LIABILITY BEGINS AT HOME: AN ALTERNATIVE COMPENSATION SCHEME FOR NAFTA EXPROPRIATIONS

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I. INTRODUCTION

The conventional image of a government "expropriating" investor property has been that of a military cadre seizing an investor's factory or warehouse by force for the state's enrichment or a political leader embezzling funds. But today, an "expropriation" is more likely to take the form of a domestic public health regulation that works to reduce the profit margin of a foreign investor's local business. Perhaps the greatest contribution of the North American Free Trade Agreement

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(NAFTA) to the theory of international law is its assertion that the latter expropriation is as deserving of compensation as the former.

NAFTA entitles foreign investors to just compensation when host governments expropriate their property.[1] Critics charge that NAFTA's protection of private property will discourage local host governments from passing efficient public health regulation because it is so easy for foreign investors to make successful claims for just compensation.[2] Some suggest solving this problem by narrowing the definition of what constitutes an "expropriation," thereby reducing the number of cases where an investor can bring a claim.[3] But a simpler solution exists.

Rather than ask ad hoc arbitral panels to get into the esoteric business of defining an expropriation (a task that the U.S. Supreme Court, after trying for over 200 years, has yet to accomplish in its jurisprudence regarding government expropriations, or "takings"[4]), NAFTA should assign expropriation liability to an investor's "home" government rather than to the host government. Upon the investor making a prima facie showing of economic loss, the home government would become liable. If, however, the host government effected the expropriation illegitimately—that is, in a discriminatory manner and without a "public purpose"—the home government would have the chance to shift liability to the host government through the arbitration process. Under my proposed plan, the military cadre seizing indiscriminately would be liable, but the democratic regulator would not.

There are several advantages to this Alternative Scheme. First, it reduces the "democratic deficit"[5] created by ad hoc

1. North American Free Trade Agreement [NAFTA], U.S.-Can.-Mex., art. 1110, Dec. 17, 1992, 32 I.L.M. 289.

2. *See infra* notes 48-59 and accompanying text.

3. *See* Vicki Been & Joel C. Beauvais, *The Global Fifth Amendment?: NAFTA's Investment Protections and the Misguided Quest for an International "Regulatory Takings" Doctrine*, 78 N.Y.U. L. REV. 30 (2003).

4. For the Supreme Court's most recent and perhaps most controversial consideration of this issue, see Kelo v. City of New London, 545 U.S. 469 (2005).

5. Critics have argued that when unelected arbitral panels are empowered to bind elected governments, a "democratic deficit" is created. *See, e.g.*, Jennifer Gerbasi & Mildred Warner, *Is There a Democratic Deficit in the Free*

arbitral panels effectively invalidating local legislation; second, it levels what is now an uneven playing field for foreign and domestic investors; third, it tasks arbitral panels with a function they are better qualified to perform—the implementation of a liability rule, rather than the creation of a fuzzy property rule; fourth, it curbs any jurisprudential "overflow" of NAFTA's liberal expropriation standard into the domestic takings standards of the signatories; and fifth, it promises to avoid the years-long arbitration process that already plagues NAFTA's Investor-State Dispute Mechanism (ISDM). As such, the Alternative Scheme will help NAFTA to do what it is supposed to do, and what the present ISDM undermines: namely, increase the free flow of goods and services between NAFTA's signatory parties for their mutual economic benefit.

If the home government effectively indemnifies its investors for their host government's expropriations, will this encourage host governments to expropriate with impunity? No. While this Alternative Scheme does not make host governments internalize the *economic* costs of their actions, it does make them internalize the *political* costs. And this is the appropriate metric. As has been persuasively argued in recent scholarship on American takings law, political entities respond more reliably to political incentives than they do to economic incentives.[6] This Alternative Scheme promises to eliminate the most politically inefficient expropriations and distribute the costs of politically efficient expropriations among the appropriate parties—the transnational beneficiaries of free trade.

Part II of this paper describes the mechanics of NAFTA's present expropriation compensation mechanism in Section A and summarizes its most frequent critiques in Section B. Part III presents my Alternative Scheme. Section A lays out the conceptual basis for this proposed program, and Section B describes the procedure for an investor to bring an expropriation compensation claim under the Alternative Scheme. Section C analyzes the challenge of separating "public purpose" from "non-public purpose" regulations and looks for guidance in the examples of international insurance regimes such as the

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Trade Agreements?: What Local Governments Should Know, PUBLIC MANAGEMENT, Mar. 2004, at 16, 16-21.

6. *See infra* notes 68-73 and accompanying text.

Overseas Private Investment Corporation and Multilateral Investment Guarantee Agency. Finally, Section D reviews two recent NAFTA expropriation cases and suggests how the Alternative Scheme might have produced different and superior results.

II. The Pros and Cons of NAFTA Chapter Eleven

A. *The Process of Bringing an Expropriation Claim Under the Present Scheme*

After years of off-and-on negotiations, Canada, Mexico, and the United States ratified NAFTA in 1992 and 1993, and the agreement took effect on January 1, 1994.[7] Article 102 articulates the agreement's six primary objectives:

> a) eliminate barriers to trade in, and facilitate the cross-border movement of, goods and services between the territories of the Parties;
>
> b) promote conditions of fair competition in the free trade area;
>
> c) increase substantially investment opportunities in the territories of the Parties;
>
> d) provide adequate and effective protection and enforcement of intellectual property rights in each Party's territory;
>
> e) create effective procedures for the implementation and application of this Agreement, for its joint administration and for the resolution of disputes; and
>
> f) establish a framework of further trilateral, regional and multilateral cooperation to expand and enhance the benefits of this Agreement.[8]

President Clinton explained the promise of the agreement at the time: "As we link our economies we not only will increase the efficiency of production in each country but also will create new, better quality jobs and improve the entire hemi-

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7. Ralph H. Folsom, NAFTA in a Nutshell 68-69 (1999).

8. NAFTA, *supra* note 1, art. 102.

sphere's competitiveness in the global marketplace."[9] His view was shared by his Canadian and Mexican counterparts.[10]

NAFTA's Chapter Eleven, "Investment," describes the rights of investors of one signatory party when operating within the territories of the other parties.[11] Chapter Eleven requires host countries to treat such "foreign" investors at least as well as domestic investors and investors from other foreign countries,[12] and to observe an international "minimum standard of treatment."[13] While these provisions are relatively standard in international investment treaties, two additional prohibitions on host country behavior demonstrate NAFTA's hallmark emphasis on economic liberalization. First, article 1106 prohibits host governments from placing "performance requirements," such as minimum import and export levels and mandatory investment in the local community, on foreign investors.[14] Such conditions had previously been common in international trade agreements, but NAFTA has helped usher in the age of their extinction.[15] Second, article 1110 prohibits

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9. Press Release, White House Office of the Press Sec'y, Statement by the Press Secretary on the President's Message on NAFTA to Latin American Heads of State (Nov. 18, 1993), *available at* http://www.presidency.ucsb.edu/ws.

10. Former U.S. President George H.W. Bush, Canadian Prime Minister Brian Mulroney, and Mexican President Carlos Salinas—the three heads of state during the chief negotiations of NAFTA—convened at the American embassy in Ottawa, Canada in December 2002 to celebrate the agreement's tenth anniversary. Press Release, U.S. Dep't of State, Former Leaders Bush, Mulroney, and Salinas Celebrate NAFTA's 10th Anniversary (Dec. 9, 2002) *available at* http://usinfo.state.gov/xarchives/display.html?p=washtile-english&y=2002&M=December&x=20021209177427smiller@pd.state.gov0.1011011. Mulroney released a statement saying: "Our countries are stronger, our economies more robust, our peoples more prosperous, our social structures more resilient, our capital markets more stable, our roles in the world more vigorous as a result of NAFTA." *Id.* Salinas likewise commented: "Almost all jobs created in Mexico between 1995 and 2000 came from activities linked to exports and the associated investment." *Id.*

11. NAFTA, *supra* note 1, art. 1101.

12. *Id.* arts. 1102-1103.

13. *Id.* art. 1105.

14. *Id.* art. 1106.

15. The subsequently proposed but ultimately abandoned Multilateral Investment Agreement (MIA) included a ban on performance requirements even broader than NAFTA's. *See* ANDREAS F. LOWENFELD, INTERNATIONAL ECONOMIC LAW 474-75 (John H. Jackson ed., 2002). The consolidated text of the MIA is available at http://www.web.net/coc/maitext.html.

host governments from expropriating foreign investors' property or property rights without paying compensation.[16]

Article 1110 covers acts of direct or "indirect" expropriation and measures that are "tantamount" to expropriation.[17] Critics charge that this language greatly expands the scope of actions that might be considered expropriations.[18] In particular, "creeping expropriations," in which a series of otherwise non-actionable state actions amount to an expropriation, may now require compensation, as may actions U.S. courts call "regulatory takings."[19] These contentions, however, remain hotly disputed.[20] America's chief NAFTA negotiator maintains that the article 1110 definition of expropriation merely articu-

16. NAFTA, *supra* note 1, art. 1110.

17. *Id.*

18. For the most comprehensive and eloquent presentation of this critique, see Been & Beauvais, *supra* note 3, at 31 (2003).

19. A "regulatory taking" occurs when a private party's property sustains a loss of value as a result of government regulation. Lucas v. South Carolina Coastal Council, 505. U.S. 1003, 1014-16 (1992). Defining the necessary extent of economic loss that qualifies as a "taking" and thus requires "just compensation" under the Fifth Amendment has plagued the Supreme Court for decades. *Id.* In *Penn Central Transportation Company v. New York City*, the Court announced an "ad hoc," multifactor test for evaluating regulatory takings. 438 U.S. 104, 124 (1978) (listing factors including "direct investment-backed expectations," fairness, "reciprocity of advantage," and percentage of the property "taken").

In determining how much of a party's property was "taken," a persistent question has been how to define the numerator and denominator in the equation. In *Penn Central*, for example, the plaintiffs claimed that 100% of their air rights over Grand Central Station were "taken" by New York City, but the Court held that, rather, these air rights comprised only a partial percentage of their total property interest in the railway station. *Id.* at 130. In *Lucas*, the Court carved out an exception to the *Penn Central* ad hoc test, holding that when 100% of a property's value is "taken" by regulation, the government must always pay the owner just compensation. 505 U.S. 1003, 1015-16 (1992). However, this failed to provide any guidance on how to define the numerator and the denominator. More recently, the Court has affirmed the propriety of the *Penn Central* test. *See* Palazzolo v. Rhode Island, 533 U.S. 606, 617 (2001).

20. *See* Daniel M. Price, *NAFTA Chapter 1—Investor-State Dispute Settlement: Frankenstein or Safety Valve?*, 26 CAN-U.S. L.J. 107, 111 (2000); Madeline Stone, Note, *NAFTA Article 1110: Environmental Friend or Foe?*, 15 GEO. INT'L ENVTL. L. REV. 763, 777 (2003); Joseph de Pencier, *Investment, Environment and Dispute Settlement: Arbitration Under NAFTA Chapter Eleven*, 23 HASTINGS INT'L & COMP. L. REV. 409, 415 (2000).

lates the existing international standard,[21] but that "so-called regulatory takings are potentially addressable under the expropriation norm."[22] In practice, NAFTA dispute arbitration panels have so far interpreted the concept of expropriation conservatively, describing it as consistent with the international norm[23] while nevertheless dropping hints that future panels could adopt a much broader understanding.[24]

Article 1110 lays out a four-part test for evaluating the legitimacy of government actions. The article prohibits expropriations unless they are enacted:

a) for a public purpose
b) on a non-discriminatory basis
c) in accordance with due process of law . . . [and]
d) on payment of compensation.[25]

Section 2 of article 1110 defines compensation as "equivalent to the fair market value of the expropriated investment immediately before the expropriation took place,"[26] a description that generally reflects the "Hull Formula" for expropriation compensation. In 1938, U.S. Secretary of State Hull argued in response to Mexico's nationalization of American oil companies that compensation for expropriation should be "prompt, adequate, and effective."[27] Secretary Hull's insis-

21. Price, *supra* note 20, at 111 ("[I]n NAFTA, the parties used the classic international law formulation: an investment is not to be expropriated or nationalized, directly or indirectly, except for a public purpose through due process of law, in a nondiscriminatory fashion, and against payment of prompt, adequate, and effective compensation.").

22. *Id.*

23. NAFTA arbitral panels have stated that the NAFTA expropriation standard is merely coterminous with the traditional international expropriation standard. *See, e.g.*, S.D. Myers, Inc. v. Canada (U.S. v. Can.), 40 I.L.M. 1408, ¶ 286 (NAFTA Ch. 11 Arb. Trib. 2000) (Partial Award); Pope & Talbot, Inc. v. Canada (U.S. v. Can.), 7 ICSID (W. Bank) 55, ¶¶ 99-104 (NAFTA Ch. 11 Arb. Trib. 2000) (Interim Award), *available at* http://www.dfait-maeci.gc.ca/tna-nac/documents/pubdoc7.pdf; *see also* LOWENFELD, *supra* note 15, at 476-80.

24. Metalclad Corp. v. United Mexican States (U.S. v. Mex.), 40 I.L.M. 36 (NAFTA Ch. 11 Arb. Trib. 2000) (Final Award), *available at* http://naftaclaims.com/Disputes/Mexico/Metalclad/MetalcladFinalAward.pdf.

25. NAFTA, *supra* note 1, art. 1110.

26. *Id.*

27. LOWENFELD, *supra* note 15, at 397-402. For the full text of the correspondence between Secretary Hull and the Mexican government, see 3 GREEN HACKWORTH, DIGEST OF INTERNATIONAL LAW § 288 (1942).

tence on "adequacy" has been traditionally interpreted to mean "fair market value."[28] Since the 1930s, the United States' incorporation of Hull Formula language into hundreds of Bilateral Investment Treaties (BITs) has made it the presumptive standard for modern expropriation compensation.[29] In NAFTA, article 1110's compensation definition adopted that of the U.S.'s Model BIT.[30]

When a foreign investor believes its property rights have been expropriated by a host government, it may bring a compensation claim before a special NAFTA arbitral tribunal.[31] While the investor's home government is formally notified of the proceedings, the investor brings its claim against the host government entirely at its own discretion.[32] In the past, international investment arbitrations were traditionally contested by the two governments involved.[33] In the 1960s, however, the International Centre for the Settlement of Investment Disputes (ICSID) Convention established the investor-state process, and NAFTA and its BIT progeny have increasingly made this process the norm.[34] Proponents admire the efficiency, simplicity, and "de-politicizing" effect of the investor-state system.[35] Critics point out that whereas most previous international investor-state arbitrations concerned matters of private law, NAFTA panels have the de facto authority to invalidate

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28. LOWENFELD, *supra* note 15, at 480.

29. In time, the Hull Formula successfully supplanted its predecessor and rival, the Calvo Doctrine (named for its author, the Argentine jurist Carlos Calvo), which states that foreign investors should simply receive expropriation compensation on par with domestic investors according to the laws of the host government. *Id.* at 395. While the Calvo Doctrine gained wide acceptance in the developing world and in the United Nations as late as the 1970s, the Hull Formula eventually won the race. *Id.* at 483-84.

30. Model Bilateral Investment Treaty and Sample Provisions from Negotiated BITs, art. III, § 1 (1984), *reprinted in* 1 BASIC DOCUMENTS OF INTERNATIONAL ECONOMIC LAW 655, 657 (Stephen Zamora & Ronald A. Brand eds., 1990).

31. NAFTA, *supra* note 1, arts. 1120-25.

32. John B. Fowles, *Swords Into Plowshares: Softening the Edge of NAFTA's Chapter 11 Regulatory Expropriation Provisions*, 36 CUMB. L. REV. 83, 91-92 (2006).

33. LOWENFELD, *supra* note 15, at 484-85.

34. *Id.*

35. *See* Price, *supra* note 20, at 112.

public domestic law. As such, NAFTA cedes extraordinary authority to foreign investors and ad hoc arbitral panels.[36]

Parties who consent to litigate their claim before a NAFTA Tribunal must waive their right to bring their claim before any other court.[37] Normally, there is no opportunity to appeal the decision of a NAFTA Tribunal, although the courts of the local government where the Tribunal sits may hear appeals in extraordinary circumstances.[38] Tribunal proceedings are closed to the public, and panels may accept or refuse amicus submissions by non-governmental third parties at their discretion.[39] Arbitral decisions also have no formal precedential value for future Tribunals.[40]

B. *Critiques of NAFTA's Expropriation Provision*

Citizens groups such as the Council of Canadians,[41] the Development GAP,[42] and Public Citizen,[43] along with a gaggle of academics, have advanced four main criticisms of NAFTA's

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36. *See, e.g.*, INTERNATIONAL INSTITUTE FOR SUSTAINABLE DEVELOPMENT, PRIVATE RIGHTS, PUBLIC PROBLEMS: A GUIDE TO NAFTA'S CONTROVERSIAL CHAPTER ON INVESTOR RIGHTS, at vii (2001), *available at* http://www.iisd.org/pdf/trade_citizensguide.pdf.

37. NAFTA, *supra* note 1, art. 1121.

38. For example, a NAFTA arbitral tribunal's award in the case of *Metalclad Corp. v. United Mexican States* was ultimately reversed on grounds external to NAFTA by domestic Canadian courts. United Mexican States v. Metalclad Corp., [2001] B.C.S.C. 1529.

39. *See* United Parcel Service of America, Inc. v. Canada (U.S. v. Can.), ¶ 73 (NAFTA Ch. 11 Arb. Trib. 2001) (Decision on Amici Curiae), *available at* http://naftaclaims.com/Disputes/Canada/UPS/UPSDecisionReParticipationAmiciCuriae.pdf ("The Tribunal declares that it has power to accept written amicus briefs from the Petitioners. It will consider receiving them at the merits stage of the arbitration following consultation with the parties, exercising its discretion in the way indicated in this decision and in accordance with relevant international judicial practice.").

40. NAFTA, *supra* note 1, art. 1136.

41. "NAFTA is a bad deal for Canada. It undermines democracy, strips Canada of control over our energy resources, threatens to put water up for sale, and endangers health care and other public services." The Council of Canadians, Trade, NAFTA, http://www.canadians.org/trade/issues/NAFTA/ (last visited Oct. 15, 2007).

42. SARAH ANDERSON ET AL., INST. FOR POLICY STUDIES, THE DEVELOPMENT GAP & EQUIPO PUEBLO, NO LAUGHTER IN NAFTA: MEXICO AND THE UNITED STATES TWO YEARS AFTER (1996), http://www.developmentgap.org/trade/No_Laughter_in_NAFTA.html (last visited Oct. 20, 2007) (citing NAFTA's negative effects on jobs, production, rural communities, and women).

article 1110. The first of these arguments charges that article 1110 will be used to "attack perfectly standard exercises of the police power that purport to protect public health, safety, welfare, and the environment."[44] Other critics insist that it will give foreign investors an unfair advantage over their domestic competitors.[45] Some believe that article 1110 threatens to surreptitiously alter the domestic takings jurisprudence of the signatory parties.[46] Finally, a few critics have argued that article 1110 simply doesn't work: that the just compensation clause fails to promote efficient regulation and makes poor economic sense.[47]

The central and perhaps most troubling allegation about NAFTA's expropriation chapter is that it effectively impedes local governments from pursuing efficient regulation for the benefit of the public welfare. As one pair of writers put it, article 1110 threatens to "deter beneficial social and environmental regulation because regulators may soften or abandon proposed regulatory changes (or discontinue existing regulatory programs) rather than incur the cost of defending against takings claims, and/or paying a compensation award."[48]

The recent NAFTA case *Methanex v. United States* provides a helpful case study for this critique.[49] In 1999, California banned the gasoline additive methyl tertiary-butyl ether (MTBE) after regulators found that MTBE leaks had consistently and significantly contaminated state drinking water sys-

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43. PUBLIC CITIZEN, NAFTA CHAPTER 11 INVESTOR-STATE CASES: LESSONS FOR THE CENTRAL AMERICAN FREE TRADE AGREEMENT (2005), *available at* http://www.citizenstrade.org/pdf/pcnaftareport_Feb2005.pdf.

44. *See* Marc R. Poirer, *The NAFTA Chapter 11 Expropriation Debate Through the Eyes of a Property Theorist*, 33 ENVTL L. 851, 852-53 (2003); *see also* INTERNATIONAL INSTITUTE FOR SUSTAINABLE DEVELOPMENT, *supra* note 36, at 1. *See generally* Jesse Williams, *Regulating Multinational Polluters in a Post-NAFTA Trade Regime: The Lessons of* Metalclad v. Mexico *and the Case for a "Takings" Standard*, 8 UCLA J. INT'L L. & FOREIGN AFF. 473 (2003).

45. *See* Matthew C. Porterfield, *International Expropriation Rules and Federalism*, 23 STAN. ENVTL. L.J. 3, 43 (2004); Been & Beauvais, *supra* note 3, at 129.

46. Been & Beauvais, *supra* note 3, at 139.

47. *See id.* at 88.

48. *Id.* at 132.

49. Methanex Corp. v. United States (Can. v. U.S.), 44 I.L.M. 1345 (NAFTA Ch. 11 Arb. Trib. 2005) (Final Award), *available at* http://naftaclaims.com/Disputes/USA/Methanex/Methanex_Final_Award.pdf.

tems.[50] Methanex, a Canadian corporation, produces methanol, the chief constituent in MTBE.[51] Under NAFTA, Methanex brought a claim against the United States for $970 million, alleging that California had denied Methanex "fair and equitable" treatment,[52] improperly favored domestic competitors,[53] and "expropriated"[54] Methanex's American gasoline additive market share.[55]

In 2002, a NAFTA tribunal dismissed most of Methanex's claims on jurisdictional grounds but let the company amend and reargue its complaint. Methanex reargued in 2003, and the tribunal finally dismissed Methanex's claim in 2005.[56] Had Methanex been able to show that its property interest had been expropriated, the effect on efficient local regulation would have been dramatic. Assume that Methanex actually suffered the losses it claimed, $970 million, but that the diffuse public health benefits of banning MTBE to California citizens of this and future generations are far greater. A dispassionate cost-benefit analysis suggests that California should enact the regulation, but the enormous lump-sum, up-front liability that could be assigned by a NAFTA tribunal would penalize California for pursuing this otherwise fiscally prudent path.

NAFTA critics would have a harder time arguing that the United States should not pay compensation if California had actively solicited Methanex's business, for instance in the location and construction of a plant, and then subsequently outlawed its product. In this case, California would appear to bear at least some blame for Methanex's loss.[57] But in a situation in which California and Methanex had no prior direct relationship before the investor initiated litigation, NAFTA's effect on efficient regulation may be "chilling" indeed.

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50. *See* PUBLIC CITIZEN, *supra* note 43, at 31.

51. *Id.*

52. NAFTA, *supra* note 1, art. 1105(1).

53. *Id.* art. 1105(2).

54. *Id.* art. 1110.

55. PUBLIC CITIZEN, *supra* note 43, at 32.

56. Methanex Corp, 44 I.L.M. at 1464, pt. VI.

57. The arbitral panel said as much in its final decision dismissing Methanex's claim when it found that regulations are not expropriations ". . . unless specific commitments had been given by the regulating government to the then putative foreign investor contemplating investment that the government would refrain from such regulation." *Id.* at 1455, pt. IV, ch. D, ¶ 7.

Not surprisingly, environmentalists have often taken the lead in advancing this critique of NAFTA expropriations.[58] Environmental regulation, with benefits and beneficiaries that can be difficult to identify and quantify, and which necessarily takes a long-term view of the public good, is perhaps particularly susceptible to damage awards against governments that are immediate and significant. It is important to note, however, that investors have brought expropriation claims over a range of non-environmental government actions, demonstrating that article 1110 may pose a threat to a variety of "public purpose" regulations.[59]

Other NAFTA critics allege that article 1110 delivers a tactical advantage to foreign investors by providing them with a remedy unavailable to their domestic competitors. Takings claims, especially the "regulatory takings" and measures "tantamount to expropriation" at issue here, are historically difficult to assert under domestic law.[60] Even in the United States, which offers perhaps as much protection of personal property rights as any nation in the world, article 1110 suggests a lower

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58. *See* INTERNATIONAL INSTITUTE FOR SUSTAINABLE DEVELOPMENT, *supra* note 36, at vii; Williams, *supra* note 44.

59. *See, e.g.*, Kenex Ltd. v. United States (Can. v. U.S.), (NAFTA Ch. 11 Arb. Trib. 2002) (Notice of Arbitration), *available at* http://www.state.gov/documents/organization/13204.pdf (concerning a Canadian hemp production company's contest of U.S. Drug Enforcement Agency regulations criminalizing the importation of hemp foods).

60. For surveys of takings jurisprudence under Mexican domestic law, see generally Patrick Del Duca, *The Rule of Law: Mexico's Approach to Expropriation Disputes in the Face of Investment Globalization*, 51 UCLA L. REV. 35 (2003); Scott R. Jablonski, *NAFTA Chapter 11 Dispute Resolution and Mexico: A Healthy Mix of International Law, Economics and Politics*, 32 DENV. J. INT'L L. & POL'Y 475 (2004). For a discussion of expropriations under Canadian law, see James McIlroy, *Private Investment Claims Against State and Provinces—The Impact of NAFTA Chapter 11 on Sub-Federal Government Agencies*, 27 CAN.-U.S. L.J. 323, 326 (2001) ("In Canada things are different. Under Canada's Charter of Rights and Freedoms, that only came into force about twenty years ago, Canada deliberately excluded property rights. So the constitutional protection of property found in the U.S. is not reflected in Canada's laws or political culture. Under Canadian law a legislator may enact a statute that expropriates private property without compensation as long as its does so with clear language. Most provincial statutes provide for compensation when real property, land, is expropriated, but they do not have to.") and also see Terri L. Lilley, Note, *Keeping NAFTA "Green" for Investors and the Environment*, 75 S. CAL. L. REV. 727, 749-53 (2002) (comparing the domestic takings doctrines of NAFTA's three signatory parties).

takings standard than most Fifth Amendment takings jurisprudence.[61]

Under this argument, NAFTA will cause two main adverse effects. By offering foreign investors a remedy that is foreclosed to their domestic counterparts, article 1110 not only creates an uneven playing field in the marketplace, but it also gives domestic investors a perverse incentive to style themselves as foreign. Accordingly, it will be in the interest of domestic investors to claim whatever cross-boundary origin, ownership, or presence that they can in order to avail themselves of NAFTA's friendly law.[62]

The third criticism is that NAFTA's expropriation "jurisprudence," crafted by ad-hoc multinational tribunals, threatens to unduly influence the domestic expropriation jurisprudence of NAFTA's signatory parties.[63] The U.S. Supreme Court has painstakingly wrestled with the questions of what constitutes "taking," "just compensation," and "public use" as articulated by the Fifth Amendment.[64] While most legal analysts agree that the results of this two century-plus odyssey are deeply unsatisfying,[65] the prospect of obscure tribunals creating de facto precedents is equally troubling. For politically progressive critics who already feel pinched by the inroads that property rights advocates have made in the American judiciary and electorate,[66] the possibility that a NAFTA-influenced regime could cause the most property-friendly nation in the

61. *See* Been & Beauvais, *supra* note 3, at 59.

62. This is essentially what the investor plaintiff in *Methanex* tried to do. While Methanex itself does not produce the regulated additive at issue, MTBE, it claimed standing under NAFTA on the ground that it wholly owned two U.S. companies that produce the additive. *See* PUBLIC CITIZEN, *supra* note 43, at 31.

63. This is one of the central theses of the Been & Beauvais article. *See* Been & Beauvais, *supra* note 3, at 59.

64. U.S. CONST. amend. V.

65. Probably every legal "expert" believes that his or her private corner of the law is the most unsettled, contradictory, or outrageous. Nevertheless, American takings jurisprudence tries the patience of even its greatest practitioners. "Even the wisest lawyers would have to acknowledge great uncertainty about the scope of this Court's takings jurisprudence." Nollan v. Cal. Coastal Comm'n, 483 U.S. 825, 866 (1987) (Stevens, J., dissenting).

66. *See, e.g.*, William Greider, *The Right and U.S. Trade Law: Invalidating the 20th Century*, THE NATION, Oct. 15, 2001, *available at* http://www.thenation.com/doc/20011015/greider.

world to become even more so is unsettling.[67] Meanwhile, neither Canadian nor Mexican law explicitly recognizes a private party's right to just compensation in the event of a public expropriation. Given this, the effect of such a change on them would be much more dramatic.

Finally, in recent years, a few astute critics have questioned in the NAFTA context and otherwise whether making governments pay for taking property is sensible at all. One of the central rationales for making governments pay just compensation is that it forces them to "internalize" costs and take economic responsibility for their decisions.[68] Governments, in theory, will only pursue economically efficient regulation if they are made to realize both the costs and the benefits of these actions. In their seminal critique of article 1110, Professor Vicki Been and Joel Beauvais persuasively suggest that NAFTA's compensation mechanism fails to achieve this cost-internalization.[69] The authors draw heavily on the recent work of Professor Daryl Levinson, who, writing about American domestic takings generally, demonstrates that making governments pay is as least as likely to promote inefficient regulation as it is efficient regulation.[70] Professor Levinson contends that it is a mistake to analogize governments to private companies.[71] While a private company is a "profit-maximizer" that is highly responsive to economic costs, a government is not.[72] His key insight is that governments are responsive to political rather than economic costs.[73] The following proposal for an

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67. Under Canadian law, legislators may or may not elect to offer private parties compensation in the context of legislation that works expropriations. *See* McIlroy, *supra* note 60, at 326. Likewise, Mexico's expropriation laws, dating to the 1917 Constitution and the 1936 Law of Expropriation, work to ensure that "the Revolutionary constitutional agenda of property redistribution, particularly agricultural property, ecclesiastical property, and subsoil resources, is today largely achieved." Del Duca, *supra* note 60, at 50.

68. The classic statement of this takings rationale was formalized by Professor Frank Michelman. *See* Frank I. Michelman, *Property, Utility, and Fairness: Comments on Ethical Foundations of "Just Compensation" Law*, 80 HARV. L. REV. 1165, 1172-83 (1967).

69. Been & Beauvais, *supra* note 3, at 88.

70. Daryl J. Levinson, *Making Government Pay: Markets, Politics, and the Allocation of Constitutional Costs*, 67 U. CHI. L. REV. 345, 354-57 (2000).

71. *Id.*

72. *Id.* at 355.

73. *Id.* at 357.

Alternative Compensation Scheme for NAFTA expropriations proceeds from this insight.

III. An Alternative Scheme for Bringing Expropriation Claims Under NAFTA

A. *Home Governments as Indemnitors of Their Native Investors Abroad*

Critics of NAFTA's expropriation provision, whatever their grounds for dissent, typically propose the same solution: Narrow NAFTA's definition of "expropriation" to at least bring it in line with U.S. criteria for "regulatory takings," or roll it back further still.[74] American courts' own well-documented struggle with defining takings, however, demonstrates the difficulty that NAFTA tribunals would face in formulating a concise and coherent expropriation standard. A simpler, if unorthodox, solution to NAFTA's expropriation problems exists. When a local government passes a "public purpose" regulation that is found to expropriate a foreign investor's property, we should require the investor's home government to compensate the investor.

This Alternative Scheme neither endorses nor rejects NAFTA tribunals' current definition of what constitutes an expropriation.[75] Rather, this note argues that a discrete liability rule can better mitigate the potential negative effects of NAFTA's expropriation provision than can an ill-defined property rule.

The Alternative Scheme would work in the following way. Article 1110 prohibits expropriations except when the action is pursued for a public purpose; applied in a non-discriminatory manner, accords with due process of law; and the respon-

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74. *See* Been & Beauvais, *supra* note 3, at 136-37.

75. Indeed, it is not yet clear what that definition is. Arbitral panels have suggested that the NAFTA understanding of expropriation is consistent with traditional international conceptions, but, even in these statements, critics have identified hints of a much broader definition forthcoming. *See* Price, *supra* note 20, at 111-12; Been & Beauvais, *supra* note 3; *see also* Methanex Corp. v. United States (Can. v. U.S.), 44 I.L.M. 1345, 1456, pt. IV, ch. D (NAFTA Ch. 11 Arb. Trib. 2005) (Final Award), *available at* http://naftaclaims.com/Disputes/USA/Methanex/Methanex_Final_Award.pdf. What the NAFTA meaning of expropriation is, and what it should be, has been ably explored elsewhere and is outside the scope of this Note.

sible government pays the affected investor just compensation. Under the Alternative Scheme, when an investor believes it has suffered an expropriation at the hands of its host government, it would bring a claim for indemnification not against the host government, but against its home government. Upon the investor making a prima facie showing of economic loss caused by the host government's action, the home government would become liable for the investor's loss.

The home government, then, would have the option of impleading the host government for restitution. If the home government can show a violation of article 1110—that the host government's action was not undertaken for a "public purpose," was applied in a discriminatory manner, or did not observe due process of law—the liability would shift to the host government. If, however, the expropriation was "legitimate," the liability would remain with the home government.

This alternative compensation scheme has several advantages over the present system, and would address the major critiques of the NAFTA expropriations system as outlined *supra*. First and foremost, local governments would be free to pursue legitimate public purpose regulation without being subjected to immediate lump-sum expropriation damages.[76] The democratic relationship between a locality's representatives and their constituents would not be compromised by the

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76. Under NAFTA, the signatory parties (the national governments) are responsible for damage payments. *See* Been & Beauvais, *supra* note 3, at 90. The national governments may pass these costs on to the "offending" local government according to domestic law, but nothing in NAFTA explicitly provides for or prohibits this. *Id.* Been & Beauvais point to this fact to show that damage awards fail to internalize costs for local governments in the first place, because local governments do not necessarily pay the costs. In Canada, for example, the Federation of Canadian Municipalities has sought the national government's assurance that local governments will never be penalized for "legal" measures that are nevertheless found to violate NAFTA. *Id.* (citing Fed'n of Canadian Municipalities, Municipal Questions Respecting Trade Agreements (2001), http://www.fcm.ca/english/documents/worldtrade1.html).

A related problem is uncertainty as to which government should pay the award. In *Metalclad*, before the judgment was overturned, Mexico was late in delivering its compensation payment to the investor because the national and local government could not agree who was responsible, or for how much. *See* Been & Beauvais, *supra* note 3, at 90. Still, whether the national or local government ultimately bears the brunt of the costs, the effect on efficient regulation may fairly be said to be "chilling."

actions of an unelected, international tribunal. Instead, legitimate expropriation costs would be distributed throughout the national electorate of the home government, a direct result of that democratically-elected home government's decision to engage in international free trade. The economic costs of free trade would be distributed among its economic beneficiaries.[77]

Second, foreign investors would no longer enjoy a tactical advantage over their domestic counterparts. Presently, foreign investors can seek relief from host governments' actions before NAFTA tribunals, whereas this remedy is foreclosed to domestic investors. While foreign investors may be indemnified by their home governments under the Alternative Scheme, the Scheme contemplates host governments being asked to compensate either all investors whose property is expropriated, or none (without the current discrepancy between foreign and domestic). In the case of an "illegitimate" expropriation, domestic investors can seek relief under domestic law, and home governments can subrogate the foreign investors' claims under the Alternative Scheme. In the case of a "legitimate" expropriation, neither domestic nor foreign investors would receive compensation from the host government.[78]

Third, the Alternative Scheme would neutralize any untoward influence that NAFTA takings jurisprudence might have on the signatory parties' domestic expropriation jurisprudence. Such a radically different compensation apparatus would belie the analogy. Home government indemnification would announce an altogether different theory and procedure for assigning expropriation liability; a theory uniquely designed to both suit the abilities of an ad hoc arbitration panel (as opposed, for example, to an Article III court) and to advance the objectives of free trade. Under the Alternative

77. *See* Price, *supra* note 20, at 113 ("How can we let international arbitrators decide whether or not a law adopted by the Congress of the United States, or the legislature of a state, is fair and equitable or constitutes an expropriation? . . . There is a very easy answer to that question. We can do that because we agreed to do that.").

78. Foreign investors may still receive compensation from their home government in the case of a "legitimate" expropriation. As further explained under the Alternative Scheme, however, investors would be discouraged from burdening their home governments with claims that appear to lack merit. *See infra* Part III.B.

Scheme, as will be explored, assignment of liability will ultimately hinge on the host government's ability to show a "public purpose"—a standard that would be largely informed by historical international expropriations and present international expropriation insurance provisions.[79] In contrast with international expropriation doctrine, where the scope of "public purpose" has been extensively explored and debated, the U.S. Supreme Court has consistently declined to inquire into the public purpose bona fides behind domestic takings.[80] This distinction creates further conceptual distance between the two doctrines, and reduces the chance that NAFTA expropriation decisions will bleed into domestic takings jurisprudence.

Despite these benefits of the Alternative Scheme, there remain two elephants in the room. First, a major justification for requiring governments to pay compensation when they "take" private property is to force them to internalize costs; when governments have to pay, the theory goes, they will only pursue efficient regulation.[81] The Alternative Scheme patently fails—indeed, it does not even try—to achieve this goal. Second, according to NAFTA's proponents, a core virtue of the treaty's investor-state dispute mechanism is that it streamlines the process by bypassing the investor's home government.[82] The Alternative Scheme brings the home government back into the picture.

In fact, keeping the home government in the picture is necessary to internalize the *political* costs of NAFTA expropriations. This is the appropriate objective for takings compensation, and the Alternative Scheme's ability to achieve this objective is its greatest virtue. By exposing both national governments in an expropriation dispute to potential liability, two kinds of dialogue are opened. First, horizontally, the two peer national governments are motivated to negotiate with one an-

79. *See infra* Part III.D.

80. The Fifth Amendment addresses government seizing property for a "public use," not "public purpose." In a recent case before the Supreme Court, plaintiffs protesting a town's exercise of eminent domain argued in part that a public use is different from a public purpose, contending that the former is more instrumental in nature, concerning "means," while the latter focuses on "ends." The Court rejected this argument. *See* Kelo v. New London, 545 U.S. 469, 479-80 (2005).

81. *See* Michelman, *supra* note 68, at 1181-82.

82. *See* Price, *supra* note 20, at 112.

other to settle the liability. Second, vertically, the host government is motivated to negotiate with the constituent local government that has undertaken the expropriation, and the home government is motivated to negotiate with its native investor. Neither bald expropriations nor frivolous expropriation claims are likely survive this process, eliminating the most politically inefficient actions from the system.

As modern scholarship has persuasively contended, governments fail to respond rationally to economic costs; rather, as political entities, they are most responsive to political costs.[83] The compensation scheme that best internalizes these political costs will prove the most efficient. Here, an efficient scheme is one that implicates all of the beneficiaries and cost-bearers in the process and justly distributes benefits and costs among those parties. As will be shown, this political efficiency will both eliminate the political externalities borne by parties with endemic disadvantages in local government processes and streamline expropriation claims that currently occupy the NAFTA arbitral process for years at a time.[84]

83. *See* Levinson, *supra* note 70, at 345.

84. The Alternative Scheme is well-suited to an agreement such as NAFTA, in which the parties have a strong interest in each other's well-being given their shared borders and already closely-linked economies (though significant inequalities still exist between the parties). As discussed *infra*, the operation of political incentives and pressures will be most effective when parties are "repeat players" and thus discouraged from punishing each other with impunity.

While the Alternative Scheme may also work well in a trading relationship marked by significant inequalities, it should not be pretended that the Alternative Scheme is designed to or would alleviate such inequalities. The Alternative Scheme brings the "missing" government to the arbitral table, and this could work to discourage a sophisticated investor from a developed country from burdening an underdeveloped host country with aggressive expropriation claims. But the Alternative Scheme is primarily designed to aid the operation of free trade. Insofar as free trade functions to reduce global inequalities by redistributing wealth, the Alternative Scheme would work to do the same. Insofar as free trades works to exacerbate these inequalities, so would the Alternative Scheme. For discussions of the effects of liberal trade regimes on global inequality, see, e.g., JEFFREY SACHS, THE END OF POVERTY: ECONOMIC POSSIBILITIES FOR OUR TIME (2005); THOMAS FRIEDMAN, THE LEXUS AND THE OLIVE TREE: UNDERSTANDING GLOBALIZATION (2000).

B. *The Operation of Political Incentives and Pressures*

The current procedure by which a disputing investor and state avail themselves of NAFTA's dispute settlement mechanism is fairly simple, and under the Alternative Compensation Scheme it would remain so. Presently, an investor must wait six months after an alleged expropriation before filing a claim with an arbitral panel.[85] NAFTA contemplates that the parties will use this six month waiting period to settle their dispute through "consultation and negotiation."[86] The investor next submits a Notice of Intent to Submit a Claim for Arbitration to its host government ninety days before actually filing its claim.[87] The Notice of Intent must identify the provisions of NAFTA that are alleged to have been breached, the issues and the factual basis for the claim, and the relief sought, including the amount of any damages.[88] An investor must bring its expropriation claim within three years of the alleged violation, or any such claims are extinguished.[89]

After filing a claim, the investor notifies the other named parties within thirty days.[90] An unnamed signatory party, upon notifying the disputing parties, may make a submission to the arbitral panel on any question of interpretation of NAFTA language.[91] The investor may choose to submit its claim under one of three international arbitration frameworks: the International Centre for Settlement of Investment Disputes (ICSID) Convention, the Additional Facility Rules of ICSID, or the United Nations Commission on International Trade Law (UNCITRAL) arbitration rules.[92] The ICSID Convention rules require that both the host government and the investor's

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85. NAFTA, *supra* note 1, art. 1120.
86. *Id.* art. 1118.
87. *Id.* art. 1119.
88. *Id.*
89. *Id.* art. 1117.
90. *Id.* art. 1127.
91. *Id.* art. 1128.
92. *Id.* art. 1120. Convention on the Settlement of Investment Disputes Between States and Nationals of Other States, Mar. 18, 1965, 17 U.S.T. 1270, 575 U.N.T.S. 159 [hereinafter ICSID Convention]; International Centre for Settlement of Investment Disputes (ICSID), Additional Facility Rules, ICSID Doc. ICSID/11/Rev. 1 (Jan. 2003) [hereinafter Additional Facility Rules]; UNCITRAL Arbitration Rules, G.A. Res. 31/98, U.N. Doc. A/RES/31/98 (Dec. 15, 1976).

home government be members of the Convention.[93] Since at present the only NAFTA party also party to ICSID is the United States, this option is foreclosed until either Canada or Mexico join as well.[94] ICSID's Additional Facility Rules stipulate that at least one party be an ICSID member, so this option is available to the investor when the United States is either the host or home government.[95] The UNCITRAL rules are the most popular choice; twelve of the approximately twenty disputes that have been fully litigated before NAFTA tribunals have operated under this system.[96]

An investor typically joins an expropriation claim with one or more claims under other Chapter Eleven provisions. For example, there are provisions that require host governments to treat NAFTA party investors at least as well as domestic investors, all other foreign investors, and "in accordance with international law."[97] The crux of the investor's argument, then, is that the host government has treated it discriminatorily and expropriated its property. Nondiscriminatory treatment is one element of article 1110's definition of legal expropriations, so an investor's alternative claims are essentially subsumed in its expropriation analysis.

Under the Alternative Scheme, the investor would still use the six month "consultation and negotiation" period to try to settle its claim with its host government. If the investor were unable to settle its claim within that period, it would then file a Notice of Intent to Submit a Claim not with its host government but instead with its home government, and still no fewer

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93. *See* ICSID Convention, *supra* note 92, art. 25; Jessica S. Wiltse, Comment, *An Investor-State Dispute Mechanism in the Free Trade Area of the Americas: Lessons from NAFTA Chapter Eleven*, 51 BUFF. L. REV. 1145, 1159 (2003).

94. The World Bank Group, ICSID, List of Contracting States, http://www.worldbank.org/icsid/constate/c-states-en.htm (last visited Oct. 31, 2007).

95. Wiltse, *supra* note 93, at 1159; *see generally* Additional Facility Rules, *supra* note 92.

96. Wiltse, *supra* note 93, at 1160.

97. *See, e.g.*, Methanex Corp. v. United States (Can. v. U.S.), (NAFTA Ch. 11 Arb. Trib. 1999) (Notice of Intent), *available at* http://naftaclaims.com/Disputes/USA/Methanex/MethanexNoticeOfIntent.pdf (asserting claims under articles 1105 and 1110); Ethyl Corp. v. Canada (U.S. v. Can.), (NAFTA Ch. 11 Arb. Trib. 1996) (Notice of Intent), *available at* http://www.naftaclaims.com/Disputes/Canada/EthylCorp/EthylCorpNoticeOfIntent.pdf (asserting claims under articles 1102, 1106, and 1110).

than ninety days before it files its actual claim with the arbitral panel. The home government, then, would have its own ninety-day window to try to facilitate a settlement between its native investor and the investor's host government. And the home government would have an incentive to try to do so—it would be potentially liable for its partner government's legitimate, public purpose expropriation. As it sees fit, the home government could either apply political pressure on its native investor to drop the claim or it could apply political pressure on the host government to ameliorate its confiscatory regulation or pay compensation for its expropriation.

NAFTA proponents count the "de-politicizing" effect of the current Investor-State Dispute Mechanism as one of its chief strengths. They believe that the great advantage of the ISDM over previous systems as well as over contemporary systems like the World Trade Organization (WTO) Dispute Settlement Body is that the investor does not have to ask its home government to bring a claim on its behalf; rather, the investor brings the claim itself. The Alternative Scheme preserves this investor autonomy. The investor is free to stick its home government with its expropriation "bill." Indeed, the investor has at least a great a chance of actually receiving compensation under the Alternative Scheme, as the home government may decide that it is politically wiser to pay the investor rather than litigate the claim. To the extent that the Alternative Scheme "re-politicizes" the dispute mechanism, it does so in a limited and desirable fashion. Since host governments must bear the political costs of their expropriations in the form of political pressure applied by investor-home governments, host governments will only expropriate investor property when it is politically efficient to do so.

In other words, local host governments will "expropriate"—insofar as that term can be applied to a "regulatory taking"—when the political benefits of a public health regulation outweigh the political costs of disadvantaging foreign investors, their home governments, and the local host government's own national government. While some critics might find any such tradeoff to be objectionable, it is at least the tradeoff that *politicians* are qualified to make. Conversely, when politicians are asked to evaluate the *economic* benefits of public health regulation against the *economic* costs of disadvantaging foreign investors, they inevitably make poor choices.

Should an investor's claim go to arbitration, the investor would still have to show that its property was expropriated. Arbitral panels could apply the same indeterminate expropriation standard that they have applied in the past or, consistent with an alternative system that shifts the evaluation to the *public purpose* of the expropriation, panels could simply ask investors to make a prima facie showing of expropriation. While a variety of courts have struggled to define expropriations or "takings," a lesser evidentiary standard might facilitate a clearer definition. Elements might naturally include the investor showing a determinate economic loss and that the state action was a "but-for" cause of that loss.

The real action of the arbitration, then, would be in the home government's decision whether or not to implead the host government. Should the investor successfully show an expropriation, the home government would then have to show that the host government violated one of the three remaining tenets of article 1110: non-discrimination, due process, or public purpose. The focus would then properly be not on the extent of the investor's loss but on the character of the host government's action. The two partner governments would then have the opportunity to either arbitrate or craft an equitable settlement, which might include dividing liability and reaching an understanding on what will constitute an "expropriation" in the future. Consequently, the political costs of expropriations would be distributed on the same national, signatory party-level as the political benefits of free trade.

Again, the great advantage of the Alternative Scheme is that it gives host governments a political incentive to make only politically efficient expropriations. The idea is that the costs of a government's action should come in the same currency as the benefits. So when a government reaps the political benefits of passing legislation that is popular with its own constituents but unpopular with those outside of its jurisdiction, those disadvantaged external parties—here, the foreign investor—have a voice in the form of the political pressure that their own government will apply in seeking to settle any claims of liability.

In order to bring the Alternative Scheme into existence, a new "liability" section would have to be appended to the existing Chapter Eleven, Section B language. This section would stipulate that a home government is liable for a host government's public purpose expropriations, and that the home government may implead the host government before the arbitral panel.

This alteration is a relatively small change to the NAFTA dispute settlement language, but it nonetheless begs the question of why we shouldn't simply go to the root cause of the problem and narrow the scope of statutory expropriations to eliminate egregious claims. However, this option has already been found hopelessly problematic by NAFTA's own architects.[98] The failure of the abandoned Multilateral Investment Agreement (MIA) to better define "expropriation" provides a case in point.[99] In 1995, the member nations (all developed countries) of the Organisation for Economic Co-operation and Development (OECD) sought a global agreement on the appropriate standards for investment liberalization, protection, and dispute settlement.[100] The resulting agreement was open to any nation able to meet its standards, and several developing countries joined the negotiating progress as observers.[101] Buoyed by the apparent early success of NAFTA, the MIA adopted NAFTA's definition (or lack thereof) of expropriation word for word—"expropriations or . . . measures tantamount to expropriation or nationalisation."[102] The clear inference and expectation was that creeping expropriations and

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98. *See* Price, *supra* note 20, at 111 ("The negotiators tried for some time to consider putting a line in the text that would distinguish between legitimate regulation on the one hand, bona fide and nondiscriminatory, and a taking on the other hand. We quickly gave up that enterprise. If the U.S. Supreme Court could not do it in over 150 years, it was unlikely that we were going to do it in a matter of weeks with one exception.").

99. Org. for Econ. Co-operation and Dev. [OECD], The Multilateral Agreement on Investment, OECD Doc. DAFFE/MAI(98)17 (May 4, 1998) (Report by the Chairman to the Negotiating Group), *available at* http://www1.oecd.org/daf/mai/pdf/ng/ng9817e.pdf.

100. For a comprehensive account of the MIA negotiating process and its relevance for expropriations standards, see Rainer Geiger, *Regulatory Expropriations in International Law: Lessons from the Multilateral Agreement on Investment*, 11 N.Y.U. ENVTL. L. J. 94 (2002).

101. *Id.* at 94 n.1.

102. *Id.* at 100.

regulatory takings would be captured in this language. An interpretive addendum explained that this definition was intended to "incorporate existing international legal norms" and that losses suffered through "regulation, revenue raising, and other normal activity in the public interest undertaken by governments" would not be considered expropriations.[103] But the Agreement did not identify where normal activity ended and expropriations began.

With the 1997 NAFTA arbitral decision in *Ethyl Corp. v. Government of Canada*,[104] in which a private American investor's action effectively repealed a Canadian government regulation, the MIA negotiators felt pressure to assure observers that its definition of expropriation would not be overly broad.[105] In the spring of 1998, the OECD Council of Ministers published a Declaration stating that the "normal, non-discriminatory exercise of regulatory powers of governments" would not be construed as expropriations under the MIA.[106] But like NAFTA's own assurance that its goals should be accomplished "in a manner consistent with environmental protection and conservation,"[107] the MIA's additional language gives little useful guidance on the meaning of expropriation within this abandoned treaty.

Perhaps the appropriate question is: What functions are ad hoc, appointed arbitral panels best situated to perform—those of a law-giver, or those of a mediator? Under the Alternative Scheme, arbitral panels are tasked with facilitating compromise among all of the affected parties as much as they are tasked with defining what constitutes an expropriation. Such is the fundamental advantage of a liability rule over a property rule. The Alternative Scheme promises investors compensation, host governments the freedom to regulate in the public interest, and NAFTA signatories the free flow of goods and services as they originally intended.

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103. *Id.*

104. Ethyl Corp. v. Canada (U.S. v. Can.), 38 I.L.M. 708, 719-20 (NAFTA Ch. 11 Arb. Trib. 1997) (Award on Jurisdiction), *available at* http://www.naftaclaims.com/Disputes/Canada/EthylCorp/EthylCorpAwardOnJurisdiction.pdf.

105. *See* Geiger, *supra* note 100, at 100.

106. *Id.* at 100-01.

107. NAFTA, *supra* note 1, pmbl.

C. *Political Risk Insurers' Conception of "Public Purpose"*

It may be contended that the Alternative Scheme does not so much trade a fuzzy property rule for a discrete liability rule as it trades one fuzzy property rule for another. While the Alternative Scheme would clarify, or at least de-emphasize, the definition of what constitutes an expropriation or a "taking," once an expropriation is shown, the Alternative Scheme would assign liability between the two governments based on whether the host government's expropriating action was undertaken for a "public purpose." But what does "public purpose" mean?

A quick look at the efforts of American courts to define "public purpose" demonstrates the depth of this problem. The Fifth Amendment states that "private property [shall not] be taken for public use, without just compensation."[108] The vast majority of litigation surrounding the Takings Clause has centered around the meaning of the words "taken" and "just compensation;" seldom have cases focused on whether government condemnations have been undertaken for a truly "public use." On the few occasions when this issue has arisen, it has usually been in the context of a government condemning private property and transferring that property to a second private party.[109]

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108. U.S. CONST. amend. V.

109. In 1954, the U.S. Supreme Court ruled that it was constitutionally legitimate for governments to condemn "blighted" properties in order to clear them and transfer them to private parties who would facilitate their redevelopment. Berman v. Parker, 348 U.S. 26 (1954). The Court found redeveloping blighted property to be within the traditional scope of the goals to which a government may apply its "police power"—to achieve "public safety . . . health, morality, peace and quiet, law and order." *Id.* at 32. In 1984, the Court stated more explicitly that the public use scope of the Taking Clause was "coterminous" with the scope of the state's police power. Haw. Hous. Auth. v. Midkiff, 467 U.S. 229, 240 (1984) ("The 'public use' requirement is . . . coterminous with the scope of a sovereign's police power."). Interestingly, though, the author of the *Midkiff* opinion, Justice O'Connor, has recently repudiated this claim. *See* Kelo v. New London, 545 U.S. 469, 500-01 (O'Connor, J., dissenting) ("[W]e said in *Midkiff* that '[t]he "public use" requirement is coterminous with the scope of a sovereign's police powers.' This language was unnecessary to the specific holdings of those decisions.") (internal citation omitted). Of course, the scope of a state's police power has only ever been defined by domestic courts and legislatures in the most general terms. *See e.g.*, Midkiff, 467 U.S. at 239.

More recently, the question of what "public use" means has received renewed attention and greater scrutiny. In 2003, the Michigan Supreme Court reversed what had become regarded as its infamous decision in *Poletown Neighborhood Council v. City of Detroit*,[110] which had validated Detroit's condemnation of a middle-class neighborhood so that it could convey the land to General Motors for the construction of a new automobile plant.[111] The U.S. Supreme Court, however, has refused its most recent invitation to give content to the "public use" requirement.[112]

If American courts have essentially read the "public use" clause of the Fifth Amendment to be without any independent meaning,[113] what confidence can litigants have in NAFTA arbitral panels to appropriately define and apply the "public purpose" concept? The answer may lie in the expropriation standards articulated by two international investment insurance re-

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110. Poletown Neighborhood Council v. Detroit, 304 N.W.2d 455 (Mich. 1981), *overruled by* County of Wayne v. Hathcock, 684 N.W.2d 765 (Mich. 2004).

111. *Hathcock* overruled *Poletown*, announcing that such economic development condemnations could not be characterized as a "public use." 684 N.W.2d at 476.

112. In *Kelo v. City of New London*, plaintiff property owners suggested that governments should be required to make some showing that their condemnations, particularly those undertaken for economic development, are "reasonably" likely to have a "public use." Kelo, 545 U.S. at 476-77. The Court, however, refused to second-guess the city's assertion that this land was necessary for its project, holding that even condemnations and transfers to private parties to be used for a "public purpose," namely development, satisfies the Fifth Amendment's "public use" requirement. *Id.* at 489-90 ("[T]he necessity and wisdom of using eminent domain to promote economic development are certainly matters of legitimate public debate. This Court's authority, however, extends only to determining whether the City's proposed condemnations are for a 'public use' within the meaning of the Fifth Amendment to the Federal Constitution. Because over a century of our case law interpreting that provision dictates an affirmative answer to that question, we may not grant petitioners the relief that they seek.").

113. *See, e.g.*, Berman, 348 U.S. at 32 ("We deal . . . with what traditionally has been known as the police power. An attempt to define its reach or trace its outer limits is fruitless, for each case must turn on its own facts. The definition is essentially the product of legislative determinations addressed to the purposes of government, purposes neither abstractly nor historically capable of complete definition. Subject to specific constitutional limitations, when the legislature has spoken, the public interest has been declared in terms well-nigh conclusive.").

gimes, the United States' Overseas Private Investment Corporation (OPIC) and the Multilateral Investment Guarantee Agency (MIGA). In contrast with the vague preambular language appended to NAFTA and the ill-fated MIA, OPIC and MIGA specifically define what they will and will not cover within the text of their expropriation clauses.[114] Based on the OPIC and MIGA standards, regulations with a "public purpose" are simply those that are passed lawfully, within the scope of the traditional nation of a state's police power, and pursued in an nondiscriminatory manner.

Created in 1969, OPIC is an intellectual descendent of the Marshall Plan.[115] It was intended to encourage American investors to invest in developing nations and as a way to promote capitalism and stem the tide of communism.[116] OPIC offered loans to American investors for their international projects, provided insurance against political risk, and facilitated contacts with potential hosts.[117] Today, with the Cold War over, OPIC's intellectual underpinning is more economic than political, and it works to promote free markets and trade liberalization. At the same time, domestic critics have attacked OPIC as an unjustifiable "corporate subsidy," and in recent years the agency has barely survived legislative attempts to cancel the program.[118]

OPIC political risk insurance is available to American citizens and corporations that are at least ninety-five percent

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114. *See infra* notes 125-32 and accompanying text (OPIC expropriation standards) and notes 133-36 and accompanying text (MIGA expropriation standards).

115. For a comprehensive consideration of OPIC, see generally Maura B. Perry, *A Model for Efficient Foreign Aid: The Case for the Political Risk Insurance Activities of the Overseas Private Investment Corporation*, 36 VA. J. INT'L L. 511 (1996).

116. *Id.* at 520-22.

117. *Id.*

118. *Id.* at 513-14. These attacks, however, are not the result of OPIC's ineffectiveness but rather just the opposite. Part of OPIC's statutory mandate is that it pay for its own operations—essentially, that it turn a profit. *Id.* at 514. In fact, OPIC claims twenty-five consecutive years of profitability. *See id.* at 537. In this sense, OPIC is a quasi-private operation, but it retains several qualities of a public agency. OPIC is subject to the "policy guidance" of the State Department and the "budget guidance" of the Office of Management and Budget. *Id.* at 518. The U.S. government negotiates BITs on OPIC's behalf, and OPIC, in turn, pledges the "full faith and credit" of the U.S. government in its financial commitments. *Id.* at 518-19.

owned by American interests.[119] By contrast, MIGA, a division of the World Bank, offers investment insurance to any investor from one of its member countries when they invest in another member country.[120] The World Bank created MIGA in 1988 with the stated objective of increasing capital and technology flows to developing countries.[121] The idea was that MIGA could fill in the gaps left by national insurance programs (such as OPIC), which often have strict eligibility requirements, by offering insurance to investors of all its member countries.[122] Accordingly, the content of MIGA's political risk insurance closely tracks with that of OPIC. OPIC covers four types of risk: currency inconvertibility, expropriation, political violence, and standalone terrorism.[123] To these four, MIGA adds "breach of contract risk."[124]

The terms by which each program defines "expropriation" suggests a guide for NAFTA arbitral panels as they seek to distinguish between legitimate and illegitimate expropriations. OPIC covers the "loss of an investment due to expropriation, confiscation, or nationalization by the host government."[125] Coverage includes not only physical property but also funds or assets, including equity investments and loans.[126]

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119. *See* Paul E. Comeaux & N. Stephan Kinsella, *Reducing Political Risk in Developing Countries: Bilateral Investment Treaties, Stabilization Clauses, and MIGA and OPIC Investment Insurance*, 15 N.Y.L. SCH. J. INT'L & COMP. L. 1, 36 (1994).

120. *Id.* at 42-43. Currently, 23 "industrialized countries" and 148 "developing countries" are a party to MIGA, with the applications of two additional countries pending. *See* World Bank Group, Multilateral Investment Guarantee Agency [MIGA], MIGA Member Countries, http://www.miga.org/site level2/level2.cfm?id=1152 (last visited Sept. 7, 2007).

121. Convention Establishing the Multilateral Investment Guarantee Agency pmbl., Oct. 11, 1985, T.I.A.S. No. 12089, 1508 U.N.T.S. 99, *available at* http://www.miga.org/sitelevel2/level2.cfm?id=1107.

122. Comeaux & Kinsella, *supra* note 119, at 40.

123. *See* OVERSEAS PRIVATE INV. CORP., OPIC HANDBOOK 23-25 (2006), http://www.opic.gov/pdf/OPIC_Handbook.pdf [hereinafter OPIC HANDBOOK].

124. WORLD BANK GROUP, MULTILATERAL INVESTMENT GUARANTEE AGENCY, INVESTMENT GUARANTEE GUIDE 5-6 (2007), *available at* http://www.miga.org/documents/IGG06+pa.pdf [hereinafter MIGA GUIDE]. For a further description of MIGA, see generally Christopher K. Dalrymple, Note, *Politics and Foreign Direct Investment: The Multilateral Investment Guarantee Agency and the Calvo Clause*, 29 CORNELL INT'L L. J. 161 (1996).

125. *See* OPIC HANDBOOK, *supra* note 123, at 21.

126. *Id.* at 22.

OPIC only covers "total expropriations," meaning that investors cannot file a claim asserting that some fraction—be it eight percent or eighty percent—has been expropriated by their host government.[127] Indeed, in filing a claim, the investor assigns its rights to OPIC, which OPIC may then use to pursue its own claim against the host government to recoup its subrogation costs.[128]

OPIC also protects against creeping expropriations, which it defines as "unlawful government acts" that function over a period of time to deprive the investor of "fundamental rights in a project."[129] However, OPIC narrowly defines the kinds of expropriations that it will indemnify as those resulting from acts that are "violations of international law" or "material breaches of local law."[130] The relevant international law would be customary, not treaty-based, meaning that discriminatory acts by host governments that singled out foreign investors and other violations of minimum international standards of treatment would entitle investors to OPIC compensation.[131] Finally, OPIC explicitly defines the kind of losses it does not cover—those stemming from "*lawful* regulation or taxation by host governments."[132]

MIGA differs chiefly from OPIC in that it does not restrict its coverage to "total expropriations." MIGA protects against acts by the host government that may "*reduce* or eliminate ownership of, control over, or rights to the insured investment."[133] Its policy likewise states that "[c]overage is available on a limited basis for partial expropriation."[134] But MIGA's substantive line-drawing in defining its expropriation coverage tracks closely with that of OPIC: "Bona fide, non-discriminatory mea-

127. *Id.* at 23. Additional insurance for partial expropriations may be available under OPIC on an ad hoc basis. Perry, *supra* note 115, at 530 n.108.

128. Perry, *supra* note 115, at 529-30.

129. OPIC HANDBOOK, *supra* note 123, at 23.

130. Notice of Adoption of Form Contract, 51 Fed. Reg. 3438, (OPIC Jan. 27, 1986), OPIC Contract of Insurance, Form 234 KGT 12-85 § 4.01 (rev. June 1, 2002).

131. *See* Price, *supra* note 20, at 111.

132. OPIC HANDBOOK, *supra* note 123, at 23 (emphasis added).

133. MIGA GUIDE, *supra* note 124, at 5; *see also* MIGA, Guarantees, Types of Coverage, http://www.miga.org/guarantees/index_sv.cfm?stid=1547 (last visited Aug. 31, 2007) (emphasis added).

134. MIGA GUIDE, *supra* note 124, at 5.

sures by the host government in the exercise of legitimate regulatory authority are not covered."[135] MIGA further defines bona fide measures as those "normally taken by governments to regulate their economic activities such as taxation, environmental and labor legislation as well as normal measures for the maintenance of public safety," so long as these measures are not discriminatory against the foreign investor.[136] Essentially, like OPIC, MIGA covers acts that would be deemed illegal under customary international law but not acts stemming from legal domestic regulation.[137]

Recall the four elements of a legal expropriation under NAFTA article 1110: such actions must be (1) undertaken for a public purpose, (2) on a nondiscriminatory basis, (3) in accordance with due process of law ("fair and equitable treatment . . . in accordance with international law"), and (4) coupled with payment of compensation.[138] In an arbitral proceeding under the Alternative Scheme, it is the question of compensation that initially hangs in the balance. Once the investor makes a prima facie showing of economic loss resulting from government action, the focus then shifts to the first three elements of article 1110. In order to shift liability, the home government must show that the host government failed to honor one of these elements. Following the OPIC and MIGA standards (and also in accordance with American jurisprudence), element one, "public purpose," is just another way of articulating elements two and three, nondiscrimination and due process.[139] Even the references in the third "due process" element to "fair and equitable treatment" and "international law" are essentially another way of saying that foreign investors must be accorded the same rights as any other investor—i.e., that they must not be discriminated against.

Therefore, what really hangs in the balance during an expropriation is whether or not the host government discriminated procedurally against the foreign investor in expropriat-

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135. *Id.*

136. Dalrymple, *supra* note 124, at 187 (citing Commentary on the Convention Establishing the Multilateral Investment Guarantee Agency, 1 ICSID REV. FOR. INV. L.J. 193, 200 (1986)).

137. *See* Perry, *supra* note 115, at 529-30.

138. NAFTA, *supra* note 1, art. 1110.

139. *See supra* notes 108-14 (U.S. jurisprudence), 130-32 (OPIC standard), and 133-35 (MIGA standard) and accompanying text.

ing its property. This is the central and original concern in international investment law, and it is a great advantage of the Alternative Scheme that it makes discrimination the pivotal issue in arbitral proceedings.[140] Under the Alternative Scheme, NAFTA arbitrators would be left to focus on whether procedures were employed fairly and uniformly, an inquiry that they are far better qualified to undertake then that of determining the substantive rights of parties under an amorphous expropriation standard. Host governments would remain free to regulate in the public interest, so long as they do so in a non-discriminatory manner, and investors would be compensated by their home governments when their "fundamental rights" are expropriated by a host government's action.

A related insight offered by Maura Perry in her definitive article on OPIC lends additional credence to the viability of the Alternative Scheme.[141] Perry points out that OPIC's mission is, in a sense, self-contradictory.[142] OPIC is supposed to supplement, not compete with, private insurers offering political risk insurance for overseas investors.[143] At the same time, OPIC must turn a profit on its insurance business in order to remain in existence. One might think that any profitable insurance business would be captured by private investors, leaving only high risk, unprofitable opportunities for OPIC to "fill in the gap."[144] Yet, puzzlingly, OPIC has turned a profit every year of its thirty-five year existence and in many ways outperforms its private sector counterparts.[145] Why?

Perry suggests that the political leverage OPIC enjoys as an agency of the U.S. government endows it with a significant competitive advantage over private insurers.[146] Unlike private insurance, OPIC has a policy of always disclosing its contractual relationship with American investors to their host governments.[147] As Perry observes, "would-be expropriating govern-

140. *See* Price, *supra* note 20, at 111-12. This is in contrast to the current NAFTA regime, in which discrimination is only one of several factors to be considered in a claim of expropriation.

141. *See* Perry, *supra* note 115.

142. *Id.* at 517-19.

143. *Id.* at 514-16.

144. *Id.*

145. *Id.*

146. Perry, *supra* note 115, at 554.

147. *Id.*

ments are fully aware that, following an expropriation, they will be in possession of an entity in which the U.S. government is a shareholder."[148] The political and economic clout of the United States is an implicit if not explicit threat.[149] Investors recognize that what they purchase when they purchase OPIC political risk insurance is OPIC's unique ability to "resolve disputes before they reach the stage when a claim is necessary."[150]

In effect, OPIC insurance forces host governments to internalize the *political costs* of their expropriating actions. These are precisely the incentives and pressures that the Alternative Scheme sets into motion. Since home governments are liable for legitimate expropriations undertaken by host governments, host governments will only expropriate when the domestic political advantage and public interest clearly outweigh the transnational political cost and then only in strict conformity with due process of law. Like OPIC-insured investments, the Alternative Scheme works to eliminate frivolous, inefficient expropriations by forcing host governments to internalize the political costs of their actions.

D. *How the Methanex and Metalclad Cases Would Have Been Decided Under the Alternative Scheme*

This paper has considered the workings of the Alternative Scheme once the parties' dispute has gone to arbitration, or even once the investor has made a successful prima facie showing of economic loss. But it is important to keep in mind that the Alternative Scheme would be most effective prior to arbitration, and indeed would help in avoiding arbitration. Two models based on the facts of the *Methanex* and *Metalclad* cases provide a useful illustration.

As discussed *supra*, Methanex is a Canadian corporation that produces methanol, the chief ingredient in the gasoline additive MTBE, which is designed to make gas burn more effi-

148. *Id.*

149. *Id.*

150. *Id.* at 555 (quoting STEPHEN J. KOBRIN, DESCRIPTION AND ANALYSIS OF THE U.S. MARKET FOR POLITICAL RISK INSURANCE FOR OVERSEAS INVESTMENTS IN DEVELOPING COUNTRIES 4 (OPIC Contract 85- C-015) (1986)).

ciently.[151] After California banned MTBE, Methanex filed a claim against the United States alleging violations of NAFTA articles 1105 ("minimum standards of treatment") and 1110, (expropriation without just compensation) and seeking damages of $970 million.[152] In 2002, a NAFTA tribunal made a preliminary ruling, finding that because Methanex did not produce the regulated product (MTBE) itself, it lacked standing to bring a claim.[153] Nonetheless, the tribunal allowed Methanex ninety days to amend its complaint, asking it to show how the California regulation specifically discriminated against Canadian methanol producers.[154] The company then resubmitted its amended claim, and, over seven years after Methanex first brought its action, the claim was finally dismissed.[155]

Now imagine that the Alternative Scheme was in place and that Methanex was required to file its original claim against its home government, Canada. Would Methanex have filed a claim at all? Quite possibly, Methanex would hesitate to jeopardize its relationship with its home government by suing it for $970 million. Perhaps it would simply drop the case, or perhaps it would seek a more modest sum. If it chose the latter, Canada would have four options: (1) contest the claim and show in arbitration that Methanex did not suffer an expropriation; (2) negotiate with Methanex to settle the claim; (3) negotiate with the United States to assign the liability; or (4) contest the claim and show that the United States should be held liable. If Methanex had strong evidence of discriminatory treatment by California, Canada would have a solid bargaining chip to use against the United States. In that case, Canada could use that chip to pressure the United States into either accepting a share of the liability or convincing California to amend its regulation.

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151. Methanex Corp. v. United States (Can. v. U.S.), (NAFTA Ch. 11 Arb. Trib. 1999) (Notice of Intent), *available at* http://www.naftaclaims.com/disputes_us_6.htm; *see supra* notes 49-56 and accompanying text.

152. *Id.*

153. PUBLIC CITIZEN, *supra* note 43, at 32-33.

154. *Id.* at 33.

155. Methanex Corp. v. United States (Can. v. U.S.), 44 I.L.M. 1345, 1464, pt. VI (NAFTA Ch. 11 Arb. Trib. 2005) (Final Award), *available at* http://naftaclaims.com/Disputes/USA/Methanex/Methanex_Final_Award.pdf.

Given the novel nature of Methanex's "market share" theory of expropriation, and the apparently nondiscriminatory, public interest character of California's regulation, the political incentives animated by the Alternative Scheme would likely work to extinguish Methanex's claim. Methanex would have a hard time convincing Canada that it would be better off pressuring the United States to accept the liability than it would be simply pressuring Methanex to drop its claim or contesting that claim in arbitration. The importance of Methanex's ongoing relationship with its home government would focus the company's attention on the legitimacy of its claim.[156] The *Methanex* claim is precisely the kind of extravagant claim that the Alternative Scheme would work to extinguish, while the California regulation is precisely the kind of state action that the Scheme would protect.

The *Metalclad* dispute presents a more difficult case for application of the Alternative Scheme.[157] Metalclad, an American corporation, had worked closely with the Mexican national government on the construction of a landfill for the storage of hazardous waste.[158] Mexico had assured Metalclad that it would assist in securing all of the necessary permits from the state and local governments, even as those local gov-

156. Might home governments then abuse the Alternative Scheme in order to extinguish all investor claims? Or, to phrase it another way, might a government explicitly or otherwise signal to its native investors that any expropriation "bills" it receives will not be looked upon favorably and may expose the investors to some sort of retribution?

While a home government would obviously want to limit its indemnity exposure, there is no reason to believe that a home government would want to jeopardize the private property of its native investors over the border, or the viability of the free trade agreement itself, by subjecting investors to unchecked expropriations. Whether in NAFTA or a hypothetical free trade agreement, these, after all, are governments that have made a political decision to prioritize free trade, and the alienability of private property is a cornerstone of such trade. Plus, any such "no indemnity" policy could all too easily be matched by the other signatory party or parties, leading to an unraveling of the entire agreement: a kind of mutually-assured economic destruction. A home government would pay a political cost for refusing to entertain expropriation claims by its native investors, and the premise of the Alternative Scheme is that governments are sensitive to such costs.

157. *See* Metalclad Corp. v. United Mexican States (U.S. v. Mex.), 40 I.L.M. 36 (NAFTA Ch. 11 Arb. Trib. 2000) (Final Award), *available at* http://naftaclaims.com/Disputes/Mexico/Metalclad/MetalcladFinalAward.pdf.

158. PUBLIC CITIZEN, *supra* note 43, at 27.

ernments consistently indicated that they would not grant the necessary permits.[159] After Metalclad had spent $20 million on construction and labor costs, the local governments denied Metalclad the permits it needed to proceed with the facility, rendering Metalclad's property useless.[160]

The locality, Guadalcazar, denied the final building permit on four grounds: it had denied earlier applications for the facility; Metalclad had begun construction without a permit; the city had environmental concerns about the project; and the local citizenry had opposed the project.[161] Metalclad filed a claim against Mexico under article 1110, alleging that an expropriation was undertaken without a public purpose, in a discriminatory manner, without regard for due process of law, and without payment of just compensation.[162] Metalclad sought $90 million in damages, and the arbitral panel, finding that Mexico had failed to extend "fair and equitable treatment" to Metalclad in accordance with NAFTA, awarded Metalclad close to $17 million.[163]

Under the Alternative Scheme, Metalclad would have filed its claim against the United States. What would the United States have done? It might have found it politically efficient to simply pay the claim, or settle for a lower amount. If the United States was particularly interested in protecting its investors' interests within the NAFTA arena, it might have pressured Mexico to accept liability for the expropriation. The United States could have achieved this via arbitration by showing that Mexico or its subsidiary governments discriminated against the investor—a viable claim in this instance—or it could have negotiated informally with Mexico to settle the liability. The precedential value of establishing the illegitimacy of Mexico's "expropriation" via the arbitration process might be attractive to the United States. Mexico, then, would internalize the political costs of its local government's decision, insofar that the cost of the compensation would be spread across its national electorate. Again, the beneficiaries of free trade would bear the costs of free trade.

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159. *Id.* at 28.

160. Metalclad Corp., 40 I.L.M. 36, ¶ 114.

161. PUBLIC CITIZEN, *supra* note 43, at 28.

162. *Id.*

163. *Id.*

In the actual sequence of events, the local government was successful in denying Metalclad its building permit and expressing the will of its people, though it only narrowly avoided having to indemnify its federal government.[164] After sustaining the NAFTA judgment, Mexico attempted to withhold federal funds from the regulating state, San Luis Potosi, in an attempt to force the state to compensate Metalclad itself.[165] In 2004, the Mexican Supreme Court ruled unanimously that the federal government did not have the right to withhold the federal funds and was itself responsible for the payment.[166]

The question of whether local or federal governments are responsible for damage payments is not directly addressed by NAFTA.[167] The issue is left to be determined by the signatory parties' domestic law.[168] However, as in the *Metalclad* case, domestic law is often not immediately clear, or at least does not prevent the federal government from attempting to collect. The Alternative Scheme contemplates expropriation costs being borne and dispersed at the national level, as are the economic benefits of free trade. At the same time, the Alternative Scheme relies on the ability of federal governments to apply political pressure on local governments to eliminate politically inefficient and illegitimate expropriations. The key differences are in the kind of pressure applied and when it is applied. The Alternative Scheme motivates federal governments to apply political pressure, to the extent reasonable and desirable, prior to the expropriating act. The existing scheme motivates federal governments to pressure local governments only after the fact, and then only in the guise of an invoice. The Alternative Scheme allows governments to deal in their own currency—political pressures and incentives—rather than in the currency of private commerce.

If in fact the investor was properly due any compensation in the first place, the *Metalclad* controversy ended happily. Metalclad was compensated, the locality achieved its public purpose regulation, and the costs were dispersed throughout

164. *Id.*

165. *Id.* at 29.

166. *Id.* at 30 (citing Carlos Aviles, *Corte anula descuento a recursos federales para gobierno de San Luis Potosi*, EL UNIVERSAL, Mar. 5, 2004).

167. *See* Been & Beauvais, *supra* note 3, at 90.

168. *Id.*

the national population. Note, however, that the final assignment of the costs did not occur until eight years after the beginning of arbitration, despite the supposedly "expedited" investor-state dispute settlement mechanism of NAFTA. The Alternative Scheme gives all interested parties the incentive to reach a settlement prior to an expropriation taking place and provides for the negotiated assignment of costs after the fact. Whether the Alternative Scheme would have dispersed Metalclad's compensation payment throughout the American population, the Mexican population, or a combination of the two, the result would be at least as satisfying, just, and proportional to NAFTA's benefits as the actual outcome.

IV. Conclusion

The present NAFTA expropriation scheme attempts to streamline the compensation process by empowering investors to bring claims independently without having to rely on their home governments. The tacit trade-off is that big-picture fairness may be sacrificed for speed and simplicity. But as is evidenced by the *Metalclad* (eight years from claim to resolution) and *Methanex* (also eight years) cases, there is nothing speedy or simple about the current system. Not only does the present system sacrifice time, it also sacrifices otherwise sensible regulation by empowering investors to stick host governments with large, up-front, lump-sum claims. The Alternative Scheme promises to not only reduce the "democratic deficit" of foreign investors stymieing locally-approved regulation, but also to level the playing field between foreign and domestic investors, safeguard the domestic takings standards of the signatory parties, and task arbitral panels with the functions they are best qualified to perform.

Perhaps the inefficiency of the current system is not surprising when one of the three principal parties, the home government, is systematically excluded from the investor-state arbitration process. The most efficient system is the one that brings all of the relevant parties to the table and provides them with incentives that accurately account for the political costs and benefits of their actions. By forcing host governments to pay a political cost for a regulatory expropriation that discriminates against foreign investors, the Alternative Scheme encourages host governments to regulate in a non-discriminatory manner. And when host governments regulate well and fairly, they are relieved of any burden to compensate foreign investors for incidental losses in revenues. If the investor wishes to be compensated for these losses, it is up to the investor itself to weigh the pros and cons of sticking its home government with the bill, and then up to the home government to weigh the pros and cons of attempting to pass the liability either back to the investor, or to its trading partner, the host government. By virtue of the Alternative Scheme's liability rule, each party enjoys maximum strategic flexibility, allowing the political costs to ultimately rest with the appropriate party. As free trade seeks to maximize the free flow of goods and services, so should its expropriation scheme maximize the free exchange and assignment of liability.