[28] *Metalclad v. Mexico* supra, para. 103

[29] 125 S. Ct. 2074 (2005)

[30] *Waste Management II*, para. 98 (emphasis added), available at [http:// www.naftalaw.com](http://www.naftalaw.com). See, Mathew Porterfield, “Does CAFTA give greater rights to foreign investors? Roundtable Discussion Outline, March 15, 2005, p. 4 (on file Harrison Institute of Public Law, Georgetown University).

Appendix III

Excerpts from:

“Using Contractual Waiver Clauses to Limit the
Jurisdiction of International Tribunals in
Investor-State Dispute Resolution”

by

Clayton Romans

Harrison Institute for Public Law
Georgetown University Law Center

March 2008

(on file)

In recent years, both the level of international investment and the number of investment-related treaties has increased significantly. Investment agreements typically include not only a set of substantive investor protections but also procedural provisions that permit investors to bring disputes concerning treaty protections before the International Centre for Settlement of Investment Disputes (ICSID), the leading international arbitration institution devoted to investor-State dispute settlement, and/or other international arbitral fora. ...

In response to this increasing litigation...States are looking beyond treaty texts for mechanisms to limit international arbitration. This paper analyzes the potential effectiveness of waiver provisions as indicated by key tribunal decisions. Waivers, which are clauses in various forms built directly into investor-State contracts, offer States an innovative tactic for preserving local jurisdiction, particularly over traditionally municipal matters, which, in turn allow States to exert greater control over the interpretation and execution of domestic law. The effect of waivers seems to hinge on tribunal treatment of treaty language pertaining to contract claims. ...

In the relatively few number of decisions that have addressed waiver provisions, tribunals have not rejected altogether the notion that investors can waive international arbitration, at least not in regards to contract claims. In fact, analysis reveals that treatment of the waiver issue is largely dependent upon whether contractual rights or treaty rights are at issue...

Proponents of waivers have argued—and most tribunals have accepted—the individual-rights paradigm: that one of the primary or “special” purposes of BITs [bilateral investment treaties] is to shift rights from States directly to investors. If BITs reflect States “downgrading” international dispute settlement from state-state level to state-investor level, it is arguable that logically an investor should have the ability reject that dispute settlement mechanism. Opponents contend that even if investors do enjoy individual rights disconnected from any larger State-to-State obligation, such rights cannot be waived before a dispute arises; i.e. investors cannot agree to waive rights before the rights are infringed...

Despite scholarship that seems to validate the notion of individual rights and investors' ability to agree to waivers, tribunals have not looked as favorably on the provisions that reflect and apply this understanding, namely forum selection (exclusive jurisdiction) clauses. ...

Even as some tribunals have refrained from exercising jurisdiction over contractual disputes that are disconnected from specific treaty violations, to date no tribunal has directly upheld a forum clause that waives any treaty-vested right or international arbitration of such rights. Tribunal jurisdiction over treaty-based disputes in the face of forum clauses, although vigorously contested in early disputes, has been widely accepted; however, a recent ICSID decision casts this consensus in doubt...

The majority view: Waivers do not limit jurisdiction over treaty claims

Lanco v. Argentina, the first major ICSID decision to deal with a waiver of investor rights in context of a forum selection clause held what would become an oft-cited premise: that such clauses could not inhibit tribunal jurisdiction over treaty claims. ...

Unlike *Lanco*, *Azurix v. Argentina*, a more recent ICSID decision, presented the tribunal with an express waiver clause. A U.S. company, Azurix signed a concession agreement for the distribution of potable water in Buenos Aires that required it to waive dispute resolution in any forum other than local administrative courts. ... The tribunal rejected the clause's application to treaty claims...

Together *Lanco* and *Azurix* indicate that, regardless of a tribunal's treatment of waivers over contractual disputes, it will not uphold a forum waiver clause limiting jurisdiction to domestic courts if the clause's terms conflict with treaty guarantees "as the functions of these various instruments are different." Effective waiver texts arguably should acknowledge treaty obligations and focus instead on claims arising directly out of the contractual agreements themselves.

The minority view: impact of Aguas del Tunari v. Bolivia [sometimes referred to as Bechtel v. Bolivia]

On the opposite side of *Lanco* and *Azurix* is *Aguas del Tunari v. Bolivia*, which represents the longest jurisdictional battle in ICSID history. It is a complex case that touches on several central issues in investor-State arbitration, including the ability of States to require investors to waive dispute resolution in international tribunals. The dispute, widely reported and followed around the world, arose out of a water concessions agreement between Bolivia and Aguas del Tunari (AdT). Because Bolivia believed that a concessionaire for a critical natural resource such as water should be subject to Bolivian law and courts, it incorporated a forum selection clause into its agreement with AdT. The text of the exclusive jurisdiction clause reads: "[The Concessionaire] recognizes the jurisdiction and competence of the authorities that make up the System of Sectoral Regulation (SIRESE) and of the courts of the Republic of Bolivia, in accordance with the SIRESE law and other applicable Bolivian laws.

Later disregarding the waiver, AdT brought claims before an ICSID tribunal, AdT arguing that the clause only “recognized” the “jurisdictional competence” of domestic courts, rather than limiting AdT to their jurisdiction. Ultimately, the tribunal essentially agreed with AdT. Bolivia pointed to the concession agreement negotiations as evidence that both parties understood the “very carefully constructed” clause to deprive AdT of a right international arbitration. Bolivia also argued that “...it was inconceivable, and equally unacceptable, that this company [the Concessionaire] could bring any dispute it had with the Bolivian government outside of Bolivia, or be subject to any law other than the law of Bolivia, consistent with [the Bolivian Constitution].” Citing both *Lanco* and *Vivendi* AdT argued that “even where an explicit and affirmative exclusive jurisdiction clause exists within a concession contract, such a clause does not affect the jurisdiction of an ICSID tribunal in respect to a claim made under a BIT.” Since AdT presented its claims as treaty-based rather than based on the concession agreement, the clause would have no effect. The tribunal agreed. ...

Despite ignoring the waiver in the AdT agreement, the tribunal stated in dicta that ICSID jurisdiction can be waived, as long as the waiver is clear and explicit: Assuming that parties agreed to a clear waiver of ICSID jurisdiction, the Tribunal is of the view that such a waiver would be effective. Given that it appears clear that the parties to an ICSID arbitration could jointly agree to a different mechanism for the resolution of their dispute other than that of ICSID, it would appear that an investor could also waive rights to invoke the jurisdiction of ICSID. However the Tribunal need not decide on the question in this case.

Unlike the tribunal in *Azurix* which went to great lengths to avoid the topic, here the tribunal addressed the question explicitly. The tribunal also implicitly rejected the argument advanced by AdT that the enormous leverage, or negotiating advantage, possessed by a State should disqualify waivers in which a State could possibly use such pressure improperly. ...

Drafting principles and strategic considerations for future waiver implementation

Analysis of these key tribunal decisions reveals drafting and strategic principles that may inform states in their efforts to craft effective waiver provisions in future contracts. The contract-treaty distinction remains central to any analysis, but it does not necessarily relate significantly to the construction of the waiver clause itself. Several textual principles, however, can be discerned from tribunal decisions, which may guide drafting towards waiver clauses that withstand tribunal scrutiny. States may also consider altering their negotiating strategies when drafting BITs in order to achieve a meaningful limitation on international arbitration and tribunal jurisdiction. Certainly, waiver clauses would stand a better chance of surviving tribunal scrutiny if the implicated BIT contained a dispute settlement provision similar to that in the Italy-Jordan BIT: “In case the investor and an entity of the [CP] have stipulated an investment agreement, the [dispute settlement] procedure foreseen in such investment agreement shall apply.” These kind of provisions, despite retaining awkward wording, are arguably uncontroversial. On the other hand, not only are treaty negotiations often heavily politicized affairs, but States have relied on waiver clause precisely in order to avoid complicated, perhaps unobtainable BIT re-negotiations. Given the difficulty of BIT

negotiations and the uneven success of waiver clauses thus far, States may look to different waiver models outside the forum selection paradigm or choose to focus exclusively on seeking alternative BITs...

Waivers that explicitly preclude the jurisdiction of tribunals are more likely to be Effective

The principle of specificity remains important because a tribunal will be forced to address a clause's enforceability more directly if the clause in dispute is tightly constructed; specific, explicit language aids a tribunal in determining the underlying meaning of both BIT and contractual clause. In *Lanco* the disputed waiver clause's lack of specificity represented a significant factor in the tribunal's decision. The text of the clause did not expressly select the national courts to the *exclusion of other forums*. As a result, the clause conceivably could have been interpreted as selecting *either* domestic courts *or* ICSID tribunals. In *Azurix*, the tribunal noted that "the rights under the Concession Agreement and under the BIT are not the same," and acknowledged Azurix's contention that the "generality of the waiver would exclude even the [domestic] courts," indicating that just as in *Lanco*, the waiver language was not sufficiently specific. ...

In *Aguas Del Tunari v. Bolivia*, the lack of specificity in drafting proved fatal to the waiver clause; the tribunal declined to address the clause, finding that the language was not specific enough in any event. Thus, even though the tribunal concluded that a clearly worded, precisely written waiver could theoretically be effective, it noted that the concession agreement signed by AdT was silent about international arbitration and, as a result, could be taken to imply a waiver of the right to invoke ICSID.

Effective waivers should be limited to procedural but not substantive treaty Rights

The *Aguas del Tunari* dicta aside, most tribunals have rejected any interpretation of waiver clauses that limit the ability of investors to seek redress for violations of fundamental treaty rights. Given that international tribunals are viewed as the proper legal forum for making such determinations, scrutiny of jurisdiction clauses has typically focused on whether or not a treaty claim is implicated. The reluctance to uphold waivers typically hinges on the tribunal's desire to protect substantive, fundamental treaty rights; the procedural rights to determine jurisdiction are important insofar as they relate. Therefore, waivers crafted with this distinction are more likely to be upheld because of their lesser degree of controversy. Even if the procedural right to tribunal adjudication is waived, substantive treaty rights could still be vindicated through state-to-state dispute settlement, or through litigation in a domestic court with jurisdiction. Further, with the expansive interpretation increasingly accorded to umbrella clauses, municipal matters are frequently being "elevated" to treaty status. Thus, a choice of forum waiver must, in a sense, be crafted to be anti-umbrella, specifying that it is the underlying facts or issues that are key, not the manner in which they are pleaded as a breach of treaty or breach of contract....

Including waivers as material conditions of contracts may increase their viability

One innovative waiver mechanism, which remains untested by international arbitration, is the use of an exclusive jurisdiction waiver as a material condition of the contract or concession agreement between a host State and private investor. Under this model, an investor who sought to go outside the contractually specified forum would render the agreement void. Therefore, any litigation of the agreement before international tribunals would be self-defeating...

Whether or not a forum selection clause can comprise a material condition of a contract is unclear. Furthermore, public policy concerns may cause tribunals to disregard the clause altogether and consider claims as if no condition had been set. Moreover, this line of thinking would be consistent with the idea that an arbitration clause is a contractual device that cannot achieve purposes that parties cannot purpose by contract.

Incorporation of an exhaustion requirement may increase utility of waivers

Exhaustion requirements, once a mainstay of customary international law and a component of the Calvo Doctrine, have not received the same level of use or focus as exclusive jurisdiction clauses, possibly because they do not provide the same degree of constraint on international tribunals. Traditionally, an exhaustion of domestic remedies was required in international law as a prerequisite to international dispute resolution. ISCID Article 26 leaves open the possibility of a State imposing an exhaustion requirement....

Conclusion

The cases discussed in this paper signal one of the challenges facing states stemming from the rise of BITs, namely how to contain the reach of international tribunals into municipal legal decisions by way of expansive dispute resolution and umbrella clauses. Waiver clauses represent a potential response; however, given the mercurial treatment international tribunals have accorded them, waivers remain just one of several potential, if not fully vindicated, solutions available. A full accounting of recent decisions does not indicate widespread embrace of waivers, yet certain decisions, such as *Aguas del Tunari*, give hope. With the increased attention on umbrella clauses, States must continue to grapple with and respond to the contract-treaty rights distinction that has determined jurisdictional disputes at the tribunal level over the past two decades, particularly in light of the fact that most tribunals have limited, at a minimum, waiver applicability to contractual violations.

States would be wise to approach the use of waivers with this understanding and to contemplate the suggested waiver modifications in this paper. ...States can continue to look towards other tactics, such as refreshed treaty negotiating strategies, in their attempt to limit tribunals' reach. Some might even follow Bolivia's lead and withdraw from ICSID altogether while scaling back concomitant treaty commitments. Regardless, the march of treaty-related litigation will continue apace--most likely at a faster pace, in fact, if statistics are any indication--and States must similarly continue to

respond to the challenge of retaining sovereign control in the face of expansive international arbitration.....