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TRADE LAW MEMORANDUM

METHANEX DECISION

FURTHER IMPLICATIONS FOR NAFTA CHAPTER ELEVEN

28 August 2002

NAFTA Investment Claims Face Serious Limitations

Our last memorandum reviewed the UPS arbitration against the Canadian government and Canada Post. We pointed out the implications of that case for future NAFTA investment disputes. We noted that the government of Canada (supported by the U.S. and Mexican governments) brought a motion to dismiss a large part of the UPS case on the basis that it was outside the scope of the NAFTA investment dispute provisions.

The arbitration panel will decide this key jurisdictional question in a few weeks and, if Canada succeeds, the case will have important ramifications for future NAFTA Chapter 11 claims.

A similarly important Chapter 11 case involves a claim by Canadian company, Methanex Corporation, against the United States. Methanex says that actions by the State of California, banning the use of a methanol-based product known as MTBE, infringed various investment protection provisions of the NAFTA.

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During the course of the proceedings, the U.S. government brought an application to dismiss the Methanex claim on the basis that it falls outside the scope of NAFTA Chapter Eleven. Canada and Mexico supported the United States. The arbitration panel agreed. In an order issued August 7th, it found that there was no basis under the NAFTA for much of the Methanex claim.

The Methanex Claim

MTBE is a gasoline additive produced from methanol. Methanol is the major product made by Methanex and Methanex alleges that the California ban on MTBE constitutes a disguised trade and investment restriction that has negatively impacted on Methanex's U.S. investments. There are shades of the so-called MMT case and a somewhat similar claim by Ethyl Corporation claim against the government of Canada in 1998.

Among the Methanex allegations is that California's ban was implemented to favour the U.S. ethanol industry, principally led by Archer Daniels Midland Co. ADM's ethanol competes directly with methanol in the production of gasoline additives. Methanex alleges that intensive lobbying by ADM and the U.S. ethanol industry, together with substantial contributions to the California governor's election campaign, were the reasons behind the California ban.

U.S. Government Position

In its motion to dismiss the Methanex claim, the U.S. government asserted that none of the allegations by Methanex raised a NAFTA investment issue. The mere fact of ADM's political contributions alone does not point to any kind of *prima facie* discrimination against Methanex as an investor in the United States.

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More importantly, the U.S. argued that the arbitration claim failed the jurisdictional test because, under Article 1101 of the NAFTA, an impugned measure must “relate to” an investment by a Canadian investor in the United States. The U.S. position was that the California measure concerned MTBE and not methanol, methanol producers or Methanex.

Arbitration Panel’s Decision on Article 1101

NAFTA Article 1101 sets out the scope of the investment dispute provisions in Chapter 11 and provides that the Chapter only “applies to measures adopted or maintained by a Party relating to: (a) investors of another Party [or] (b) investments of investors of another Party in the territory of a Party.” The key issue is the meaning of the term “relating to.”

Methanex took the position that any measure that “affects” a foreign investment, directly or indirectly, is covered by Article 1101. The U.S. government position was that the “affects test” was too broad and that a direct connection between the measure complained of and the investment is required under that Article.

The arbitration tribunal accepted the U.S. submission. Applying international rules of treaty interpretation, the tribunal held that Article 1101, which it described as the “gateway” leading to the dispute resolution provisions of Chapter 11, requires that there be such a direct connection between the measure complained of and the investment. Incidental or indirect effects are not enough.

The tribunal rejected the broad approach advocated by Methanex as imposing no practical limit on these investment-type disputes and said, to the contrary, that “a strong

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dose of common-sense” is required in the interpretation of the term. In accordance with the normal rules of interpretation, combined with evidence of the intentions of the NAFTA governments, the phrase “relating to”,

“ . . signifies something more than the mere effect of a measure on an investor or an investment and that it requires a legally significant connection between them . . .” (emphasis added)

On the basis of the facts alleged in the Methanex pleadings, it held that the claim failed this key jurisdictional test. However, to be fair, the Tribunal has allowed Methanex time to file fresh material that sets out its specific factual allegations, backed up by documentary evidence to support the required “legally significant connection”.

Concluding Observations

Like the UPS arbitration, the Methanex case has far-reaching implications for future NAFTA investment disputes. Contrary to the arguments of some interest groups about a never-ending flood of NAFTA claims against government regulatory and other public policy measures, what we see could be the opposite – serious limits on the kinds of cases that investors can bring forward.

This conclusion, obviously, has to be tested against the final decisions of the arbitrators in the UPS case and in this case. It may be premature to draw conclusions until we have those results. However, the Methanex decision, even as an interim ruling, signals that arbitrators will carefully scrutinize jurisdictional questions and will not let NAFTA investor claims past the starting gate unless they qualify under carefully construed treaty language.

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It may be possible for Methanex to overcome the jurisdictional hurdle. Whether this proves to be so, the tribunal's decision on the need for a "legally significant connection" under NAFTA Chapter 11 is an important development. Together with the NAFTA Commission's directives on the interpretation of other key Chapter 11 provisions, it represents a decisive narrowing down of these provisions.

In predicting a flood of investor challenges to government policies, critics of the NAFTA have overlooked this important factor – the willingness, and indeed the duty, of arbitrators to scrutinize investor claims carefully to make sure that they meet basic jurisdictional qualifications.

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