

**REVIEW OF THE DECISION ON JURISDICTION OF THE METHANEX
TRIBUNAL, AUGUST 5, 2002**

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Introduction

The Methanex Tribunal decision on jurisdiction is a fairly complex one on some levels, yet a fairly straightforward one on others. The key findings and their impacts are discussed below.¹

Non-Technical Summary

On August 5 2002, the Tribunal in the NAFTA Chapter 11 case *Methanex vs. the United States of America* delivered an interim ruling. This brief non-technical summary discusses the ruling and its significance for sustainable development. For more background on the case and IISD's involvement, see http://www.iisd.org/trade/investment_regime.htm.

Methanex argued in its first statement of claim that two Californian environmental measures, including a measure banning MTBE (a gasoline additive for which Methanex produced the major ingredient), amounted to an expropriation of its investments, and were carried out in a manner that failed to meet minimum international standards. It later amended its claim to add allegations that the governor of California had been influenced to discriminate against Methanex by campaign contributions from a US maker of ethanol – a substitute for MTBE. Its amended statement of claim argued that this involved distinct instances of expropriation and violation of minimum international standards, and also involved a failure to accord Methanex national treatment.

The Tribunal's decision, however, did not rule on any of Methanex's claims – it was a ruling on whether it had the jurisdiction to even hear the case. The US made a number of arguments to the effect that it did not. The Tribunal dismissed all but one of these

¹ Thanks to Daniela Yanai, IISD intern for the summer of 2002, for her very helpful review of the decision.

arguments, but the one that remained was powerful enough to decimate Methanex's case, leaving only a slim line of possible argument.

Article 1101 of NAFTA is the gateway to the use of Chapter 11 remedies, and it sets out the scope and coverage of the subsequent provisions as follows:

“This Chapter applies to measures adopted or maintained by a Party relating to:

- a) investors of another Party;
- b) investments of investors of another Party in the territory of the Party;”

So if it could be argued that the measures in question were not “related to” Methanex, then Chapter 11 would not apply, and the Tribunal would have no jurisdiction to hear the case. This is just what the US successfully argued, noting that Methanex is not a producer of MTBE, nor are its US operations. As Methanex merely supplied a component of MTBE, the US argued – and the Tribunal agreed – that there was no “legally significant connection” between the measures and the investor.

The only line of argument left to Methanex, according to the Tribunal, were its new allegations from the amended statement of claim. If it could be established that the measures were intended to discriminate against Methanex in favour of a domestic competitor, then the Tribunal would rule that the measures were “related to” Methanex, and would have jurisdiction to hear the case.

The Tribunal asked Methanex to submit a fresh pleading with just this argument, submitting at that time evidence enough to back up its claims, and elaborating its arguments of expropriation, and failure to grant national treatment and minimum international standards. Methanex was given 90 days to do so. If and when this happens the Tribunal will consider how to proceed.

What are the implications of this ruling? IISD and others have long been concerned about the potentially broad range of measures subject to challenge under Chapter 11. In particular, environmental, human health and other social welfare measures of general application have been seen as unduly subject to attack. This decision does not limit or reduce the type of measures subject to challenge. Indeed, it confirms that measures of general application for these public welfare purposes *can* be challenged, as long as they have a legally significant connection to the investor bringing the claim.

The decision does reduce the number of investors who can bring a claim, by shutting out those only indirectly affected by a measure. But how much it limits the number of potential claimants is not clear, as it is not clear whether the phrase “legally significant connection” means a direct legal connection, or something broader.

IISD has argued that a blanket exception from Chapter 11 of measures cast as public welfare measures would not be appropriate, as this could invite abuses of environmental or other measures for protectionists purposes. As such, inasmuch as it limits certain excessively broad interpretations of Art. 1101, the Tribunal's decision should have a

slightly beneficial impact, but the extent of that impact is uncertain, due to the vagueness of the test they adopted. The impact of the decision is also limited because it does not address any of the concerns over the substantive scope of the provisions Methanex's claims are under.

It bears mentioning that the Tribunal went out of its way to express its satisfaction that the extensive legal arguments of all sides in the hearings to date had managed to leak through its wall of confidentiality, and were now posted on several web sites (which are cited in the report). This is a significant statement, coming as it does from a prestigious panel of arbitrators, and will serve to bolster arguments for greater transparency in future.

The Key Ruling

Methanex has lost on jurisdiction on almost all issues in its case. The reason revolves around the language of Article 1101, which requires that an arbitration under Chapter 11 “applies to measures adopted or maintained by a Party relating to” an investor or its investments. The key issue here was whether the measures adopted by California banning the sale of MTBE were measures “relating to” Methanex.

The essence of the decision is that the Tribunal found there was no ***“legally significant connection between the measure and the investor or the investment.”*** (Para 139, and 147) Methanex always faced the problem that neither it nor anything it made was directly regulated by the California regulations. Rather, a product made by others (MTBE) that Methanex supplied one component for (methanol) was regulated. The Tribunal found this was too indirect a connection, and one that if accepted as founding a claim would allow Chapter 11 to be a vehicle to address every type of indirect economic impact of any government measure. This broad scope for Chapter 11 was completely rejected by the Tribunal.

Exactly what “legally significant connection” means is not clear. It is not a phrase with any previous legal meaning that I know of. There are some outside markers set out by the Tribunal that provide bookends for the possible range of interpretations for this phrase.

The Tribunal held that, as a general rule, NAFTA Chapter 11 should not be subject to a restrictive interpretation simply because it vests rights in private corporations. Rather, Chapter 11 remains subject to the same rules of interpretation as any other state-to-state treaty under the Vienna Convention on the Law of Treaties. As a result, the Tribunal makes it clear that it will not adopt a test demanding that the measure be “primarily aimed at” a foreign investor – a relatively restrictive test for entry into Chapter 11 arbitration. On the other hand, it also rejects the Methanex argument that any measure that *affects* an investor is therefore “related to” the investor or investment.

The Tribunal has apparently sought out a middle ground somewhere between an indirect economic impact and a measure aimed primarily at one investor. What is not clear here

is whether a legally significant connection is meant to be synonymous with a direct legal connection. A direct legal connection would arise in any case where a measure directly regulates what the investor can do with its investment, whether it relates to the operation of a facility, the sale of a product, etc., and whether or not it addresses just that one facility or product or many similar facilities and products. A legally significant connection could be more expansive than this, but is not likely to be more restrictive than this. Thus, a measure of general application that legally applies to an investor or a product it makes would fall within the scope of a “legally significant connection.” How much more broadly, if at all, the term might apply is difficult to assess. At the same time, a measure of general application that has no legal application to an investor but may have an incidental economic impact is not within this test. (Paras. 130-131 show this point, supported by the reference in para. 147 to the adoption by the Tribunal of the US’ proposed test, described in Para. 130.)

Because of the adoption of the US’ proposed test by the Tribunal, further analysis of the detailed US legal submissions may aid in understanding the scope of the test. However, the Tribunal itself notes that with this test it is “not easy to define the exact dividing line, just as it is not easy in twilight to see the divide between night and day.” (Para. 139) This fuzzy-test approach is consistent with trade law analogies such as the indefinable line of equilibrium under Art. XX of the GATT seen in the Shrimp-Turtle case and the accordion-like quality of the like products tests under Art. III of the GATT seen in the Japanese Alcoholic Beverages case.

There is another question raised by this ruling on which the Tribunal offers no guidance. NAFTA defines measures to include a range of legal and policy instruments, essentially any act of government that creates a constraint on an investor can be understood as a measure. This decision may or may not have a significant impact in defining when the threshold for Chapter 11 is reached as regards non-legal measures that, by definition, do not have a legally significant connection to an investor. Arguably, the principle of a significant connection would still remain relevant.

The Result on Jurisdiction Based on the Key Ruling

The key (but undefined) ruling provides this Tribunal’s “definitive interpretation” of Art. 1101 of NAFTA and when a measure is “related to” an investor or investment for the purposes of using Chapter 11. As a result of this ruling, the Tribunal agreed with the US government that it did not have the jurisdiction to hear any of the claims made in the first statement of claim by Methanex. In that claim Methanex argued that California’s measures, including the ban on MTBE, amounted to an expropriation of its investments, and did not meet minimum international standards of treatment.

But Methanex had also submitted an amended statement of claim that reiterated the original claims of harm as an investor, but added claims that Articles 1102 (national treatment), 1105 (minimum international standards) and 1110 (expropriation) were also breached because of a direct and specific intent to harm Methanex as a foreign company

and purveyor of a foreign product. This line of argument is referred to by the Tribunal as the *intent* issue.² The long and short of this argument is that the campaign financing and contribution system in the US compromised then candidate for California Governor Gary Davis and led to a discriminatory ban on MTBE in order to favour US-based ethanol producer Archer-Daniels-Midland (AD).³

The Tribunal ruled that Methanex's original claims, as repeated in its amended statement of claim, again failed to meet the jurisdictional requirement of a significant legal connection. However, if Methanex could prove the intent argument on a full evidentiary basis, then the Tribunal would be satisfied that the measure in question was "related to" Methanex or its US investments, meaning the Tribunal would have jurisdiction to hear the case. The US agreed that if there was a direct intent to discriminate against Methanex, this would be a basis for the Tribunal to have jurisdiction, and this seems an obvious enough approach.

As a result, the Tribunal deferred its final ruling on jurisdiction pending the submission of new pleadings and a full evidentiary package by Methanex. It gave Methanex a further 90 days for this purpose. If sufficient facts are adduced to support the intent argument, then the US will be invited to reply, hearings may be held, and the full process will run its course. However, this would be limited to legal and factual arguments relating to the intent argument. All arguments based on the effect of the measure per se have been found beyond the jurisdiction of the Tribunal as lacking a significant legal connection.

The legal scope for claims based on the intent argument is not fully clear. The amended statement of claim relates the intent argument to a breach of Art. 1102 (national treatment) and to Art. 1105 (on minimum international standards). Both these seem logically connected with the intent argument. The amended statement of claim also links this issue to Art. 1110 on expropriation, arguing that the discriminatory intent breaches the requirement that an expropriation be for a valid public purpose and be non-discriminatory. It is not clear whether the Tribunal will allow claims for breaches of each of these provisions to proceed if a new pleading is filed, or just one or two of them.

What the Tribunal Did Not Rule Upon

To underscore the limited scope of the ruling in this case, I should first explain what the Tribunal did and did not rule upon. Part of this explanation lies in the discussion on

² The exact scope of the intent issue is not clear. Methanex argued that the product was foreign not just to the US but to California. This approach would allow discrimination against methanol from other states to be argued as part of the intended discrimination, not just Canadian-rooted discrimination. How this would work under Chapter 11 is not clear.

³ Methanex states in its amended statement of claim that "Methanex is not alleging the Governor Davis or ADM in any way violated US or California campaign contribution statutes or other relevant laws. The issue, however, is not whether Governor Davis' and ADM's actions were legal in the United States, but whether they were so unfair, inequitable and discriminatory that they violate NAFTA and international law." (Footnote 2)

admissibility and jurisdiction that permeates the middle sections of the decision. After much discussion, the technical legal niceties of the debate between jurisdiction and admissibility are, quite simply, put aside by the Tribunal. In essence, the Tribunal holds that in determining issues of jurisdiction, it has a very limited mandate to ensure that the persons bringing a claim, and the facts that are alleged in support of the claim, fall within Articles 1101, 1116 and 1117 of NAFTA. These are basic provisions saying there must be a measure relating to an investor or investment covered by Chapter 11 (1101), the claim must be brought by the investor (1116), or it can be brought by an investor acting for an enterprise in the state in question (i.e. acting for its investment). It cannot rule upon the facts or interpretations of the law at the jurisdiction stage, applying only cursory tests of whether the facts alleged are incredible, frivolous or vexatious. With the notation that there are some additional procedural issues that may be raised at the jurisdiction phase that are not in question here, the Tribunal rules that this was the scope for its jurisdictional phase. Thus, arguments relating to the scope of Article 1102, 1105 or 1110 were beyond its remit at this time.

As a result, the Tribunal did not address any issues concerning the interpretation of these articles. For example, US arguments that market share was not an expropriable asset were not considered. The Tribunal made it clear it was not ruling on any of these interpretational issues, and that no support for arguments one way or another should be presumed from their decision on jurisdiction.

Sustainable Development Implications of this Ruling

A NAFTA Chapter 11 decision is not legally binding on subsequent arbitrations. Nonetheless, they do provide important indications of the state of the law, and are routinely quoted in later cases. Consequently, it is important to consider the implications of a ruling in different contexts.

IISD and others have long been concerned about the potentially broad range of measures subject to challenge under Chapter 11. In particular, environmental, human health and other social welfare measures of general application have been seen as unduly subject to attack. This decision quite clearly does not limit or reduce the type of measures subject to challenge. Indeed, it confirms that measures of general application for these public welfare purposes *can* be challenged, as long as they have a legally significant connection to the investor bringing the claim.

The decision reduces the number of investors who can bring a claim, by eliminating incidental economic impact as a basis for making a claim. But how much it limits the number of potential claimants is not clear, as it is not clear whether the phrase “legally significant connection” means a direct legal connection, or something broader. In other words, certain excess interpretations of the range of potential claimants can be seen as constrained by this decision, but the principle of challenging measures of general application is left intact. At the same time, the decision does not in any way address the

substantive grounds on which such challenges may be made (in this case, expropriation, national treatment and minimum international standards of treatment).

IISD has argued that a blanket exception from Chapter 11 of measures cast as public welfare measures is likely not appropriate, as this could invite abuses of environmental or other measures for protectionists purposes. As such, inasmuch as it limits certain excessively broad interpretations of Art. 1101, the Tribunal's decision should have a slightly beneficial impact. But the extent of that impact is uncertain, due first to the vagueness of the test they adopted and second to the absence of any comment on the substantive rules in Chapter 11.

Transparency

The Tribunal made a small but in my view important statement on transparency issues. In Para. 19 of the decision, it lauds the scope and quality of the extensive written submissions it received in the case, noting that that "... in a document such as this, it is not possible for us to pay sufficient tribute to the enormous industry and legal scholarship required for such detailed, lengthy and learned submissions. Fortunately, however, it appears that these submissions lie in the public domain for future reference, along with the helpful submissions of Canada and Mexico." It then goes on to site some web-based sources. This endorsement of the value of public access to the pleadings in a Chapter 11 case is well worth noting both for future Chapter 11 cases and for the promotion of transparency in trade and investment litigation more broadly.

Next Steps in the Case

The Tribunal has given Methanex 90 days to submit new pleadings based solely on the intent arguments. It has also set out some evidentiary standards and processes for Methanex to meet in making its new submissions. Only after such new submissions are received will the Tribunal make any further jurisdictional, substantive or procedural decisions. This necessarily includes any decisions on *amicus* submissions. The only thing the Tribunal has said is that any future proceedings will join the jurisdiction and merits phases into one process.

In my view, there is a possibility that Methanex may not continue the case. Notwithstanding its statement that Methanex can use circumstantial and inferential evidence, the Tribunal has set a pretty high bar for evidence on the discriminatory intent argument.⁴ Meeting this bar may require considerable political capital to be expended on a product that is, in essence, a sunset product in any event. Unless Methanex intends to challenge every state ban on MTBE on the basis of the same discriminatory intent – an unrealistic option at best – Chapter 11's utility as a bulwark against further bans on MTBE has been seriously reduced in this particular case (while this same bulwark role is

⁴ One can see this from the fact that the Tribunal has deferred its decision even on jurisdiction to hear the argument until more than the existing circumstantial and inferential evidence is provided to the Tribunal.

not impacted in other cases where there is a legally significant connection). Consequently, simply addressing California will have little corporate benefit beyond the immediate potential for compensation. At the same time, it might undermine future political cooperation for other product lines. (Methanex is investigating the use of methanol as a hydrogen substitute in fuel cell cars, for example.)

Only 90 days will tell for sure what the next steps in the case will be.