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# A Brave New Lochner Era? The Constitutionality of NAFTA Chapter 11

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## ABSTRACT

*In the eight years since its adoption, NAFTA Chapter 11 has escaped significant scrutiny from academics and journalists alike. However, with the recent filing of several Chapter 11 expropriation claims involving U.S. states, Chapter 11 has begun to gain some notoriety in the press and sparked at least two legal symposia this past year.*

*This Note begins by highlighting the recent Methanex Chapter 11 claim involving the State of California. Methanex, a Canadian chemical manufacturer and importer, claimed $1.6 billion in damages over California's ban of the chemical MTBE. Despite the EPA's classification of MTBE as a possible carcinogen and an academic study that documented its presence in over ten thousand groundwater sites, Methanex claimed that California's ban "expropriated" their investment. Methanex argued it is due just and timely compensation for this purported expropriation. Moreover, Chapter 11 disputes, by and large, remain closed to public scrutiny because of the rules of international investment arbitration.*

*It is not surprising that such claims sparked a modest debate over the policy implications of Chapter 11 and its dispute resolution procedures. Though several critics note that many Chapter 11 claims push the limits of credulity and that adjudication of these claims needs to occur in fora to which the public has access, the threshold question of whether NAFTA Chapter 11 is constitutional remains ignored. This Note argues that Chapter 11 raises serious constitutional questions concerning the Eleventh Amendment and Article III. With the Supreme Court's renewed emphasis on federalism, it is far from clear whether NAFTA Chapter 11 is constitutional.*

*At the outset, a word of caution is due to the reader. This Note makes an important substance-over-form assumption by assuming that the Eleventh Amendment is implicated. Arguably, the Eleventh Amendment is never reached because the United States, as signatory party of NAFTA, stands in as a proxy for any U.S. state mired in a Chapter 11 dispute. If a judgment is won involving a U.S. state, the judgment is formally won against the United States. Though the United States will then sue the state for the repayment of any judgment,*

*arguably the Eleventh Amendment is never reached because the state is never party to the original suit. Though such reasoning is provocative in its own right, this Note assumes the Eleventh Amendment is reached because the substance of such a suit is a proceeding against the state qua state.*

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## I. INTRODUCTION

In his opening statement before the Senate Committee on Environment and Public Works, Senator Howard Metzenbaum called the factory and living conditions in Mexico "truly unbelievable."[1] Metzenbaum then reeled off a litany of horribles, arguing that if NAFTA permits American corporations to increase their profits by standing on the backs of the Mexican poor and exploiting Mexico's non-existent environmental enforcement it would be nothing short of immoral.[2] Billionaire Ross Perot echoed a far more practical concern during the second and third debates of the 1992 Presidential election.[3] In perhaps the most notable quote of the entire campaign, Perot warned that, if NAFTA passed, there would be "a giant sucking sound of jobs being pulled out of this country."[4]

Both Metzenbaum's ideals and Perot's folksy prudence summarize the two popular arguments attacking NAFTA during its passage through Congress.[5] However, both arguments ignore the import of NAFTA Chapter 11 and what might be the most significant evisceration of state police power since the Supreme Court freed the states from *Lochner's* shackles in 1937.[6] Labeled by several as an

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1. Economic and Environmental Implications of the Proposed U.S. Trade Agreement with Mexico: Joint Hearing Before the Senate Comm. on Environment and Public Works and the Subcomm. On Labor and Human Resources, 102nd Cong. (1991), *reprinted in* 9 REAMS AND SCHULTZ, THE NORTH AMERICAN FREE TRADE AGREEMENT, A LEGISLATIVE HISTORY OF PUBLIC LAW 103-82, Doc. 36 at 2 (1994).

2. *Id.* Senator Metzenbaum specifically stated that,

> the lure of low wages and little effective regulation have drawn hundreds of U.S. companies to this area. U.S. corporations now employ a half a million Mexicans in this region, some as young as 12 years old. These companies set up shop and overwhelm the local infrastructure. Factory waste and chemical residue pour into open canals which in turn irrigate crops. . . . Families live in shacks constructed of cardboard boxes and packing crates. . . . Children eat and sleep on dirt floors and drink rain water which is collected in discarded chemical drums. . . . If this free trade agreement is at all based on the maquiladora model and will simply expand these inhuman conditions throughout Mexico, then our acceptance of this agreement would be nothing short of immoral.

*Id.*

3. David S. Broder & Ruth Marcus, *Clinton, Bush, Perot Stick to Issues in Debate*, WASH. POST, Oct. 16, 1992, at A1.

4. David Jackson, *Perot blasts trade pact in debate*, Dallas Morning News, Oct. 20, 1992, at 14A.

5. *See, e.g., Trade Pact Signed; Foes Vow Protests Opponents say NAFTA will cost U.S. Workers Jobs, Ruin Environment*, S.F. EXAMINER, Dec. 17, 1992, at D1; *see also Protests Predicted if NAFTA Approved*, SEATTLE TIMES, Dec. 17, 1992, at A5.

6. West Coast Hotel Co. v. Parrish, 300 U.S. 379 (1937) (upholding a state minimum wage law for women and, more importantly, establishing the rational basis

"obscure clause,"[7] NAFTA Chapter 11 hamstrings traditional state police power actions by providing foreign investors with a secret forum where significant monetary relief can be sought under a theory that state action indirectly "expropriated" their investment.[8]

Under Chapter 11, a domestic corporation of any NAFTA country can challenge any government action of the other participating states under the broad and vaguely defined rubric of "expropriation."[9] Methanex, a Canadian producer of methyl tertiary butyl ether (MTBE), recently utilized this mechanism to challenge California's regulatory ban of MTBE. On March 25, 1999, California Governor Gray Davis issued an executive order banning the use of MTBE for gasoline.[10] MTBE had long been placed on the EPA's list of possible carcinogens and, according to a University of California-Davis study, it was found in over ten thousand groundwater sites.[11] Within three months, Methanex, a Canadian Producer of MTBE, submitted a Notice of Intent to the United States NAFTA office claiming that California "expropriated" its investment in violation of Chapter 11.[12]

Methanex requested damages of approximately $1.6 billion. Utilizing Chapter 11's dispute resolution mechanism, Methanex forced California's action to be reviewed by an international arbitration panel rather than an Article III or state court.[13] Because the stakes are high for California, international arbitration unpredictable, and international law on indirect takings remains

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standard of review for State legislative acts which overruled the *Lochner* standard and its progeny). Of the 20 volumes cataloguing NAFTA's legislative history there is virtually no mention of Chapter 11. *See generally* REAMS AND SCHULTZ, *supra* note 1.

7. Mathew Nolan and Darin Lippoldt, *Obscure NAFTA Clause Empowers Private Parties, Investor-Protection Clause Lets Companies Haul Signatories into Arbitration for Violation of Pact*, NAT'L L.J., Apr. 6, 1998, at B.

8. J. Martin Wagner, *International Investment, Expropriation and Environmental Protection*, 29 GOLDEN GATE U. L. REV. 465 (1999); Robert W. Benson, *Free Trade as an Extremist Ideology: The Case of NAFTA*, 17 U. PUGET SOUND L. REV. 555 (1994).

9. *See supra* note 8 and accompanying text.

10. Julia Ferguson, *California Concerned about Contaminated Water: Canadian Corporation Files NAFTA Expropriation Claim Against U.S.*, 1999 COLO. J INT'L ENVTL. L. & POL'Y 65 (2000).

11. *Id.* Ferguson does note that the degree of danger that MTBE poses is debatable. The EPA has listed it as only a "potential" human carcinogen because exposure to MTBE has been linked to tumors and nervous systems disorders. The World Health Organization has not classified MTBE as a carcinogen. *Id.* However, since *West Coast Hotel* the rational basis standard does not require a level of evidence even remotely close to strong conclusiveness standard—any reasonable inference is sufficient justification. *See, e.g.*, Williamson v. Lee Optical Co., 348 U.S. 483, 487-88 (1955) (holding that a law need not be logically consistent with its aims in every respect to be constitutional).

12. *Methanex's Legal Battle (attempt to resist California ban on MTBE)*, NITROGEN & METHANOL, Nov. 1, 2000, at 29.

13. *Institute Seeks to Intervene in Methanex Suit*, WINNIPEG FREE PRESS, Nov. 25, 2000, at B24.

unsettled, there is strong incentive to settle Methanex's claims even though California's actions would easily pass federal and state scrutiny.[14] Defensive settlement in the face of high stakes has been the fate of at least one similar Chapter 11 suit.[15]

Chapter 11 also affords the investor perhaps the most coveted of protections for challenging a public regulation: complete secrecy.[16] Proceedings under the rules of international arbitration are kept secret; Chapter 11 incorporates these rules.[17] In short, an alleged expropriation caused by a public regulation, the drafting and passage of which were public, is decided in a secret proceeding. The public cannot access evidence, arguments, or the ultimate rationale for the judgment.[18]

In asking the question "What in Capitalism cannot be Co-opted?" the Frankfort School's Herbert Marcuse noted the conflict between wealth-maximizing schemes like Chapter 11 and arguably inefficient governmental or constitutional structures such as the doctrines of federalism and separation of powers.[19] For those like Marcuse, who are critical of the weight given to market values, the Methanex dispute is a textbook example of how capitalism tacitly extorts concessions of public control in order to increase efficiency and profitability.[20]

For those wary of phrases like "triumph of capital," Chapter 11 fails on an altogether different ground because of its disregard for federalism's *sine qua non* of local control. In the proliferating global economy, the growing popularity of Chapter 11 expropriation claims could eventually hamper both state and local decision-making. Liability for significant economic damages and fear of acquiring an "anti-investment" image are two specters that haunt states.[21]

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14. *See generally* M. SORNARAJAH, THE INTERNATIONAL LAW ON FOREIGN INVESTMENT 277-321 (1994).

15. Julia A. Solaway, *Environmental Trade Barriers under NAFTA: The MMT Fuel Additives Controversy*, 8 MINN. J. GLOBAL TRADE 55, 84 (1999).

16. *See infra* note 86 and accompanying text. One attorney for a NAFTA Chapter 11 dispute justified the secrecy on the grounds that potential embarrassment from publicity is avoided. INTER PRESS SERV., Sept. 23, 1998, at 4.

17. *See infra* note 86 and accompanying text.

18. Though beyond the scope of this Note, another topic well worth researching is what arguments under Freedom of Information Act, the Constitution, or California's own Sunshine laws, can be made to gain access to the information in the proceeding and attend the hearings themselves.

19. HERBERT MARCUSE, ONE DIMENSIONAL MAN: STUDIES IN THE IDEOLOGY OF ADVANCED INDUSTRIAL SOCIETY 196 (1991).

20. *See generally* RICHARD POSNER, ECONOMICS OF JUSTICE, 70-119 (1981) (arguing that the common law's emphasis on economic efficiency is the primary function of law).

21. *See* Lori Wallach, *NAFTA "Investor-to-State" Provision Creates Giant Loophole for Companies to Evade Justice*, *at* http://www.citizen.org/pressroom/release.cfm?ID=907. Wallach, the Director of the Public Citizen's Global Trade Watch, NAFTA, argues that Chapter 11 is not so much about trade as about creating powerful

Though perhaps not having the initial emotional appeal of the image that NAFTA allows American corporations to increase their profits by stepping on the Mexican poor, the harm that Chapter 11 poses to state and local sovereignty could have more far reaching and long-term effects.

This Note examines the constitutionality of NAFTA Chapter 11. Part II attempts to explain the lack of consideration given to Chapter 11 by academics, journalists, and Congress. Chapter 11's general framework will then be laid out. Part III addresses in detail the significant Eleventh Amendment and Article III problems that Chapter 11 presents by analyzing Chapter 11 as if it operates in a domestic rather than international context. In other words, if Congress created an *interstate* arbitration tribunal for takings claims made by residents of one state against another state, what would be the result? Part IV then examines whether the federal government's foreign affairs powers, invoked because of NAFTA's international character, absolve Chapter 11 of its constitutional failings. This Note finds such absolution doubtful.

This analysis of Chapter 11's constitutionality involves three of the most nebulous and difficult areas of the Supreme Court's jurisprudence: the scope of the treaty power, the Eleventh Amendment, and Article III courts. This Note relies primarily on the Supreme Court's own language while attempting to integrate the vast corpus of secondary literature on these three difficult and dense areas. Though attempting to be comprehensive, these areas of jurisprudence are so nuanced that a thorough scholarly treatment would require many more pages.

## II. CHAPTER 11: NOT SIMPLY ANOTHER BILATERAL INVESTMENT TREATY

Intuitively, it is troubling that a foreign investor can arguably extort settlement from the State of California over a simple health and safety regulatory action. Though Chapter 11 has been gaining some attention in the past year, in general it has received little scholarly attention over the first six years of its existence, other than a few criticisms by a handful of environmentalists.[22] Hence it is initially worth asking why Chapter 11 has largely been ignored. Examining the context in which Congress passed Chapter 11 reveals several reasons why it has not drawn much attention from mainstream media, academics, or politicians.

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new rights for corporations and investors at the expense of the public interest and democratic governance. *Id.*

22. *See supra* note 8 and accompanying text.

A brief perusal of Chapter 11 would lull the reader into believing that it is yet another ordinary bilateral investment treaty (BIT). BITs provide the necessary legal rules and incentives for protecting and securing direct foreign investment.[23] In fact, for some capital-exporting states, a BIT is a prerequisite for acquiring investment insurance by the foreign investor.[24] By 1994, over 700 BITs had been concluded.[25] On the surface, Chapter 11's structure and language mirrors other BITs.[26]

Perhaps more important than this belief that Chapter 11 is just another BIT is that Chapter 11 already existed in NAFTA's parent, the Canadian Free Trade Agreement (CFTA).[27] NAFTA integrated much of CFTA's structure and incorporated essentially the same language of CFTA's expropriation section.[28] The one interesting item added to NAFTA is the significant language specifying in detail the method, mode, and time of compensation if an expropriation takes place—as if the gentlemanly Americans and Canadians did not need an exact compensation structure, but the Mexicans did.[29]

From a historical standpoint, this xenophobic difference provides the most powerful reason for Chapter 11's general acceptance. Wall Street pushed for a powerful cause of action and an exact compensation structure because of fears arising from the perceived instability of Mexican politics and the "Calvo clause" of the Mexican Constitution.[30] The investment community still recalls President Cardenas invocation of the Mexican Constitution's Calvo clause in 1938 to nationalize the Mexican oil industry and expropriate foreign holdings totaling eighty-one million dollars.[31] In the minds of Wall Street, Chapter 11 and its contentious compensation structure[32] was necessary if American investors were to invest significantly in Mexico.[33]

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23. Kenneth J. Vandevelde, *The Economics of Bilateral Investment Treaties*, 41 HARV. INT'L L.J. 469 (2000).

24. RUDOLPH DOLZER & MARGRETE STEVENS, BILATERAL INVESTMENT TREATIES 1, 12 (1995).

25. *Id.* at 1 (noting the proliferation of BITs in the last two decades).

26. *Id.* at Annex I (providing an invaluable compilation of model BITs from several countries. NAFTA Chapter 11 is quite similar to these agreements.).

27. JOHN R. MACARTHUR, THE SELLING OF FREE TRADE 137 (2000).

28. *Id.*

29. *Id.*

30. *See* Richard D. English, *Energy in the NAFTA: Free Trade Confronts the Mexican Constitution*, 1 TULSA J. COMP. & INT'L L. 1 (1993).

31. MACARTHUR, *supra* note 27, at 133-36.

32. *See, e.g.*, DOLZER, *supra* note 24, at 108-12; *see also* SORNARAJAH, *supra* note 14, at 357-414 (noting that compensation for expropriation is one of the most controversial topics in international law).

33. *See generally* Gloria L. Sandrino, *The NAFTA Investment Chapter and Forging Direct Investment in Mexico: A Third World Perspective*, 27 VAND. J. TRANSNAT'L L. 259 (1994) (discussing Mexico's purported seventy year history of expropriating foreign assets).

In the context of the mainstream interpretation of Mexico's history of expropriation, the commonplace nature of BITs in global investment today, and CFTA's precursor expropriation clause, there appeared to be "little news" in Chapter 11's inclusion. Coupled with the irony that Wall Street's demand for Chapter 11's broad, powerful cause of action and detailed compensation structure has only been used against U.S. states in the last few years, this seeming lack of novelty explains Chapter 11's general obscurity.

Chapter 11 gained notoriety when the Canadian funeral home conglomerate, the Loewen Group claimed that the basic structure of Mississippi's trial system "expropriated" their investment.[34] After a large jury verdict for tortious interference with contract that threatened to bankrupt the conglomerate, the Loewen Group made a Chapter 11 claim alleging that Mississippi's civil trial system and its bond requirement for appeal effectively expropriated its investment in violation of Chapter 11.[35]

Another explanation for the lack of comment on Chapter 11 lies in the general structure of the NAFTA agreement. On its face, Chapter 11 appears to be far less problematic than NAFTA's other two dispute resolution systems, Chapters 19 and 20.[36] Both of these chapters involve binational panels, and unlike Chapter 11, empower the panel to definitively interpret U.S. law while denying Article III review of the panel's decision.[37] As might be expected, these chapters have received a substantial amount of scholarly attention.[38] Furthermore, Congress recognized the potential constitutional difficulties with Chapter 19 and 20 and included a right to a direct appeal regarding their constitutionality in NAFTA's Implementation Act.[39]

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34. *See, e.g.*, David Haigh, *Chapter 11—Private Party vs. Governments, Investor—State Dispute Settlement: Frankenstein or Safety Valve?* 26 CAN.-U.S. L.J. 115, 126 (2000); Brian Milner, *Loewen Group invokes NAFTA Clause, Funeral Home files damages against U.S. Government for crippling State Court ruling*, GLOBE & MAIL, Nov. 11 1998, at B1.

35. *See supra* note 34 and accompanying text.

36. The North American Free Trade Agreement, Dec. 17, 1992, 32 I.L.M. 605, 682-99 [hereinafter NAFTA].

37. *Id.*

38. Michael S. Valihora, *NAFTA Chapter 19 or The WTO's Dispute Settlement Body: A Hobson's Choice for Canada?*, 30 CASE W. RES. J. INT'L L. 447 (1998); Ethan Boyer, *Article III, the Foreign Relations Power, and The Binational Panel System of NAFTA*, 13 INT'L TAX & BUS. LAW. 101 (1996); Robert P. Deyling, *Free Trade Agreements and The Federal Courts: Emerging Issues*, 27 ST. MARY'S L.J. 353 (1996); Patricia Kelmar, *Binational Panels of the Canada-United States Free Trade Agreement in Action: The Constitutional Challenge Continues*, 27 GEO. WASH. J. INT'L L. & ECON. 173 (1993); Jim C. Chen, *Appointments with Disaster: The Unconstitutionality of Binational Arbitral Review Under the United States-Canada Free Trade Agreement*, 49 WASH. & LEE L. REV. 1455 (1992) (one of the few scholars concluding that these schemes are unconstitutional).

39. 19 U.S.C. § 1516a(g)(4)(H) (1994).

Finally, as will be made evident in Part III, Chapter 11's emergence from obscurity results in part from the U.S. Supreme Court's revival of federalism over the past several years.[40] With what some have called a radical shift[41] towards states' rights in the past five years, it is an open question whether Chapter 11 offers a viable constitutional scheme. In the first half of the twentieth century, the U.S. Supreme Court significantly weakened states rights when it held that the Executive's treaty power could regulate an area normally the exclusive province of the state police power.[42] Following the Supreme Court's holdings in *Seminole Tribe v. Florida* and its progeny, Congress' ability to trump state sovereign immunity through its treaty power appears to be a newly opened question.[43] NAFTA passed before the Supreme Court's recent reinvigoration of state sovereign immunity.

NAFTA includes eight parts, spanning issues from trade in goods to intellectual property.[44] Chapter 11 is included in part five, which governs *Investment, Services and Related Materials.*[45] Chapter 11 specifically creates a cause of action for "expropriation," as well as a dispute resolution mechanism for resolving "expropriation" claims.[46]

Despite its relation to other BITs, Chapter 11 has been called the most comprehensive investment accord ever entered into by the United States.[47] Chapter 11 is divided into three sections.[48] Section A lays out its broad scope and provides at least four basic protections.[49] Section B creates the mechanism for resolving NAFTA investment disputes,[50] and section C provides definitions.[51]

Before detailing Chapter 11's basic protections as set forth in section A, one must recognize Chapter 11's sweeping definition of "investment."[52] The definition is not restricted to the traditional formulation of equity and debt securities or direct investment in an

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40. *See infra* Part III.

41. Herbert Hovenkamp, *Judicial Restraint and Constitutional Federalism: The Supreme Court's* Lopez *and* Seminole Tribe *Decisions*, 96 COLUM. L. REV. 2213, 2220 (1996).

42. *See infra* Part II, Section 2, part A. As will be argued later, it is not clear whether Chapter 11 could even operate under an expansive reading of *Missouri v. Holland*. *See generally* Missouri v. Holland, 252 U.S. 416 (1920).

43. *See infra* Part III.

44. NAFTA, *supra* note 36, at 296-456, 605-800.

45. *Id.* at 639.

46. *Id.* at 639-49.

47. Richard C. Levin & Susan Erikson Marin, *NAFTA Chapter 11: Investment and Investment Disputes*, 2-SUM NAFTA: L. & BUS. REV. AM. 82, 83 (1996).

48. NAFTA, *supra* note 36, at 639.

49. *Id.*

50. *Id.* at 642.

51. *Id.* at 647.

52. *Id.*

enterprise.[53] It also includes "real estate or other property, tangible and intangible," as well as capital commitments to contracts concerning the investor's property or contracts where repayment depends upon production.[54] This comprehensive definition includes the "goodwill value" of a business. Though international law has scant and conflicting precedent for recognizing indirect takings, defining investment in such a broad manner is a standard tactic of BITs—perhaps reflecting an effort to generate new law for indirect expropriation claims by bootstrapping a broad definition of investment to international agreements.[55]

This broad definition of investment strengthens indirect expropriation claims like Methanex's because it provides language to argue against the "standard" definition of expropriation as a direct seizure of property or breach of a concessions contract.[56] Generally, traditional international law has only recognized expropriation claims involving direct takings, primarily the cancellation of concession contracts between the state and private party.[57] There are, however, conflicting decisions recognizing indirect expropriation claims.[58]

Chapter 11's far reaching powers come primarily from the mandates of Articles 1102 through Article 1114 of subchapter A, particularly from Article 1110's expropriation clause.[59] There are at least four basic rights in subchapter A: freedom of performance requirements, non-discriminatory treatment and most favored nation treatment, free mobility of investments, and a cause of action for expropriation as interpreted under international law.[60]

The first several articles address non-discriminatory treatment on behalf of the investor party.[61] Article 1102 states that foreign investors and their investments shall receive "treatment no less favorable than [the country] accords, in like circumstances, to its own [investors]."[62] Article 1103 further clarifies that parties shall receive

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53. *Id.*
54. *Id.*
55. DOLZER, *supra* note 24, at 25-30.
56. Levin, *supra* note 47, at 94 (their prototypical example of an alleged Chapter 11 violation is a dispute over a concession agreement); George H. Aldrich, *What Constitutes a Compensable Taking of Property? The Decisions of the Iran-United States Claims Tribunal*, 88 AM. J. INT'L L. 585 (1994); Patrick M. Norton, *A Law of the Future or a Law of the Past? Modern Tribunals and the International Law of Expropriation*, 85 AM. J. INT'L L. 474 (1991). *See generally* SORNARAJAH, *supra* note 14, at 277-321.
57. *See supra* note 56 and accompanying text.
58. Maurizio Brunetti, *The Iran-United States Claims Tribunal, NAFTA Chapter 11, and the Doctrine of Indirect Expropriation*, 2 CHI. J. INT'L L. 203 (2001).
59. NAFTA, *supra* note 36, at 639-42.
60. *Id.*
61. *Id.*
62. *Id.* at 639.

most favored nation treatment.[63] Finally, Article 1104 makes clear that the investor and investment shall receive the better of the two standards.[64]

After setting out the standards for non-discriminatory treatment, the next several articles have more specific aims.[65] To tie NAFTA to the broader international legal framework, Article 1105 adopts international legal standards for protecting investments. This ignores the fact that these international standards do not seem to support such a broad definition of "investment."[66] Article 1106 seeks to curtail signatories' covert control of foreign investment by forbidding the adoption of regulations that force foreign investors to meet specific requirements.[67] Article 1107 explicitly prohibits governments from interfering with the make-up of senior management or boards of directors.[68] Article 1108 details the national exceptions to the above obligations listed in the detailed Annexes I, II, III, and IV or Volume II of the agreement.[69] Article 1109 ensures transfer of investment without delay, which at one time was considered the most important clause in BITs.[70]

The focal point of Chapter 11, as well as the focus of this Note, is Article 1110. Unlike the previous articles that lay out standards, this article defines the specific cause of action in Chapter 11.[71] Article 1110 states:

> no party may directly or indirectly nationalize or expropriate an investment of an investor of another party in its territory or take a measure tantamount to nationalization or expropriation of such investment except:
>
> (a) For a public purpose;
>
> (b) On a non-discriminatory basis;
>
> (c) In accordance with due process of law and article 1105(1); and,
>
> (d) On payment of compensation in accordance with paragraphs 2 through 6. . . .

Unlike its predecessor in CFTA, Article 1110 goes on to state that compensation must be made according to fair market value of the expropriated investment, calculated from immediately before the expropriation took place.[72]

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63. *Id.*
64. *Id.*
65. *Id.* at 639-42.
66. *Id.* at 639-40.
67. *Id.* at 640 (including subjects such as production, export, domestic content, domestic use, or technology).
68. *Id.*
69. *Id.* at 641, 704-62.
70. *Id.* at 641.
71. *Id.* at 641-42.
72. *Id.*

Contrasted with prior NAFTA sections, the final four portions of section A do not create specific constraints on government action.[73] Rather, they address specific issues like the free mobility of capital investment.[74] It is important to note that section 1114 states that "nothing in this chapter shall be construed to prevent a party from adopting, maintaining or enforcing any measure otherwise consistent with this chapter that it considers appropriate . . . [to undertake for sensitive environmental concerns]."[75] This environmental catch-all was a concession to various protests about NAFTA's lack of concern for the environment. Yet, it has not prevented companies from challenging government environmental action under Article 1110.[76]

Section B lays out the specific dispute resolution system for implementing and enforcing section A.[77] The key section is 1120, which details the "no two bites of the same apple" policy.[78] For a proceeding to commence under Chapter 11, investors must choose either the forum of international arbitration or a court within the offending country's court system; they cannot pursue both avenues.[79] For example, if a U.S. or Canadian investor has already brought a claim in a Mexican court, Mexico can invoke Annex 1120.1 to prevent the claim from proceeding in arbitration.[80]

Under Chapter 11, the investor controls forum selection.[81] For example, in the case of Methanex, California is afforded no option to have the claim against it reviewed in either a federal or state court. California is also forced to accept the United States as its representative.[82] California must litigate in the plaintiff's choice of forum. Hence, a savvy investor will choose only international arbitration.[83]

Once a claim is submitted, the investor must select the arbitration rules under which he wants to proceed.[84] There are several international arbitral institutions. However, NAFTA limits the investor's choice to three: the ICSID Convention, Additional

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73. *Id.*
74. *Id.*
75. *Id.* at 642.
76. *Id.*
77. *Id.* at 642-47.
78. *Id.* at 643; *see also* Levin & Marin, *supra* note 47, at 91.
79. *Id.* at 642, 648.
80. *Id.* at 648. If the company is pursing monetary awards under arbitration, they can still seek injunctions within the offending country's court system. *Id.*
81. *Id.* at 643.
82. *Id.*
83. *See generally* Neil McDonnell, *The Availability of Provisional Relief in International Commercial Arbitration*, 22 COLUM. J. TRANSNAT'L L. 273 (1984); Henry P. de Vries, *International Commercial Arbitration: A Contractual Substitute for National Courts*, 57 TUL. L. REV. 42 (1982).
84. *See* NAFTA, *supra* note 36, at 643.

Facility Rule of ICSID, and the UNCITRAL Arbitration Rules.[85] All three of these conventions mandate secrecy in their proceeding.[86]

In sum, Chapter 11 provides the international investor with a powerful cause of action for challenging government regulation. Some may argue that this seemingly broad cause of action is undercut by section 1105's incorporation of principles of international law, where there is sparse precedent for upholding indirect takings.[87] From a legal process perspective, however, by incorporating such a broad definition of investment, the international investment community will eventually create such precedent.[88]

More significantly, not only has Congress created a powerful new cause of action, it has also created a powerful alternative forum. In a Chapter 11 action against a U.S. state, the foreign investor can elect to force review of state action before an international tribunal. This presents difficult questions of state sovereign immunity and the scope of Article III.

## III. ARGUMENT AND ANALYSIS

This section will begin by analyzing Chapter 11 as if it were operating in a hypothetical *interstate* context in order to address three crucial questions. First, can Congress, under its commerce power, abrogate state sovereign immunity to allow an out-of-state investor to sue a state? Second, can Congress condition state participation in an interstate commercial scheme on state waiver of its sovereign immunity? Finally, can disputes arising out of such a scheme be adjudicated without Article III review? This section

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85. *Id.*

86. A primary characteristic of commercial arbitration is its confidentiality. *See* Report of the Secretary-General on the Revised Draft. (A/CN.9/112), VII *Yearbook of UNCITRAL*, 157, 164 (1976). UNCITRAL Rule 25 requires that only the "parties" attend the *in camera* hearing of the arbitration. UNCITRAL Arbitration Rules, United Nations, Rule 25(4) (1977). ICSID Convention Rule 32(2) states that the "[t]ribunal shall decide, with the consent of the parties, which other persons besides the parties, their agents, counsel and advocates, witnesses and experts during their testimony, and officers of the [t]ribunal may attend the hearings." RULES OF PROCEDURE FOR ARBITRATION PROCEEDINGS, ICSID, R. 32(2), *available at* http://www.worldbank.org/icsid/basicdoc/77.htm. ISCID Additional Facility Rule 39(2) incorporates the exact language as ICSID Rule 32(2). *Id.* R. 39(2). *But see* Fulvio Fracassi, *Confidentiality and NAFTA Chapter 11 Arbitrations*, 2 CHI. J. INT'L L. 213 (2001) (arguing that the international arbitrators are not compelled to keep secrecy and can in a Chapter 11 situation allow for public access).

87. Brunetti, *supra* note 58.

88. *See* Andrew T. Guzman, *Why LDC's Sign Treaties that Hurt Them: Explaining the Popularity of Bilateral Investment Treaties*, 38 VA. J. INT'L L. 639, 683 (1998) (providing a fascinating discussion on how the proliferation of BITs has affected the doctrine of takings in customary international law).

focuses exclusively on a hypothetical domestic scheme. The international aspects of NAFTA will be addressed in Part IV.

For purposes of illustration, consider a hypothetical congressional scheme created to spur interstate commerce and investment, the "Interstate Investment Act" (IIA). Under this hypothetical Act, Congress provides special incentives and privileges to encourage private investor participation. Aware of investors' justified fears of state sovereign immunity, Congress decides to either abrogate state sovereign immunity outright or, more covertly, offers to pay states to waive immunity. Under the hypothetical IIA, the out-of-state investor is empowered to sue the state to recoup investment funds.

Furthermore, in an effort to assuage lingering investor fears, Congress throws in a few more key investor perks: a potentially much broader cause of action for a takings claim and, more importantly, the right to pursue the claim via interstate arbitration, with no Article III review. The investor can now pursue the claim in a confidential hearing before an interstate arbitral forum—an action that is much cheaper, more efficient, and avoids the lax "rational basis" standard of review of the federal court system.

This hypothetical raises three primary issues: abrogation of state sovereign immunity, incentivized waiver of state sovereign immunity, and non-Article III adjudication of a dispute involving a federal cause of action and a state party.

### A. *Could Congress Simply Abrogate State Sovereign Immunity in Order to Promote Interstate Investment?*

Five years ago, in *Seminole Tribe v. Florida,* the Supreme Court directly confronted this question.[89] To grasp the broad reach of state sovereign immunity in *Seminole Tribe*, the legal backdrop of the Eleventh Amendment and two watershed cases will briefly be addressed.

The Eleventh Amendment provides: "The Judicial power of the United States shall not be construed to extend to any suit in law or equity, commenced or prosecuted against one of the United States by Citizens of another State, or by Citizens or Subjects of any Foreign State."[90] The Eleventh Amendment literally refers to jurisdiction; the language does not mention the doctrine of sovereign immunity.[91] However, *Hans v. Louisiana* extended the text to include the comprehensive principle that a state is immune from any suit unless

89. Seminole Tribe v. Florida, 517 U.S. 44 (1996).
90. U.S. CONST. amend. XI.
91. *Id.*

it chooses to recognize it.[92] *Hans* specifically stated, "the suability of a State without its consent is a thing unknown to the law."[93] *Hans* grafted onto the Eleventh Amendment a monolithic principal that bars all suits against a state because of the substantive principal of sovereign immunity.[94]

The broad holding of *Hans* was limited twelve years ago by *Pennsylvania v. Union Gas*, which held that Congress could abrogate state immunity under the commerce power.[95] Pennsylvania attempted to raise the Eleventh Amendment as a defense when faced with liability in a Superfund cleanup.[96] Justice Brennan, writing for a plurality of the Court, held that

> the congressional power . . . would be incomplete without the authority, to render states liable in damages, it must be that to the extent that the states gave Congress the authority to regulate commerce, they also relinquished their immunity where Congress found it necessary, in exercising this authority to render them liable.[97]

The 5-4 majority in *Seminole Tribe* directly overruled Justice Brennan's plurality opinion in *Union Gas* and instead extended the principal set forth in *Hans*.[98] The Court examined the question whether the Indian Gaming Regulatory Act (IGRA) could authorize Indian tribes to sue a state in federal court if that state failed to negotiate in good faith.[99] The Court held, *inter alia*, that Congress could not abrogate state immunity under the commerce clause. The Court stated that the "plurality's rationale [in *Union Gas*] deviated sharply from our established federalism jurisprudence and essentially

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92. Hans v. Louisiana, 134 U.S. 1 (1890).

93. *Id.* at 16.

94. *Id.* Ignoring the dicta concerning the Eleventh Amendment in various Marshall Court opinions, the *Hans* Court read the Eleventh Amendment as addressing a substantive issue rather than a jurisdictional issue—in fact, the heated debate between the dissent and majorities in recent Eleventh Amendment cases boils down to this question of substance or jurisdiction. It is worth noting that the *Hans* holding has received considerable criticisms from various Supreme Court Justices, most notably Justice Souter's lengthy dissent in *Seminole Tribe* and *Alden v. Maine*, heavily criticizing the holding of *Hans*. *Seminole Tribe*, 517 U.S. at 100-85; *see also* Alden v. Maine, 527 U.S. 706, 734 (1999); Pennsylvania v. Union Gas Co., 491 U.S. 1, 7 (1989) (Justice Brennan distinguishing *Hans* in his *Atascadero* dissent and *Union Gas* plurality); Atascadero State Hosp. v. Scanlen, 473 U.S. 234, 242 (1985).

95. *Union Gas*, 491 U.S. at 7.

96. *Id.* at 6.

97. *Id.* at 19-20. Justice Stevens in his concurrence added that, with respect to the judicially created doctrine of state immunity found in *Hans* (as opposed to the literal text of the Eleventh Amendment), Congress can by statute trump the Court created rule of *Hans* and use its "plenary power to subject the States to suit in federal court." *Id.* at 24 (Stevens, J., concurring).

98. *Seminole Tribe*, 517 U.S. at 72.

99. *Id.* at 46.

eviscerated our decision in *Hans*."[100] Noting this sharp deviation from *Hans*, the Court felt "bound" to overrule *Union Gas*.[101]

Accordingly, after *Seminole Tribe*, nothing survives from the *Union Gas* precedent.[102] Congress cannot, under its commerce power, abrogate state sovereign immunity. Hence, a hypothetical scheme like the IIA that promotes interstate investment by waiving state sovereign immunity cannot be justified under the commerce clause.

Congress might also attempt to bootstrap the IIA to its abrogation power under section five of the Fourteenth Amendment.[103] An action pursued under the IIA is essentially an alleged taking by a state. With the Fifth Amendment incorporated into the Fourteenth Amendment, Congress might attempt to abrogate sovereign immunity to enforce the Fourteenth Amendment.[104] Writing for the Court, Justice Rehnquist stated, "the Eleventh Amendment, and the principle of state sovereignty which it embodies are necessarily limited by the enforcement provisions of section five of the Fourteenth Amendment."[105] The Court held in *Fitzpatrick v. Bitzker* that if the Eleventh Amendment clashed with the Fourteenth Amendment, the Fourteenth Amendment would prevail.[106]

If Congress were to pass the hypothetical IIA under its abrogation power of the Fourteenth Amendment, two questions would arise. First, is this prophylactic remedy too broad? Second, how narrowly has the Supreme Court defined property for the purposes of the Fourteenth Amendment? If the abrogation does not proportionally correspond to the Fourteenth Amendment violations, and in the IIA context if does not involve "property," then it is unconstitutional.

As to the first question, the Court has held that "as broad as the congressional enforcement power is [under section 5], it is not unlimited."[107] Congressional enforcement power is remedial in

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100. *Id.* at 64. The Court noted that *Union Gas* was a plurality opinion in which the fifth vote, Justice White, stated in his concurrence that he did not agree with much of the reasoning of the plurality. *Id.* This move is quite disingenuous on the part of Justice Rehnquist because Justice White disagreed with the reasoning employed by the plurality examining whether Congress "intended" to abrogate state immunity in the CERCLA scheme. *Union Gas*, 491 U.S. at 45. On the point at issue in *Seminole Tribe*, Justice White fully agreed with the plurality that the commerce power could trump state sovereign immunity. *Id.*

101. *Id.* at 66.

102. *Id.* at 72.

103. *See generally* Fitzpatrick v. Bitzker, 427 U.S. 445 (1976).

104. *Id.*

105. *Id.* at 456.

106. *Id.*

107. Oregon v. Mitchell, 400 U.S. 112, 128 (1970).

nature.[108] Congress must identify a pattern of state constitutional violations. Furthermore, there must be a "congruence and proportionality between the injury to be prevented or remedied and the means adopted to that end."[109] Without any history of state expropriation of foreign investment, Congress cannot provide such a broad remedial cause of action against the states under the Fourteenth Amendment.[110]

The Supreme Court has interpreted property quite narrowly.[111] In *College Savings Bank II*, the Court found that two species of "property" did not fall under protection of the Fourteenth Amendment's Due Process Clause.[112] Neither the right to be free from a business competitors' false advertising nor the more generalized right to be "secure in one's business interests" constitutes a property right recognized by the Due Process Clause.[113] Consequently, *College Savings Bank II* seems to foreclose a Fourteenth Amendment claim of indirect takings, such as California's ban on the use of MTBE.[114]

This narrow definition of property must be balanced against the Court's recent reinvigoration of indirect takings or inverse condemnation claims.[115] In *Lucas v. South Carolina Coastal Council*, the Court found that South Carolina must compensate private landowners because the government's Beach Front Management Act effectively prohibited all economically productive and beneficial uses of the land.[116] However, as is obvious, *Lucas* involves real property.

In sum, this hypothetical illustrates why Congress cannot abrogate state sovereign immunity either under the commerce power or the Fourteenth Amendment for a scheme promoting *interstate* investment and commerce.[117]

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108. *See, e.g.*, City of Boerne v. Flores, 521 U.S. 507, 518 (1997); *see also* Kimel v. Fla. Bd. of Regents, 528 U.S. 62, 82 (2000) (asserting that Congress' enforcement power serves as a remedy).

109. *Flores*, 521 U.S. at 520.

110. Fla. Prepaid Postsecondary Educ. Expense Bd. v. Coll. Sav. Bank, 527 U.S. 627, 640 (1999) (noting the recent decision in *College Savings Bank I*, just as Congress had no evidence that states were taking property without compensation by infringing patents).

111. *Id.* at 666.

112. *Id.* at 675.

113. *Id.* at 672.

114. *Id.*

115. Lucas v. South Carolina Coastal Council, 505 U.S. 1003 (1992).

116. *Id.* The Court extended the *Lucas* precedent in *Palazzolo v. Rhode Island;* however, *Palazzolo*, like *Lucas*, was another situation involving real property. Since *Palazzolo* does not adopt a broad definition of property, its reaffirmation that indirect takings occur is of no avail. Palazzolo v. Rhode Island, 121 S. Ct. 2448 (2001).

117. There is one devilish wrinkle to this analysis more suitably dealt with in a footnote. As stated in the abstract, the Author asserts that when examining the specific structure of Chapter 11, Congress arguably circumvents the limit of its abrogation power by authorizing the United States to arbitrate on behalf of California.

### B. *Could Congress Condition State Participation in the Interstate Investment Act to Waiver of Sovereign Immunity?*

Congress might attempt to justify the hypothetical scheme via the spending power. Congress would insure that states "choose" to waive immunity to receive funding. Therefore, although Congress has not literally created a funding program, it has ensured the end result of a funding program in that "benefits" are created by the IIA.

This argument seems to blur the line between cash grants, which a state can choose to accept, and outright commands, which the state must follow. By blending the spending power with the commerce power, such a purported justification conflates commands and payments. One can choose not to accept a cash bribe, but a command is involuntary. Thus, if Congress attempted to justify itself on these grounds, the Supreme Court would have to agree that the unique set of facts presented by the IIA somehow merited overlooking this distinction between spending under the spending clause and commanding under the commerce power.

If the Court were to permit Congress to blur this distinction, the critical question is whether the state can accept "payment" on the condition that it waives what perhaps is the essence of statehood, sovereign immunity. Only a few cases directly address whether Congress can provoke state waiver of immunity through its spending power; indeed, the Supreme Court has never directly confronted this question in its own spending power jurisprudence.[118] Rather, two recent opinions from the Eighth and Fourth Circuits are the only decisions examining the tying of a waiver of sovereign immunity to participation in a federal spending program.[119] On the Supreme Court level, *South Dakota v. Dole*, *New York v. United States*, and recent dicta in *College Savings Bank v. Florida Prepaid* all set forth principles in this general area of Congressional coercion, but do not

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So technically, Congress never "abrogates" California's sovereign immunity because the United States is the party in arbitration defending California's action against the disgruntled investor. However, the NAFTA Implementation Act has no language even hinting at the possibility that the United States will indemnify a state found violating Chapter 11.

Not only does this formal legal gerrymandering stretch the limits good faith, it still substantively acts as a *de facto* abrogation of state immunity because the state is still liable for damages and its policy creation is effectively constrained and skewed because of liability fears. This formalistic gerrymandering also raises another difficult question beyond the scope of this Note—whether the United States can force California to give up its right of self-representation in either an interstate or international commercial arbitration. If Congress could abrogate in this instance, could it step in and substitute itself as the defender of the state rather than the state itself?

118. *Coll. Sav. Bank*, 527 U.S. at 666; New York v. United States, 505 U.S. 144 (1992); South Dakota v. Dole, 483 U.S. 203 (1987).

119. Jim C. v. United States, 235 F.3d 1079 (8th Cir. 2000); Litman v. George Mason Univ., 186 F.3d 544 (4th Cir. 1999).

provide any concrete legal precedent.[120] As discussed *infra*, the Eighth and the Fourth Circuit provide some analysis, in *Jim C. v. United States* and *Litman v. George Mason*, respectively.

The Supreme Court emphasizes the element of choice in its spending power cases.[121] Though not a typical spending clause case, the often cited case *New York v. United States* explicitly states that attaching strings to funds is a "permissible method of encouraging a State to conform to federal policy choices."[122] States can either comply with conditions Congress mandates for receiving the funds or choose not to accept the funds.[123] The *New York* Court also laid down the so-called anti-commandeering principle: "The Constitution does not confer upon Congress the ability simply to compel the States to [act]."[124] As the Court recently stated in *College Savings Bank*, "Congress has no obligation to use its spending clause power to disburse funds to the States; such funds are gifts."[125] Congress can require waiver of immunity even though Congress cannot order the waiver directly.[126]

Because of a fear that this erases all limits to Congress' spending power, Justice O'Connor, in her lone dissent in *South Dakota v. Dole*, along with a few independently-minded law professors,[127] argues for a narrow interpretation of the spending power.[128] Justice O'Connor argues that,

> if the spending power is to be limited only by Congress' notion of the general welfare, the reality, given the vast financial resources of the Federal Government, is that the Spending Clause gives 'power to the Congress to tear down the barriers, to invade the states' jurisdiction, and to become a parliament of the whole people, subject to no restrictions save such as are self-imposed.'[129]

O'Connor's dissent aside, one can find a few limitations within the majority opinion. First, the spending power must be for the general welfare.[130] Closely connected to this, if there are conditions tied to the grant, there must be a nexus where the conditions bear some

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120. *See supra* note 118 and accompanying text.
121. *Id.*
122. *New York*, 505 U.S. at 168.
123. *Id.*
124. *Id.* at 149.
125. Fla. Prepaid Postsecondary Educ. Expense Bd. v. Coll. Sav. Bank, 527 U.S. 627, 686-87 (1999).
126. *Id.* at 687.
127. South Dakota v. Dole, 483 U.S. 203, 213 (1987); Thomas R. McCoy & Barry Friedman, *Conditional Spending: Federalism's Trojan Horse*, 1988 SUP. CT. REV. 85.
128. *Dole*, 483 U.S. at 217 (O'Connor, J., dissenting). Critics see this as resurrecting the original debate between Madison and Hamilton of whether spending for the "General Welfare" allows Congress to spend on things other than those correlated with Article I enumerated powers.
129. *Id.* (quoting United States v. Butler, 297 U.S. 1, 78 (1936)).
130. *Id.* at 207.

relationship to the purpose of the federal spending.[131] As in many other areas of its jurisprudence, the Supreme Court also invoked a clear statement rule, holding that if there are conditions tied to the federal funding, then these conditions must be clearly stated.[132] Most importantly for the purposes of this Note, the conditions cannot violate any free-standing constitutional prohibitions, nor can they be considered "coercive."[133]

*New York* and *Dole* fail to address directly whether Congress can request waiver of the Eleventh Amendment by the states. Recent authority from the Eighth and Fourth Circuits addressed this question as applied to two different federal acts. In *Litman v. George Mason University*, the Fourth Circuit examined whether Title IX in Congress' educational funding programs can impose liability on state funding recipients for non-intentional discrimination.[134] The court decided that Congress lacked this power under the Fourteenth Amendment; however, it can condition the receipt of such funds on the waiver of sovereign immunity.[135] The *Litman* court analogized the situation to a contractual relationship—federal funds exchanged in consideration for state agreement to the attached conditions.[136] The Fourth Circuit found that the state's "voluntary and knowing acceptance" of the contract waived sovereign immunity.[137] The court emphasized that the conditions of the contract were clearly stated.[138]

The Eighth Circuit reasoned along the same lines. *Jim C.* likened the situation to any ordinary quid pro quo, which the Supreme Court has repeatedly approved.[139] The *Jim C.* court found that a sacrifice of twelve percent of the state education budget did not rise to the level of coercion noted in *South Dakota v. Dole*.[140] Like the Fourth Circuit, the Eighth Circuit developed its version of the clear statement rule.[141] Hence, the court concluded that this was a valid, non-coercive waiver of state immunity.

When applying this to the IIA, there is the evident threshold problem of analogizing tangible federal funds with its concomitant choice to accept and a commerce power program aimed at creating a future non-tangible benefit that lacks choice. If this threshold problem was resolved—which is highly doubtful—then *Jim C.* and

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131. *Id.* at 207-08 (holding that that the condition of a 21 year old drinking age requirement correlates to funding for interstate highways).
132. *Id.* at 207.
133. *Id.* at 211.
134. Litman v. George Mason Univ., 186 F.3d 544, 548-54 (4th Cir. 1999).
135. *Id.* at 554.
136. *Id.* at 551.
137. *Id.* at 555.
138. *Id.*
139. Jim C. v. United States, 235 F.3d 1079, 1081-82 (8th Cir. 2000).
140. *Id.* at 1082.
141. *Id.*

*Litman* might stand as precedent for holding that Congress can tie funding to waiver of state sovereign immunity.[142]

### C. *Could Congress Eliminate Article III Review of Disputes Involving States?*

The previous sections establish that state sovereign immunity cannot be breached; hence, NAFTA Chapter 11's hypothetical domestic equivalent, the IIA, is unconstitutional. Assuming, however, that the Court allows abrogation, this section spotlights a separate constitutional flaw in Chapter 11. It examines whether Congress can force states to forego all access to Article III courts for a given dispute.

An important analytic problem arises when applying the following tests to an IIA or NAFTA Chapter 11 situation. *Northern Pipeline*, *Thomas*, and *Schor* are all cases involving individuals seeking access to Article III courts.[143] By contrast, in the IIA and NAFTA situation, a state wants to insist on an Article III court. A state cannot reliably stand on due process claims, because the novel question of whether a state can be denied due process has never before been litigated. Furthermore, the basic distinction between states and people remains, despite scholarly debate.[144]

There are several extant tests for determining what can be assigned to non-Article III courts. Two tests that hinge upon the doctrine of public rights will be examined first. Next, the multi-factored pragmatic test that appears to be gaining favor will be examined. This section concludes with an analysis of the literal language of Article III.

#### 1. Public Rights-Based Analyses

Though muted by the flexible test of *Commodity Futures Trading Commission v. Schor*, the case of *Northern Pipeline Construction Co. v. Marathon Oil Pipeline Co.* offers the most plausible justification for empowering Congress to force states into interstate arbitration.[145] Though many scholars consider *Northern Pipeline* dead letter, the analysis remains relevant because it offers bright lines as a basis for

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142. *Id.* at 1081-82.

143. Commodity Futures Trading Comm'n v. Schor, 478 U.S. 833, 837 (1986); Thomas v. Union Carbide Agric. Prods. Co., 473 U.S 568, 575 (1985); Northern Pipeline Constr. Co. v. Marathon Oil Pipeline Co., 458 U.S. 50, 56 (1982).

144. *See generally* Suzanna Sherry, *States Are People Too*, 75 NOTRE DAME. L. REV. 1121 (2000) (arguing that recent Supreme Court decisions have improperly personified states just as corporations were improperly personified a century ago).

145. *Schor*, 478 U.S. at 833; *Northern Pipeline*, 458 U.S. at 50.

discussion. Furthermore, its definition of public rights is the most favorable for justifying Congress' actions.[146]

The basic argument for denying Congress the flexibility to set up alternative courts looks to the literal language of Article III, which states that the judicial power shall rest in courts with lifetime tenure and salary protection.[147] Thus a court lacking these guarantees places the judicial power outside of Article III, contrary to its unambiguous language.

The emerging administrative state during the first half of the twentieth century recasts in a new form the question of Congress' power to set up alternative courts or grant to the executive quasi-judicial powers. Though precedent had been building, standard history interprets *Crowell v. Benson* as the Supreme Court's official blessing of administrative adjudication.[148] Fifty years later in *Northern Pipeline*, the Court signaled what could be a definitive limitation of *Crowell* and its progeny.[149] In examining the Bankruptcy Act of 1978, the Court held that Congress went too far in assigning Article III powers to Article I courts when it gave an Article I court jurisdiction over concurrent state law claims.[150] The dispute at issue involved whether a bankruptcy court could hear state contract disputes.[151] The *Northern Pipeline* Court held that Congress violated the separation of powers doctrine by expanding an Article I court's jurisdiction to include private common law rights.[152]

*Northern Pipeline's* significance is its formalistic distinction between public and private rights.[153] The dated concept of public rights goes back to *Murray's Lessee*, handed down before the Civil War.[154] However, *Northern Pipeline's* sharp juxtaposition of the public and private right affirmed Congress' latitude in the arena of public rights. In defining a public right, Congress can create presumptions or prescribe remedies.[155] Essentially, if Congress created the benefits—often described as a public right—such as a welfare program, then Congress can decide how it wants to adjudicate

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146. *Northern Pipeline*, 458 U.S. at 67-70.

147. U.S. CONST. art. III, § 1.

148. Crowell v. Benson, 285 U.S 22 (1932); Gordon G. Young, *Public Right and Federal Judicial Power: From* Murray's Lessee *through* Crowell *to* Schor, 35 BUFF. L. REV. 765, 841-46 (1994); *see also* RICHARD H. FALLON ET AL., HART AND WESCHLER'S THE FEDERAL COURTS AND THE FEDERAL SYSTEM, 395 (1996) [hereinafter HART AND WESCHLER].

149. *Northern Pipeline*, 458 U.S. at 50.

150. *Id.* at 62.

151. *Id.*

152. *Id.* at 67-70.

153. *Id.*

154. Murray's Lessee v. The Hoboken Land & Improvement Co., 59 U.S. 272, 284 (1855).

155. *Northern Pipeline*, 458 U.S. at 67-70.

disputes concerning that right as long as it meets the basic requirements of procedural due process.[156]

Though its clarity is wanting, *Northern Pipeline's* definition of private right is summed up in a two-part test. (1) Is it a claim involving private parties?[157] (2) Is it "the stuff of the traditional actions at common law tried by the courts at Westminster in 1789[?]"[158] When applying this to the hypothetical IIA, it appears that the answer is no for both of these questions. Consequently, under *Northern Pipeline*, Congress could plausibly assign the case to be heard by a non-Article III entity.[159]

The further issue of denying all Article III review, however, contradicts black letter law. Under *Crowell*, Congress must allow for some form of meaningful review by an Article III court.[160] On this requirement, both the IIA and NAFTA schemes must fail.

Six years later the Supreme Court provided a clearer definition of public rights in *Thomas v. Union Carbide*.[161] The *Thomas* Court defined public rights as rights so "closely integrated into a public regulatory scheme as to be a matter appropriate for agency resolution with limited involvement by the Article III judiciary."[162] In the case of the general strictures of NAFTA's Implementation Act, there is not a closely connected public regulatory scheme. In fact, what is labeled "foreign investment/investing" would be more properly characterized as a private right because it sounds predominately in contract and has been essentially unregulated since the birth of the United States.[163] Furthermore, a major impetus for Constitutional ratification was to encourage foreign investment, previously realized in the Colonial period but lost under the Articles of Confederation.[164]

Thus, under *Thomas*, the broad strictures and general cause of action in the IIA does not fit the public rights mold.[165] It is very difficult to analogize it to the prototypical public right, a welfare benefit or a labor relations NLRB claim. Obviously, this is not to say contrary to post-New Deal jurisprudence that Congress cannot

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156. Goldberg v. Kelly, 397 U.S. 254 (1970).
157. *Northern Pipeline*, 458 U.S. at 70.
158. *Id.* at 90 (Rehnquist, J., concurring).
159. *Id.* at 67-70.
160. Crowell v. Benson, 285 U.S 22, 53-54 (1932).
161. Thomas v. Union Carbide Agric. Prods. Co., 473 U.S. 568 (1985).
162. *Id.* at 593-94.
163. HART & WESCHLER, *supra* note 148, at 395-96.
164. *See generally* Alexander Hamilton & James Winthrop, *Further Defects in the Present System; The Power to Incorporate and the Regulation of Commerce, in* THE DEBATE ON THE CONSTITUTION 505-19 (1993) (noting that the need for the Constitution arises in part because of current commercial disorganization).
165. *See generally* NAFTA, *supra* note 36.

regulate a traditional private right—freedom and creation of contracts vis-à-vis investment—with a public regulatory scheme.[166]

Though it makes some sense to characterize foreign investment as a statutory right granted by the sovereign, it makes little sense to define a state's right to solicit foreign investment as a public or statutory right. Though the states are banned from making international compacts,[167] foreign investment in states—bonds—has always been a part of standard state government activity.[168] Perhaps, if Congress had explicitly granted to states the power to exercise their police power in a manner that singled out foreign investors or foreign governments, then this plausibly might be characterized as a statutory right.[169] However, NAFTA considered no such power and, more importantly, to return to the specific facts which prompt this Note, California's MTBE ban is a blind exercise of the police power affecting domestic as well as foreign companies.[170]

From both the investor's and the state's perspective, a Chapter 11 action is quite similar to a Fifth or Fourteenth Amendment takings action, a constitutional not a statutory right.[171] Such takings actions concern property and have nothing to do with the investor's nationality. Foreign investors have access to federal and state courts to adjudicate rights over their property in the United States just like domestic investors.

Arguably, the drafters of NAFTA recognized that Chapter 11 addresses a private right because the drafters did not take away an investor's option to pursue a claim in state or federal court.[172] The plaintiff elects to bring the suit before an international arbitration tribunal. If a *consent option* had been afforded to the states perhaps much of the constitutional dilemma could have been avoided.[173] Even so, the *Crowell* problem remains because the NAFTA scheme denies states Article III review of tribunal decisions.[174]

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166. *See generally* Crowell v. Benson, 285 U.S. 22 (1932).

167. U.S. CONST. art. I, § 10.

168. Principality of Monaco v. Mississippi, 292 U.S. 313 (1934).

169. *See, e.g.*, Crosby v. Nat'l Foreign Trade Council, 530 U.S. 363 (2000) (holding that a Massachusetts ban of Burmese products under its human rights laws violated the dormant foreign commerce power).

170. Solaway, *supra* note 15, at 77.

171. Lucas v. South Carolina Coastal Council, 505 U.S. 1003 (1992).

172. NAFTA, *supra* note 36, at 642-48.

173. Commodity Futures Trading Comm'n v. Schor, 478 U.S. 833, 837 (1986) (noting that the consent option acts as a safeguard because it protects Congress from the claim that it removed the claim, rather the litigant consented to the removal).

174. *See generally Crowell*, 285 U.S. at 22.

2. *Schor's* Multi-Factored Approach

*Northern Pipeline's* focus on the public/private dichotomy has subsequently been muted by *Commodity Futures Trading Commission v. Schor* which declined to follow *Northern Pipeline* and adopted a more pragmatic multi-factored test.[175] Paying homage to *Northern Pipeline*, *Schor* stated "Article III, section 1 not only preserves to litigants their interest in an *impartial* and *independent* federal adjudication of claims with the judicial power of the United States, but also serves 'an inseparable element of the constitutional system of checks and balances.'"[176] While affirming the importance of the separation of powers, *Schor* also limited *Northern Pipeline*, stating that "[a]lthough such rules might lend a greater degree of coherence to this area of the law, they might also unduly constrict Congress' ability to take needed and innovative action pursuant to its Article I powers."[177]

Bright lines will not suffice: "due regard must be given in each case to the unique aspects of the congressional plan" along with the other factors that underlie Article III.[178] Apparently, the Court will examine not only *Northern Pipeline's* concern with "the origins and importance of the right to be adjudicated," but at least two other factors: the concerns which drove Congress to depart from the requirements of Article III and the range of jurisdiction exercised by the non-Article III forum.[179]

Assuming Congress' motives can be ascertained in the first place, when applying *Schor's* test to NAFTA, Congress has the legitimate motive of improving international trade and increasing commerce. The expertise needed to analyze complex international trade disputes arguably is lacking in the federal court system.[180] Thus, such a maneuver would increase the efficiency of international business transactions and allow increased economic benefits. Furthermore, it is doubtful that Congress desires to supplant an Article III court with

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175. *See generally Schor*, 478 U.S. at 833; *Thomas*, 473 U.S. at 568. This test was advocated by Justice White in his *Northern Pipeline* dissent.

176. *Schor*, 478 U.S. at 850 (quoting *Northern Pipeline*, 458 U.S. at 58) (emphasis added).

177. *Id.* at 851.

178. *Id.* at 857.

179. *Id.* at 851. It is worth noting that it is difficult to reconcile *Schor's* broad and hazy multi-factored approach with the recent spate of strict separation of powers decisions embodied in *Chadha* and *Bowsher*. Such multi-factored tests provide little guidance and restraint in that Congress could drum up an infinite number of "important" purposes which, if judged under a rational basis standard, could effectively dissolve the distinction between Article III and Article I.

180. *See, e.g.*, Charles N. Brower & Lee A. Steven, *Who Then Should Judge?: Developing the International Rule of Law under NAFTA Chapter 11*, 2 CHI. J. INT'L L. 193, 197 (2001).

a court subject to more congressional control, since under the IIA and the NAFTA schemes, arbitrators are chosen by the states, and investor and have no formal connection with Congress.[181]

The next factor to be considered under *Schor* is the range of jurisdiction granted to the alternative forum and, more fundamentally, threshold issues concerning the forum's impartiality.[182] From one perspective, jurisdiction of the Chapter 11 tribunal is quite small since it only involves states and multinational investors residing in Canada or Mexico. From another perspective, however, it is massive because the state, in a certain sense, is the aggregate of individuals and these claims may involve the very essence of the state *qua* public protector. Viewed this way, the jurisdictional grant is not narrowly tailored like jurisdictional grants involving commodity futures trading or utility disputes. There is a significant problem here.

Impartiality is another significant problem that arises. A well documented phenomenon of "repeater bias" and arbitrator shopping plagues arbitration because an arbitrators' livelihood depends on attracting business from corporations who are the repeat players in arbitration.[183] A corporation will not choose an arbitrator who provides anti-business decisions.[184] Hence, this repeater bias has been suggested to cut against arbitration's impartiality.

In sum, under *Schor's* multi-factored approach, it is difficult to tell how the Court would decide. Still, one issue remains clear; Congress cannot deny all Article III involvement. Both the IIA and NAFTA preclude Article III review.

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181. NAFTA, *supra* note 36, at 642-48. With the good comes the bad, however, and the Author believes it is not a stretch to assume that pro-business members of Congress wanted to avoid Article III courts because of their purported litigious, expensive, and time consuming nature. It may even be argued that certain Members of Congress were disgruntled with the lax standard of review for state police power actions which could throw up barriers to free trade and accumulation of property.

Thus, under these assumptions, Congress granted international arbitrators the authority to define NAFTA's broad and open-ended definition of "property" and "expropriation" in order to avoid perceived inefficiencies and anti-trade aspects of the federal court system. Despite the fact that international arbitrators are not subject to congressional control or majoritarian pressures, it would seem that such motives (if ever proven) establish a latent separation of powers problem because Congress arguably rewrites judge-made law through the hand of the international arbitrator.

182. *Schor*, 478 U.S at 851-52.

183. BERNARD AUDIT, TRANSNATIONAL ARBITRATION AND STATE CONTRACTS: FINDINGS AND PROSPECTS 81 (1987); *see also* Lisa B. Bingham, *Employment Arbitration: The Repeat Player Effect*, 1 EMPL. RTS. & EMPLOY. POL'Y J. 189 (1997) (noting a sizeable gap between the success of employees with repeat player employers and of employees with non-repeat player employers in arbitration decisions).

184. *See generally* Bingham, *supra* note 184.

### 3. *California v. Arizona* and Article III's Original Jurisdiction Clause

Another significant problem for proponents of imposed state arbitration is Article III's Original Jurisdiction clause and *California v. Arizona* amplification of it.[185] On this line of analysis, Article III's language vesting original jurisdiction in the Supreme Court in cases "in which a State shall be a party" should be reinstated if there is a valid abrogation or waiver of the Eleventh Amendment.[186] In this scenario, if Congress drafts a federal law that would subject the states to suits in certain instances, and the states agree to waive immunity, Article III's Original Jurisdiction clause for state disputes would then be reinstated. Thus, federal courts could not be banned from hearing these disputes.

On its face, an act of Congress forcing a claim involving a state party to be adjudicated in anything other than a federal court contradicts the literal language of Article III. Furthermore, *Marbury v. Madison* expressly held that Congress did not have this power—Congress could neither add to nor take away from Article III's grant of original jurisdiction.[187]

*California v. Arizona* provides additional guidance for this unique situation.[188] In that case, California sued Arizona and the United States.[189] For the issue of quieting title, the United States had legitimately waived its sovereign immunity by statute.[190] The plain language of the statute also granted federal district courts exclusive jurisdiction over these disputes, cutting out any Supreme Court oversight.[191]

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185. U.S. CONST. art. III, § 3; California v. Arizona, 440 U.S. 59 (1979) (asserting that the Supreme Court's original jurisdiction conferred by Article III includes disputes between states over title to land and not only over boundaries).

186. *See generally* U.S. CONST. art. III, § 3.

187. Marbury v. Madison, 5 U.S. (1 Cranch) 137, 175-76 (1803). Congress does protect the Court from being deluged by original jurisdiction cases by granting concurrent jurisdiction to lower federal courts for some original jurisdiction cases. 28 U.S.C. §§ 1251(a)-(b) (1994). The Court acquiesced to Congress' interpretation that the Original Jurisdiction clause permits Congress the power to grant concurrent jurisdiction to lower federal courts. *See, e.g.*, Ames v. Kansas 111 U.S. 449, 464-65 (1884). What is crucial about concurrent jurisdiction for this Note is that it only limits the Supreme Court from being the court of first resort. 28 U.S.C. §§ 1251(a)-(b). The state dispute still must be adjudicated in an Article III court and the Supreme Court still has appellate jurisdiction. *Id.* Unfortunately, NAFTA Chapter 11 denies all Article III involvement. NAFTA, *supra* note 36, at 642-48.

188. *California*, 440 U.S. at 61-68.

189. *Id.* at 61.

190. *Id.* at 65.

191. *Id.* at 64-68; *see also* 28 U.S.C.A. §§ 1346(f), 2409(a) (2001) (listing the conditions under which federal courts may assert jurisdiction over quiet title claims in which the United States has an interest).

The Supreme Court agreed that Congress can waive some or even all of the United States sovereign immunity.[192] However, in stern language, the Court stated "once Congress has waived the Nation's sovereign immunity, it is far from clear that it can withdraw the constitutional jurisdiction of this Court over such suits."[193] To avoid adjudicating this constitutional question, the Court stretched the limits of statutory interpretation and read the statute in such a way as to allow the dispute to be adjudicated originally before the Court.[194]

*California v. Arizona* indicates that the Court will not accept Congressional denial of Supreme Court concurrent jurisdiction for state disputes.[195] Arguably, NAFTA Chapter 11 does just that, granting exclusive jurisdiction for disputes between foreign investors and states to an international arbitration tribunal.[196] If the Original Jurisdiction clause still has vitality, NAFTA Chapter 11 appears to be in direct conflict with it.

In sum, at the time of NAFTA's passage, Congress may have thought it possible to abrogate state immunity under the foreign commerce power—though even at that time such a power was far from apparent.[197] Even if NAFTA had followed *Seminole Tribe*, Congress ought certainly to have considered the implications Chapter 11's conflict with Article III. Article III appears to deny Congress the leverage to effectively foreclose Article III review. *Northern Pipeline* does not empower Congress to send these cases to an international arbitration tribunal; the nebulous balancing test of *Schor* is not much better. Finally, nothing indicates that the Original Jurisdiction clause is merely vestigial. Though Congress may create concurrent jurisdiction, *California v. Arizona*, read broadly, holds that Congress cannot grant exclusive jurisdiction for state disputes to a lower Article III court—*a fortiori*, this bans exclusive arbitration tribunals as well. Congress cannot abrogate state immunity or condition state benefits on an immunity waiver, or waive Article III review; therefore, Chapter 11 is unconstitutional.

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192. *California*, 440 U.S. at 67.
193. *Id.* at 65.
194. *Id.* at 66-68.
195. *Id.* at 68.
196. NAFTA, *supra* note 36, at 642-48.
197. *See supra* section A (noting that *Seminole Tribe's* overruling of *Union Gas* had not occurred at the time of NAFTA's passage); *see also* Alfred Hill, *In Defense of Our Law of Sovereign Immunity*, 42 B.C. L. REV. 485 (2001) (discussing the Congressional power to abolish state sovereign immunity).

## IV. DO THE FOREIGN AFFAIRS POWERS ABSOLVE CHAPTER 11 OF ITS CONSTITUTIONAL FAILINGS?

Because of Chapter 11's international character, this section leaves the IIA hypothetical to examine whether the federal government's foreign affairs powers override problems with the NAFTA scheme. Recently, several have questioned whether the resurgent principle of federalism now overrules watershed foreign affairs cases like *Missouri v. Holland*, a classic expression of the foreign power's incursion into state sovereignty.[198] Others have opined that the Supreme Court might very well be prepared to realize that the cost of globalization and its perceived benefits leads to a dilution of federalism.[199] This view argues that the Court would opt for a dualist approach to the dilemma and craft a different foreign affairs rule for federalism to ensure that Chapter 11-like-legislation would survive. To examine if Chapter 11 falls within the scope of the foreign affairs power,[200] four major foreign affairs cases will be used as touchstones.[201]

### A. *The Perplexing Triumvirate:* United States v. Pink, Curtiss-Wright Corporation, *and* Missouri v. Holland

It has long been recognized that a primary purpose of the federal system was to create a univocal, efficient means of conducting foreign affairs.[202] The foreign affairs power has both a positive and negative component, and the treaty power has often been thought of as the

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198. *See, e.g.*, Robert Knowles, *Starbucks and the New Federalism: The Court's Answer to Globalization*, 95 NW. U. L. REV. 735 (2001); Martin S. Flaherty, *Are We to be a Nation? Federal Power vs. "States' Rights" in Foreign Affairs*, 70 U. COLO. L. REV 1277 (1999); Curtis A. Bradley, *The Treaty Power and American Federalism*, 97 MICH. L. REV. 390 (1998); James A. Deeken, Note, *A New* Miranda *for Foreign Nationals? The Impact of Federalism on International Treaties that Place Affirmative Obligations on State Governments in the Wake of* Printz v. United States, 31 VAND. J. TRANSNAT'L L. 997 (1998); Thomas Healy, Note, *Is* Missouri v. Holland *Still Good Law? Federalism and the Treaty Power*, 98 COLUM. L. REV. 1726 (1998).

199. *See, e.g.*, Barry Friedman, *Federalism's Future in the Global Village*, 47 VAND. L. REV. 1441 (1994).

200. For the sake of expediency, this Note uses the term foreign affairs power as rubric encompassing the treaty power, Congress' foreign commerce power, and the various distinct executive powers to recognize nations and so forth.

201. *See generally* Restatement (Third) of the Foreign Relations Law of the United States (1986); LOUIS HENKIN, FOREIGN AFFAIRS AND THE UNITED STATES CONSTITUTION (2d ed. 1996) (noting cases which allow for an analysis of whether NAFTA Chapter 11 falls within the scope of foreign affairs power). This Note by no means has relied on an exhaustive search of the massive corpus of secondary literature on this topic.

202. *See, e.g.*, HENKIN, *supra* note 201, at 13-22.

focal federal foreign affairs power.[203] Without a doubt, the treaty power significantly lessens the states' role. In fact, the only positive state check on the federal foreign affairs power is the Senate supermajority requirement. The popularity of congressional-executive agreements with fast track approval as a treaty substitute has thoroughly eroded even this minimal check.[204]

On the other hand, there are two significant negative checks on states involvement in foreign affairs. The first includes the much cited ban on state international compacts.[205] Perhaps most intriguing of late, is the Supreme Court's recent holding that Congress' foreign commerce power has a dormant component.[206]

Despite these general principles outlining the power, the Framers may have kept the scope of the foreign affairs powers intentionally vague in order to quell dissent. During the Constitution's ratification, the Federalists made assurances that the federal government's various foreign affairs powers were limited in scope.[207] A well-noted debate occurred during the Virginia Ratifying Convention, where anti-Federalist argued that the inclusion of a treaty power would diminish states' rights.[208]

Federalist countered that the proposed treaty power had limits. Edmund Randolph stated, "neither the life nor property of any citizen, nor the particular right of any state can be affected by a treaty."[209] James Madison reassured the Virginia Ratifying Convention that the purpose of the treaty power is "the regulation of intercourse with foreign nations and is external."[210] Though not a part of these debates, Jefferson as Vice President and President of the Senate, repeated this assumed limitation when he wrote, "[the] President and Senate cannot do by treaty what the whole government is interdicted from doing in any way."[211] Perhaps to the satisfaction of both states' rights

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203. U.S. CONST. art. II, § 2, cl. 2.

204. *See generally* Bruce Ackerman & David Golove, *Is NAFTA Constitutional?*, 108 HARV. L. REV. 801 (1995) (tracking the evolution of the congressional-executive agreement and confronting the debate that NAFTA should have been a treaty and not a congressional-executive agreement requiring a simple majority).

205. U.S. Const. art. I, § 10.

206. Crosby v. Nat'l Foreign Trade Council, 530 U.S. 363, 371 (2000).

207. NOTES OF JAMES MADISON (Sept. 8, 1787), *reprinted in* 2 RECORDS OF THE FEDERAL CONVENTION OF 1787, at 548 (Max Ferrand ed., 1911).

208. THE DEBATES IN THE CONVENTION OF THE COMMONWEALTH OF VIRGINIA, *reprinted in* 3 DEBATES ON THE ADOPTION OF THE FEDERAL CONSTITUTION 506-14 (Jonathan Elliot ed., 1987).

209. *Id.* at 504.

210. *Id.* at 514.

211. THOMAS JEFFERSON, A MANUAL OF PARLIAMENTARY PRACTICE: FOR THE USE OF THE SENATE OF THE UNITED STATES, *reprinted in* JEFFERSON'S PARLIAMENTARY WRITINGS 421 (Charles T. Cullen ed., 1988).

advocates and nationalists, the scope of the treaty power remained largely undefined throughout the nineteenth century.[212]

In the first part of the twentieth century, three very challenging and enigmatic cases, *Missouri v. Holland, United States v. Curtiss-Wright Export Corp.*, and *United States v. Pink* destroyed this uneasy peace brokered by ambiguity.[213] One commentator described *Missouri v. Holland* as "perhaps the most famous and most discussed case in the constitutional law of foreign affairs," eventually spawning the ill-fated Bricker Amendment's cantankerous attempt to tie the treaty power to the federal government's enumerated powers.[214] Many have noted that *Curtiss-Wright* has been subjected to "withering criticism."[215] Likewise, *United States v. Pink* caused significant dissent because the Court appeared to allow executive agreements to run roughshod over the Fifth Amendment's prohibition of unconstitutional takings of property.[216]

1. *United States v. Pink*: State Law Trumped by Executive Agreement

*United States v. Pink* is often used to probe the extent of the Executive's power to make international agreements.[217] From the standpoint of this Note what is more interesting about *Pink* is the collision of state policy and common law decisions with an international agreement.[218] *Pink* involved a dispute over ownership of Russian assets located in New York.[219] By nationalizing the entire insurance industry after the revolution, the Soviets intended to bring Russian assets located outside the USSR within their reach.[220] Both the government of New York and her courts refused to recognize the Soviet nationalization's effect on assets located in New York.[221] In a *quid pro quo* formalization of state relations between the Soviets and the United States, the Soviets released U.S. assets located in Russia and assigned the rights to their U.S.-based assets to the federal

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212. Bradley, *supra* note 198, at 418-22.

213. *See generally* United States v. Pink, 315 U.S. 203 (1942); United States v. Curtiss-Wright Export Corp., 299 U.S. 304 (1936); Missouri v. Holland, 252 U.S. 416 (1920).

214. HENKIN, *supra* note 201, at 190.

215. *See, e.g.*, Bradley, *supra* note 198, at 438.

216. *See, e.g.*, A. Mark Weisburd, *Due Process Limits on Federal Extraterritorial Legislation?*, 35 COLUM. J. TRANSNAT'L L. 379, 398 (1997).

217. *See, e.g.*, G. Edward White, *The Transformation of the Constitutional Regime of Foreign Relations*, 85 VA. L. REV. 1, 120 (1999).

218. *Pink*, 315 U.S. at 210-11.

219. *Id.*

220. *Id.*

221. *Id.* at 217.

government in order that it might procure these assets for the Soviets.[222]

After President Roosevelt agreed to recognize the Soviet's claim and the United States procurement of these assets, New York continued her policy of non-recognition.[223] In the dispute that followed, Justice Douglas opined that "a treaty is a 'Law of the Land' under the supremacy clause . . . of the Constitution" to which both state law and policy must yield.[224] The Court held that the United States had priority over all other creditors and adeptly avoided deciding the more troubling question of whether U.S. priority is a de facto taking under the Fifth Amendment.[225]

2. *United States v. Curtiss-Wright Export Corporation*: Separation of Powers Doctrine Diluted in the International Context

*United States v. Curtiss-Wright Export Corporation* addresses the relationship between the separation of powers doctrine and the foreign affairs power.[226] Even in an era when the Supreme Court strictly construed the separation of powers, the Court in *Curtiss-Wright* quite willingly recognized the breadth of the Executive's reach in conducting foreign affairs.[227] The Supreme Court upheld Congress' delegation of power to the President, allowing him the discretion to prohibit and prosecute sales of munitions to Bolivia and Paraguay. This was permitted despite the fact that such a delegation was tantamount to the Executive both making and enforcing the law, an anathema in the domestic sphere. This is an especially striking move for a Court that had yet to fully accept the constitutionality of the administrative state.[228]

Along with blending Article I and Article II, Justice Sutherland found a unique source for the federal government's foreign affairs powers by looking past the enumerated powers of the Constitution to the very nature of sovereignty itself.[229] The opinion states that, after independence, Sovereignty passed not to the colonies themselves "but to the colonies in their collective and corporate capacity as the United States of America."[230] Sovereignty is not granted to the colonies per se—at least in foreign affairs context—but to the Union.[231] With sovereignty placed in the Union and not in the states, the principal of

222. *Id.* at 212-13.
223. *Id.* at 217.
224. *Id.* at 230.
225. *Id.* at 234.
226. *Curtiss-Wright*, 299 U.S. at 315.
227. *Id.* at 321.
228. *Id.* at 333.
229. *Id.* at 316.
230. *Id.*
231. *Id.* at 317.

state sovereignty has little limiting influence on the scope of the foreign affairs power.[232]

3. *Missouri v. Holland*: Expansion of Congressional Power via Treaty-Making

In *Missouri v. Holland* the sovereignty of the states collided with the sovereignty of the United States.[233] *Missouri* confronted the unique question of whether Congress, via the treaty power, could regulate an area, in this instance regulation of migratory birds, where Congress' commerce power ostensibly did not reach.[234] Writing for the Court, Justice Holmes dismissed the argument that the treaty-making power is limited to "what an act of Congress could not do unaided."[235] Nonetheless, the extension of the treaty power beyond the commerce power does not mean it is unlimited. Justice Holmes examined whether both the Constitution's "prohibitory words" and its "invisible radiations" denied Congress the power to act.[236]

Following Holmes' method, the first crucial question is whether international action will "contravene any prohibitory words to be found in the Constitution."[237] Examining Chapter 11 against the literal prohibitory words of the Eleventh Amendment, Chapter 11 does not contravene this literal jurisdictional requirement.[238]

Along with analyzing the prohibitory words of the Constitution, Justice Holmes also examined whether the Constitution's "invisible radiations" prohibited the act in question.[239] Adopting a functional approach, Justice Holmes found that the Constitution did not provide the states with an absolute right over and against the national government to regulate "transitory" property.[240]

Subjecting Chapter 11 to functional analysis and noting the expansive reach of state sovereign immunity adopted by the current Court, the invisible radiations of the Eleventh Amendment explicitly conflicts with Chapter 11 because Congress ignored state sovereign immunity and created a cause of action against the states.[241] It is irrelevant that the action is pursued in international arbitration

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232. *Id.*
233. *Missouri*, 252 U.S. at 431.
234. *Id.* at 434.
235. *Id.* at 432.
236. *Id.* at 433-34.
237. *Id.* at 433.
238. U.S CONST. amend. XI.
239. *Missouri*, 252 U.S. at 434.
240. *Id.* at 435.
241. NAFTA, *supra* note 36, at 642.

rather than federal court; sovereign immunity has been breached through the creation of a cause of action against the states.[242]

Justice Holmes' dicta that treaties do not violate either the prohibitory words or invisible radiations in the Constitution eventually received the Court's imprimatur in *Reid v. Covert*.[243] In an oft-quoted passage, Justice Black stated, "no agreement with a foreign nation can confer power on the Congress, or on another branch of Government, which is free from the restraints of the Constitution."[244] In *Reid*, the Supreme Court held that the President could not contract away Sixth Amendment rights of a U.S. citizen.[245]

Stated aptly by Louis Henkin, *Reid* indicates that the foreign affairs power is

> subject to other radiations from the separation of powers. It has been stated that a treaty cannot increase, diminish, or redistribute the constitutional powers of the branches of the federal government or delegate them to others—say, the power of Congress to declare war or the President's command of American Forces, or *a court's exercise of judicial power*.[246]

Despite the fact that *Reid* dealt with individual rights as opposed to states' rights, Henkin's intuition that *Reid* has implications concerning separation of powers has merit.[247]

Regarding Chapter 11, the crucial question that this triumvirate of cases raises is what are the outer limits on the foreign affairs powers. Following *Pink*, state statutory and common law apparently can be trumped by foreign executive agreement.[248] According to *Curtiss-Wright*, the vitality of the separation of powers doctrine is lessened in an international context.[249] Finally, *Missouri* holds Congress can regulate the states by way of treaty where Congress could not do so otherwise.[250]

Case law delineating the limitations to the foreign affairs power is scant. In *Reid,* Congress cannot by way of treaty lessen an individual's Sixth Amendment rights, and as Louis Henkin argued, this has implications for the separation of powers doctrine as well. Hence, the real question is whether *Missouri v. Holland* survives or is significantly limited by the recent spate of federalism cases like *Seminole Tribe* and *Alden v. Maine*. These cases can be read to suggest that the distinction between individual rights and states'

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242. *See, e.g., Missouri*, 252 U.S. at 434-35.
243. Reid v. Covert, 354 U.S. 1, 18 (1957).
244. *Id.* at 16.
245. *Id.* at 19.
246. LOUIS HENKIN, FOREIGN AFFAIRS AND THE CONSTITUTION 148-50 (1st ed. 1972) (emphasis added).
247. *Id.*
248. *Pink*, 315 U.S. at 229-34.
249. *Curtiss-Wright*, 299 U.S. at 318-22.
250. *Missouri*, 252 U.S. at 416.

rights no longer exists.[251] If the commonality between states and persons is great, analogy to *Reid* suggests that the federal government cannot deny via an executive agreement a state's Eleventh Amendment or Article III rights.[252]

### B. *The* Dames & Moore *Decision as Precedent*

Because *Dames & Moore* involves the intersection of expropriation claims and Article III, its facts may be the closest to the current Chapter 11 situation.[253] Furthermore, the Supreme Court in *Dames & Moore* arguably affirmed the Executive and Legislative' power to contract away access to Article III courts.[254] While the foreign affairs power does hold some sway over Article III, there is a clear analytic problem in extending *Dames & Moore* to Chapter 11. *Dames & Moore* does not concern the abrogation of state sovereign immunity, nor implicate foreign investors, but involves U.S. nationals investing internationally.[255]

The *Dames & Moore* case resulted from President Carter's Executive Order suspending outstanding claims against Iranian interests in all American courts.[256] In the challenged action, the

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251. Alden v. Maine, 527 U.S. 706, 733 (1999); Sherry, *supra* note 144, at 1126 (noting how Justice Kennedy turns to individual rights to defend the concept of State sovereign immunity).

252. *Reid*, 354 U.S. at 19. Though there is no support for this argument except the very general language in Article IV, it is still worth pondering. Article IV, § 4 states "The United States shall guarantee to every State in this Union a Republican Form of Government." Arguably, such a removal power granted to foreign citizens for challenging traditional state police power actions violates the Constitution's guarantee that the states shall have a republican form of government. As noted before, California's action was a run of the mill health and safety action. If California has to worry about lawsuits—$1.6 billion in this case—significantly upsetting the public finances when creating health and safety policy, California fails to represent and protect its citizens. Note also that if this action involved a small state like Montana, the damages requested by Methanex would effectively wipe out the entire state budget for at least one year—a calamity that would make the small state government look more like a third world country.

Granted, *United States v. Pink* indicates that when state policy and common law collide with an executive agreement, the executive agreement has priority. However, if the executive agreement in question contravenes the prohibitory words of the Constitution, abrogates state immunity, or denies a republican form of government, then the *Pink* precedent has no weight. A removal power couched in the panglossian belief of the wealth maximizing nature of free trade did not just ignore state policy or overrule common law, it breached state immunity and created substantive investor check/veto power on state legislative action hampering the democratic process. By opening states up to such suits, Congress fails to guarantee a republic form of government and has covertly bargained away a large portion of public control over its own safety to the investment and market spheres of society.

253. Dames & Moore v. Regan, 453 U.S. 654, 684-85 (1981).

254. *Id.* at 680.

255. *Id.*

256. *Id.* at 663.

Supreme Court held that the President had the authority to suspend all court claims and refer them to an ad hoc Iran-United States claim tribunal, which would deal with each claim individually through the application of international law.[257] Though the Court did not hold that this power is plenary, it held the action constitutional because the Court inferred a grant of power from Congress to the President in the structure of the IIEPA.[258]

Though affirming this broad exercise of executive power based on congressional inference, the *Dames & Moore* Court explicitly "emphasized the narrowness of their decision."[259] In other words, only when such a settlement is crucial to the resolution of a major foreign policy dispute will the Court construe the Executive's power so broadly.[260] It is also important to note that there is a long tradition permitting the federal government to settle claims of its citizens against foreign sovereignties.[261] Clearly, the agreement to create the Iran-United States Claims tribunal fits within this tradition.

The presidential and congressional power to suspend claims against a foreign state in an international incident of magnitude and refer them to international arbitration is wholly different from abrogating state immunity for ordinary foreign investment and restricting review to an international arbitration tribunal. Chapter 11 involves takings claims by a foreign citizen against one of the fifty states recognized under the foreign commerce power. *Dames & Moore* involved claims of U.S. nationals in domestic courts against a foreign sovereignty—the inverse of Chapter 11.[262]

The federal government can negotiate on behalf of states in claims by foreign nationals against the state itself. This ability to negotiate, however, cannot involve abrogating state immunity or commanding the states to enter an international arbitration tribunal without, at the very least, Article III oversight.[263] Not only does this raise an issue of state immunity, in this unique instance it would appear that the state has a right to Article III review, a right Congress denied. *Dames & Moore* provides little precedent for justifying Chapter 11's unique scheme.

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257. *Id.* at 684-85.
258. *Id.* at 686.
259. *Id.* at 688.
260. *See, e.g.*, Lee R. Marks & John C. Grabow, *The President's Foreign Economic Powers After* Dames & Moore v. Regan*: Legislation by Acquiescence*, 68 CORNELL L. REV. 68, 101 (1982) (arguing that such a limitation is inadequate).
261. *Dames & Moore*, 453 U.S. at 679-80.
262. *Id.* at 663.
263. *Id.* at 684-85.

## V. CONCLUSION

It is appropriate to end where this Note began, by highlighting the Supreme Court's strong revival of federalism. In *Alden v. Maine*, Justice Kennedy stated that no Article I power can abrogate state sovereign immunity—this certainly must include Congress' Article I foreign commerce power underlying Chapter 11.[264] Adding to this clear rule, *Alden* furthered strengthened state immunity by also grounding it in the very structure of the Constitution.[265] Justice Kennedy held that the Eleventh Amendment "acted not to change but to restore the original constitutional design."[266] By opening the states up to suit, Chapter 11 treats "these sovereign entities as mere prefectures or corporations."[267]

Under the Supreme Court's current interpretation of state sovereign immunity, it is doubtful that the treaty power can abrogate state immunity in the Chapter 11 context. Certainly the strong revival of federalism resting on its expanded foundation poses a formidable barrier to finding the treaty power to be another avenue for abrogating state immunity. Leaving open the question of the treaty power, a congressional-executive agreement passed under fast track—a latent line-item veto power—and the foreign commerce power should fail to overcome this revised and strengthened federalism.

It is troubling that the legion of NAFTA attorney negotiators and volumes of legislative history failed to consider any of these problems. Some would argue that this indicates the veracity of what those on the left would have us believe: NAFTA is the progeny of an insatiable Wall Street vis-à-vis the duplicitous consent manufacturers on K Street. Though such a thesis is an oversimplification, Chapter 11 breaches state immunity through international arbitration in lieu of *any* Article III oversight and can effectively hamstring legitimate state police power actions. With this new check on state police power actions, breach of state immunity, and express avoidance of Article III oversight, one does wonder how this is anything other than political pork for the international investor class.

*Steve Louthan**

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264. *Alden*, 527 U.S. at 712.
265. *Id.* at 722-23.
266. *Id.* at 722.
267. *Id.* at 758.

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