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NAFTA's Chapter 11: Investor Protection,  
Integration and the Public Interest

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NAFTA's  
Chapter 11:

**I**nvestor

Protection,  
Integration  
and the

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# NAFTA's Chapter 11: Investor Protection, Integration and the Public Interest

Julie Soloway

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## Introduction

**T**he North American Free Trade Agreement (NAFTA) created an institutional environment which fosters economic integration between Canada, Mexico and the United States. Since NAFTA has come into force, there has been substantial growth in trilateral trade and investment among Canada, Mexico and the United States.<sup>1</sup> The importance of both inward and outward Foreign Direct Investment (FDI) for Canada is well known. FDI in Canada is responsible for 30 percent of all Canadian jobs and 75 percent of its manufacturing exports.<sup>2</sup> More than one-half of Canadian outward FDI goes to the United States and the United States is Canada's largest source of inward FDI. Increased investor protection is one reason that Canadian and US direct investments in Mexico have boomed, from an annual flow of US\$5.7 billion in 1994 to US\$19.9 billion in 2001.<sup>3</sup> In general, a more predictable environment for investors will lead to increased investment.<sup>4</sup>

NAFTA's goals for integration, however, are relatively modest compared to many other regional trade agreements. The parties to NAFTA did not contemplate the creation of an EU-style arrangement that provides for political and social integration. Rather, the NAFTA attempts to provide for economic integration between the three countries while, at the same

time, preserving political autonomy and decision-making power in each country. Similarly, the NAFTA and its institutions were not designed to manage social welfare issues. As one commentator noted, "NAFTA was not designed with the intention to manage social welfare conditions. To the extent that the NAFTA has failed to address those conditions, this failure was built into its institutions."<sup>5</sup>

The rules of NAFTA's Chapter 11 ideally create a secure and predictable framework for the unencumbered flow of investment within North America, which, in turn, allows for substantial economic gains. Simply put, Chapter 11 provides for certain obligations that define how a NAFTA government must treat an investment or an investor from another NAFTA country (see Box 1). If any one of them adopts a "measure" which breaches an obligation contained in Chapter 11, that investor may initiate a dispute-settlement proceeding *directly* against a NAFTA government.<sup>6</sup>

Despite the economic growth that these rules are designed to encourage, their desirability in the context of an integrated North American marketplace is being seriously challenged, primarily because of the perceived effects that these rules are having, or could have, on public regulation. This paper evaluates the claim that Chapter 11 has undermined environmental regulation in North America and concludes that, for the most part, the concern has been overstated. To date, NAFTA Chapter 11 has not threatened the progress of environmental regulation in North America. This paper also concludes that certain changes to the NAFTA Chapter 11 process may be warranted, however, to take account of some of the weaknesses of the current institutional architecture.

**Box 1**  
**NAFTA Chapter 11 Obligations**

The main obligations contained in NAFTA Chapter 11 upon which a claim may be based are: (i) national treatment (the obligation to treat investments or investors from a NAFTA country no less favourably than domestic investments or investors in like circumstances) (Article 1102); (ii) most-favoured nation treatment (the obligation to treat investments or investors no less favourably than investments or investors from any other country) (Article 1103); (iii) minimum standard of treatment (the obligation to treat investments or investors in accordance with international law, including fair and equitable treatment) (Article 1105); (iv) compensation for expropriation (the obligation not to expropriate, either directly or indirectly, or to take a measure tantamount to expropriation of an investment, without compensation) (Article 1110); and (v) performance requirements (subject to certain exceptions, the obligation not to impose performance requirements, such as a given percentage of domestic content, in connection with any investment) (Article 1106).

It should be noted that through the use of reservations and exceptions, governments have excluded many important public services and a wide range of otherwise non-conforming existing measures from the national treatment and most-favoured nation obligations, as well as from the obligation not to impose performance requirements.<sup>7</sup>

**NAFTA Chapter 11 and Its Critics**

**T**he rules found in Chapter 11 are by no means novel in international economic law. The key legal principles are largely grounded in customary international law, as codified in a myriad of existing Bilateral Investment Treaties (BITs). In this way, NAFTA is not a “radically new departure from prevailing practice with respect to investment protection.”<sup>8</sup> There are over 2000 BITs currently in existence worldwide; Canada has no less than 21 Foreign

Investment Protection Agreements (FIPAs — the equivalent of a BIT) currently in force.

BITs historically have been negotiated between developed and developing countries, and because of the inequality between the negotiating parties, many BITs were intrinsically asymmetrical.<sup>9</sup> While, for example, US investors had significant foreign investment in Bangladesh, the same was not true for Bangladesh investors in the United States. Thus, traditionally, BITs were a function of an economic relationship characterized by an investor and a recipient of that investment where the negotiating power was almost always tilted in favour of the investor state. Moreover, BITs were generally based on developed country concerns regarding legal fairness and access to justice. Investor-state dispute settlement provisions were a feature of BITs because, once an investment was expropriated (whether for a legitimate public purpose or not) an investor generally had no standing in the courts of the host country and would have to persuade its own government to pursue a claim, thereby removing the decision of whether to initiate a claim from the party whose interests are directly at stake and basing that decision on broader political considerations.<sup>10</sup>

The application of this model to two countries with highly developed, mixed economies (i.e. Canada-United States) is new, and has resulted in some unanticipated consequences. More specifically, the nature of the disputes under NAFTA has differed from traditional challenges under BITs in terms of the type of measure challenged. The application of rules governing, for example, expropriation and the minimum standard of treatment have not generally been used to challenge regulatory measures adopted by a developed country with a comprehensive regulatory environment.

The United States sought to have a core set of principles imported from the BITs into the Canada-US Free Trade Agreement (FTA) and ulti-

mately into NAFTA. Compliance with these rules required significant adjustments to Mexican foreign investment rules. The United States was adamant that expropriation provisions be included in NAFTA in order to protect US investors in Mexico from the possibility of expropriation of US-owned assets without compensation or recourse to impartial dispute settlement. This was a reaction on the part of the United States to the fact that Latin American countries had historically included a “Calvo” clause in their constitutions. Named after a 19th century Argentine diplomat, these clauses limit foreign investors to domestic remedies in the case of a dispute.<sup>11</sup> Other developing countries had also confiscated US-owned property in the past without compensation. It is interesting to note that the inclusion of these ‘boilerplate’ provisions did not draw special attention during the NAFTA negotiations. What the parties failed to anticipate — or what was unknown at the time — were the implications of these provisions between countries with highly developed regulatory regimes.<sup>12</sup>

Even though significant changes were required by the NAFTA parties, they were seen as vital in securing the protection that NAFTA offered from unfettered parochial political interests (see Box 2). In the case of Canada, because of its size, Canada has “traditionally been at the forefront of countries ready, willing and able to undertake international commitments as the price of limiting the capacity of larger countries to impose arbitrary and unwanted restraints on Canadian trade, economic and other interests.”<sup>13</sup>

Empowering a private investor to directly challenge a host government depoliticizes in principle the dispute settlement process by removing it from the realm of state-to-state diplomatic relations. Under Chapter 11, a foreign investor has the comfort of knowing that a dispute concern-

ing a foreign investment would be heard and adjudicated based on legal rules rather than political negotiations over a variety of matters not related to the investment in question. It is not hard to see why an investor would feel more confident in making a substantial investment in the context of this framework.

However, as the Chapter 11 jurisprudence has begun to emerge, a number of shortcomings have been revealed, calling into question the ongoing viability of its rules in supporting and sustaining cross-border investment. Thus, while these rules do encourage investment and economic integration, many have posed the question: at what cost? If, ultimately economic integration leads to

## Box 2 NAFTA Investor-State Dispute Settlement

NAFTA’s original investor-state dispute settlement mechanism allows investors to pursue a claim against a government that it believes has breached an obligation of Chapter 11, resulting in loss or damage. If the claim cannot be resolved by the parties themselves, the complainant has the choice of submitting the dispute to binding arbitration. A three-person tribunal (or arbitration panel) is then established under the existing rules of either the United Nations Commission on International Trade Law (UNCITRAL) or the International Centre for the Settlement of Disputes (ICSID).<sup>14</sup> Each party to the dispute appoints one of the arbitrators, and the parties agree on a third, presiding arbitrator. If the tribunal finds that the claim is founded, it can order that monetary compensation be made to the investor.

NAFTA does not provide for the appeal of awards, rather, each jurisdiction contains its own domestic rules which apply to the appeal of arbitral awards. In general, an appeal will be limited to *judicial review* of a decision, that is, a domestic court will not be entitled to review a decision on its merits, but rather, it may only rule on the much narrower legal question of whether the tribunal exceeded its jurisdiction in any way.

social disintegration, it is neither desirable nor sustainable.<sup>15</sup>

The concerns surrounding Chapter 11 take place as part of a broader set of concerns about the costs of globalization, that is, increased global economic integration, and increased environmental concern and activism on the part of non-governmental organizations (NGOs). The pace at which economic integration has taken place, facilitated in part by trade liberalization arrangements, has led to widespread anxiety among citizens who fear the loss of control over the factors that govern their lives.<sup>16</sup> This fear has fixated onto both the legal and procedural provisions of Chapter 11.

The first NAFTA Chapter 11 case to generate widespread controversy was the Ethyl case, where a US investor in Canada, Ethyl Corporation, challenged a Canadian ban on the international trade of the fuel additive MMT, ostensibly imposed for the purpose of protecting public health. While the case was settled for around C\$19 million and resulted in the federal government retracting the trade ban on MMT before a decision was reached by the Tribunal, the case became a lightning rod for widespread opposition to Chapter 11, sowing the seeds for controversy in later cases. The critique centred around several issues:

First, and most likely foremost, the simple fact that a private investor could call into question a government's measure ostensibly protecting the public's health and welfare or the environment was objectionable to a wide range of civil society actors, who viewed this situation as a prime example of NAFTA favouring corporate interests over the broader public concerns.

Second, the legal obligations provided for in Chapter 11 came under attack from a substantive perspective. These rules were not viewed as neutral investment protection, rather they were viewed as inherently biased against environmental, health or safety regulations. Most prominent among the substantive concerns were the expro-

priation provisions and the uncertainty surrounding the concept of regulatory expropriation. Absent a direct takeover of foreign-owned property, what lesser interference could amount to a compensable expropriation? Would it be enough for a government action merely to affect the benefits of a foreign investment, or did the effect have to be so severe as to render the investment inoperable? And, even if a measure did put a foreign investor out of business, what if the measure addressed serious consumer or health concerns? Most critically, what would this mean for the future of environmental regulation in North America?

Not surprisingly, no immediate clear answers emerged. As the Chapter 11 jurisprudence began to develop, other concerns about the operation of investment protection rules emerged from the NGO community. NGOs have alleged that NAFTA panels' broad interpretations of the national treatment obligation (Article 1102) and the minimum standard of treatment obligation (Article 1105) went far beyond the generally accepted interpretations of these concepts in international law.<sup>17</sup> Critics argued that the uncertainty in how these rules would be interpreted would result in a "regulatory chill" whereby governments would cease to enact public health and safety measures for fear of a NAFTA challenge.

A third major area of concern arose from the process under which challenges were brought and disputes were heard. The NAFTA Chapter 11 process is, for the most part, private and does not provide a formalized mechanism for public access.<sup>18</sup> In this way, it is argued that NAFTA was deficient, given that such arbitrations involved the interpretation of issues which define the relationship of foreign investor rights to domestic public measures. By not providing an adequate framework for public participation, critics argue that Chapter 11 created a "democratic deficit."

Central to the view that Chapter 11 was inappropriate to arbitrate issues of public policy is the

question of process transparency. While Ostry “only partly in jest” describes the word transparency “as the most opaque in the trade policy lexicon,” transparency, in particular, remains one of the key concerns among critics of a liberalized investment regime.<sup>19</sup>

In addition, critics argue that Chapter 11 does not provide for adequate participation in the arbitral process, for example, through the submission of briefs or other relevant information to the panel as a “friend of the court” (*amicus curiae*). Critics view this as especially important as ad hoc arbitrators may not have “sufficiently broad expertise to adjudicate issues outside of traditional trade law, with implications that transcend trade, entailing public policy analysis, and assessment of complex environmental and health issues.”<sup>20</sup>

Some people may argue that such concerns are overblown and that the jurisprudence is still in its infancy. In NAFTA’s eight-year history as of September 2002, there have been some twenty-seven Chapter 11 complaints, only five of which have led to actual decisions. Other cases remain pending or have been settled or withdrawn.<sup>21</sup> Yet, in response to the NAFTA critique outlined above, changes are being made as a result of intense political pressure being put on the NAFTA governments. On July 31, 2001, the NAFTA Commission, made up of the three signatory governments, issued an interpretive statement<sup>22</sup> (see Box 3 on p. 11) as part of an ongoing clarification exercise, designed to “give future tribunals clearer and more specific understanding of Chapter 11’s obligations, as originally intended by the drafters.”<sup>23</sup> In this regard, the Canadian Minister of International Trade, Pierre Pettigrew, stated that the NAFTA Commission is “seeking to clarify some of the provisions...such as expropriation disciplines, to ensure they properly reflect the original intent of the NAFTA Parties in the dispute settlement process.”<sup>24</sup> Ongoing consultations with expert groups (including representa-

tives from NGOs) are currently underway to further the clarification process.

It is thus timely to evaluate (i) the veracity of the diverse claims against NAFTA Chapter 11, and (ii) the appropriate policy responses. In undertaking this exercise, we should ask: what is the problem we are trying to cure, and what is the best way to solve it? This means stepping back from reactionary or “worst case” scenarios, and taking a realistic look at the rulings of the cases to date, on the basis of their facts and rendered decisions.

## NAFTA Chapter 11 Jurisprudence

**T**he following section examines the five cases where a NAFTA Tribunal has issued a final determination. It also examines the Methanex case, where there has been an award on jurisdiction only. While many more cases have been filed and/or settled, the focus of this section is to try and identify patterns from actual decisions, in order to “set the record straight” and challenge some of the myths surrounding NAFTA.

In this regard, there is a vital distinction to be made between the *arguments* of a claimant and the *decision* of a Tribunal. Although there have been some sweeping and surprising challenges brought by certain investors, this does not mean, that these challenges are valid. As an expert recently stated, “The media and some commentators often confuse what is alleged to have occurred and what will be found by a Tribunal.”<sup>25</sup> For example, investors have lost more often on the issue of expropriation than they have won. In fact, to date there has been only one successful expropriation claim under Chapter 11.<sup>26</sup>

That said, it should surprise no one if claimants continue to push at the edges of international law

in order to obtain compensation. What is important is that any analysis of possible NAFTA reform be based on actual decisions, rather than the claims of investors.

### The limits of analyzing the jurisprudence

There are nevertheless limits to the value of analyzing the jurisprudence because, under international law, Chapter 11 decisions do not establish precedents (*stare decisis*, in legal terms). A NAFTA arbitral tribunal's ruling is not binding on subsequent tribunals.<sup>27</sup> In one recent case, a NAFTA arbitral tribunal declined to follow a prior ruling, noting that the previous case was not "... a persuasive precedent on this matter and [this Tribunal] will not be bound by it."<sup>28</sup> That said, panels will still consider the relevance of the decisions of past NAFTA and other trade tribunals.<sup>29</sup> Thus, while not binding, the case law is an important element guiding all concerned parties.

### Azinian

In March 1997, Mr. Azinian and two other American nationals, who were shareholders of Desechos Sólidos de Naucalpan S.A. de C.V. (Desona), a Mexican corporation, filed a Chapter 11 Notice of Arbitration against the Mexican government seeking damages of US\$14 million. In November 1993, Desona had entered into a concession contract with the City Council of the Municipality of Naucalpan, Mexico, for the collection of solid waste from the city. A few months later, the Municipality complained about a number of irregularities in the implementation of the concession contract and in March 1994, it cancelled the contract for non-performance by Desona. Three levels of Mexican courts confirmed the legality of the contract's annulment under Mexican law.

Azinian argued unsuccessfully before a Chapter 11 Tribunal that the actions taken by the Municipality had resulted in a violation of both the oblig-

ation to provide the minimum standard of treatment under international law and the expropriation provisions of NAFTA.<sup>30</sup> In rejecting the claim, the Tribunal noted that the claimants' fundamental complaint was that they were the victims of a breach of the concession contract. This was not by itself sufficient to support a claim under NAFTA. The Tribunal noted that NAFTA does not "allow investors to seek international arbitration for mere contractual breaches."<sup>31</sup> Rather, a successful claim under Chapter 11 must be grounded in the breach of a specific treaty obligation.

Analyzing the claim that the annulment of the contract resulted in an expropriation of Desona's contractual rights (Article 1110), the Tribunal stated that because the Mexican courts found that the Municipality's decision to "nullify the Concession Contract was consistent with the Mexican law governing the validity of public-service concessions, the question [was] whether the Mexican courts' decisions themselves breached Mexico's obligations under Chapter Eleven."<sup>32</sup> The claimants, however, had not alleged that the prior court rulings had violated any NAFTA provisions. Accordingly, if the Mexican courts found the contract to be invalid, and no objection was raised to those courts' decisions, there was by definition no contract to be expropriated.<sup>33</sup> The Tribunal stated as follows:

To put it another way, a foreign investor entitled in principle to protection under NAFTA may enter into contractual relations with a public authority, and may suffer a breach by that authority, and still not be in a position to state a claim under NAFTA. It is a fact of life everywhere that individuals may be disappointed in their dealings with public authorities, and disappointed yet again when national courts reject their complaints...

NAFTA was not intended to provide foreign investors with blanket protection from this kind of disappointment, and nothing in its terms so provides.<sup>34</sup>

The Tribunal also rejected the argument that the breach of the concession contract violated the minimum standard of treatment provision (Article 1105) and stated that “if there was no violation of Article 1110, there was none of Article 1105 either.”<sup>35</sup> The meaning of this statement is not clear; however, the Tribunal may have intended to assert, as the S.D. Myers Tribunal would later do (see below), that a violation of another provision of Chapter 11 automatically results in a violation of the minimum standard of treatment provision.

This case illustrates that the Tribunal did not view itself as a “court of appeal” for an investor disappointed with the outcome of a domestic court ruling. Rather, the Tribunal showed a high degree of deference for the domestic process by refusing to substitute its ruling for that of a Mexican court. The Tribunal limited the scope of a claim for expropriation by stating that NAFTA was not intended to protect against disappointments in dealings with public authorities. In no way has this decision expanded any of NAFTA’s substantive provisions beyond the scope of those provisions in international law.

### Waste Management

In September 1998, a US-based investor, Waste Management, filed a Notice of Arbitration against Mexico. The claim arose from a 15-year concession contract granted by the state of Guerrero and the municipality of Acapulco to Acaverde, the Mexican subsidiary of Waste Management.

Under the concession, Acaverde was required to clean the streets, collect and dispose of all solid waste in the area, and build a solid-waste landfill. In return, Acaverde would receive monthly payments from Acapulco. Waste Management contended that it provided the services agreed to for about two years, but it only received payment equivalent to five months of services rendered. Waste Management claimed that Acaverde’s concession rights were unlawfully transferred to a

third party. Waste Management also claimed that the Mexican public authorities did not accord its investment (Acaverde) treatment in accordance with international law, including fair and equitable treatment. In addition, the investor contended that the acts of the Mexican authorities constituted measures “tantamount to expropriation because the investor was deprived of the income from its investment; and because the Mexican authorities’ disregard of its rights effectively extinguished Acaverde’s viability as an enterprise.”

In June 2000, the Tribunal delivered an award, based not on these issues, but on a jurisdictional question raised by the government of Mexico. Under Article 1121 of Chapter 11, a complainant must abandon its right to initiate or continue other legal action in any other legal forum with respect to the issue before a NAFTA tribunal. This is done in the form of a written waiver submitted by the investor to the Tribunal, acknowledging that it is not pursuing the same claim concurrently before any other court or tribunal. Mexico contended, and the Tribunal accepted, that the waiver submitted by the investor did not comply with Article 1121, since concurrent domestic legal action had been pursued in violation of the waiver agreement. Accordingly, the Tribunal found that it lacked jurisdiction to hear the case.

### Pope & Talbot

In March 1999, Pope & Talbot, Inc., a US investor, claimed that Canada’s allotment of export quotas under the *United States-Canada Softwood Lumber Agreement (1996)*<sup>36</sup> (SLA) discriminated against Pope & Talbot’s Canadian subsidiary, thereby violating the national treatment, minimum standard of treatment, performance requirements and expropriation provisions of Chapter 11.<sup>37</sup> The SLA imposed quotas on duty-free softwood exports (export duties were charged above the quota limit) from the four major pro-



ducing provinces in Canada (referred to as the “covered” provinces — British Columbia, Alberta, Ontario and Quebec).<sup>38</sup> Pope & Talbot claimed damages of between US\$85 and US\$135 million.

Canada contended that since this issue concerned trade in goods, it did not fall within the scope of Chapter 11. Canada argued that the term “investment dispute” applied only to disputes about measures “primarily aimed at” investors of another party or investments of those investors. Canada also argued that if it is possible to categorize a measure as relating to trade in goods, the measure cannot be seen as relating to investors or investments, and the dispute over the measure cannot be considered an “investment dispute.” Softwood lumber is a “good”; therefore, the dispute relates to trade in a good and should have been brought under the NAFTA’s state-to-state dispute settlement provisions.

In a preliminary award, the Tribunal addressed the interrelationship between NAFTA’s Chapter 11 and Chapter 3 (trade in goods), stating “there is no provision to the express effect that investment and trade in goods are to be treated as wholly divorced from each other.”<sup>39</sup> The Tribunal rejected the idea that a “measure aimed at trade in goods *ipso facto* cannot be addressed as well under Chapter 11.”<sup>40</sup>

Pope & Talbot claimed that the export quotas violated the national treatment obligation because they imposed different treatment on softwood lumber producers from the covered provinces, which had to pay a permit fee in order to export to the US, and exporters from the non-covered provinces, which did not.

The Tribunal rejected this argument and ruled that the measure, on its face, did not distinguish between foreign-owned and domestic companies,<sup>41</sup> and did not otherwise unduly undermine the investment liberalizing objectives of NAFTA.<sup>42</sup> The Tribunal determined that Canada’s differential treatment of lumber producers from covered and non-covered provinces, existing and new pro-

ducers, holders of different levels of quotas under the Agreement, did not violate Canada’s obligations under Chapter 11 in the absence of discrimination between similarly situated foreign and domestic investors. The Tribunal also found that, in establishing different categories of producers, Canada was not motivated by discriminatory protectionist concerns.

Pope & Talbot also claimed that Canada breached its duty to treat investors in a fair and equitable manner (Article 1105) in its allocation of quotas. The Tribunal found that, under Chapter 11, foreign investors are entitled to the international law minimum plus the fairness elements.<sup>43</sup> Based on this standard of analysis, the Tribunal found that actions of officials in the Softwood Lumber Division (SLD) of the Canadian Department of Foreign Affairs and International Trade (DFAIT) violated the minimum standard of treatment.<sup>44</sup> After the Chapter 11 complaint was initiated, certain Canadian government officials had insisted on a “verification review” of Pope & Talbot’s records in support of its export quota allocation in earlier years. Specifically, by ordering Pope & Talbot to transport all of its corporate and accounting records located at the company’s head office in Portland, Oregon to Canada, it violated the obligation to provide fair and equitable treatment under Chapter 11. In doing so, the Tribunal characterized the actions of the SLD as imperious, based on naked assertions of authority and designed to bludgeon the company into compliance.<sup>45</sup>

In this regard, it should be noted that verifications are routinely conducted in international trade matters, and particularly in customs valuation, anti-dumping and countervailing duty cases, where they generally take place at the venue where the company’s records are located. Indeed, since a verification is essentially a form of “audit,” it would have made little sense to conduct such an exercise anywhere else. The SLD’s insistence that

the company transfer several truckloads of records to Canada was not only highly unusual to anyone familiar with the administration of international trade laws and counter-productive to the goal of a verification review, it was also highly oppressive to the company. The Tribunal concluded that the investor was “being subjected to threats, denied its reasonable requests for pertinent information, required to incur unnecessary expenses and disruption in meeting SLD’s requests for information, forced to expend legal fees and probably suffer a loss of reputation in government circles.”<sup>46</sup> Taken together with the tenor of SLD’s communications with the investor, and the less than forthright reports to the Minister regarding the situation between the investor and SLD, the Tribunal ruled that the verification episode amounted to a denial of fair and equitable treatment contrary to Article 1105.

The claimants also argued that, by reducing Pope & Talbot’s quota of lumber that could be exported to the US without paying a fee, Canada’s export control regime had deprived the investment of its ordinary ability to sell its product to its traditional and natural market, constituting an expropriation. At the outset of its analysis of Article 1110, the Tribunal noted that the “investment’s access to the US market is a property interest subject to protection.”<sup>47</sup> It also noted that, contrary to Canada’s assertions, under certain circumstances regulation may indeed result in expropriation; a blanket exception for regulatory measures would create a gaping loophole in international protections against expropriation.<sup>48</sup> The Tribunal went even further, stating that an expropriation may include “non-discriminatory regulation that might be said to fall within the police powers.”<sup>49</sup>

The Tribunal, however, found that there had *not* been an expropriation of property in this particular case. The ruling established that, in order to determine “whether a particular interference with business activities amounts to expropriation, the

test is whether that interference is sufficiently restrictive to support a conclusion that the property had been ‘taken’ from its owner.”<sup>50</sup> In Pope & Talbot’s case there was no such interference inasmuch as Pope & Talbot remained in control of its investment, continued to direct the day-to-day operations, was free of government interference with officers and employees, and continued to export substantial quantities of softwood lumber to the US and to earn substantial profits on those sales.<sup>51</sup>

A second ruling dealing with damages and with the NAFTA Commission’s interpretive statement of Article 1105 (see Box 3), referred to above, was delivered on May 31, 2002.<sup>52</sup> Canada had contended that, although the Tribunal had already ruled on the matter of Article 1105 in April 2001, the interpretive statement was binding on the Tribunal and, therefore, it should reconsider its findings in light of it.

At the beginning of its analysis, the Tribunal focused on answering the question of whether the NAFTA Free Trade Commission’s interpretation was in fact an interpretation or an amendment. Since the interpretation had been issued in July 2001, many commentators had considered whether future NAFTA tribunals would find that it was within their powers to question the nature of a Commission’s action. In the Tribunal’s view, it was within its power to consider this question and it could not simply “accept that whatever the Commission has stated to be an interpretation is one for the purposes of Article 1131 (2).”<sup>53</sup>

Analyzing the history of Article 1105, the Tribunal determined that there was no reference to customary international law in any of the draft versions of Article 1105. According to the Tribunal, one cannot conceive that NAFTA negotiators would not have known that, “as it is made clear in Article 38 of the Statute of the ICJ [International Court of Justice], international law is a broader concept than customary international law, which is only one of its components.”<sup>54</sup> In light of this,

**Box 3**  
**NAFTA Free Trade Commission's Notes of Interpretation of Certain Chapter 11 Provisions**

On July 31, 2001 the NAFTA Commission issued a statement on the interpretation of certain provisions of Chapter 11. It provided that each Party shall make available to the public in a timely manner all documents submitted to, or issued by, a Chapter 11 tribunal, subject to redaction of: confidential business information; information which is privileged or otherwise protected from disclosure under the Party's domestic law; and information which the Party must withhold pursuant to the relevant arbitral rules, as applied.

The parties also agreed on a clarification of Article 1105(1), which prescribes the customary international law minimum standard of treatment to be afforded to investments of investors of another Party. In summary, the clarification provides as follows:

1. The concepts of "fair and equitable treatment" and "full protection and security" do not require treatment in addition to or beyond that which is required by the customary international law minimum standard of treatment of aliens; and
2. A determination that there has been a breach of another provision of NAFTA, or of a separate international agreement, does not establish that there has been a breach of Article 1105(1).

the Tribunal noted that if it were to determine whether the Commission's action is an interpretation or an amendment, it would choose the latter.<sup>55</sup> The Tribunal, however, chose not to make such determination. After analyzing the question, the Tribunal decided to proceed assuming that the Commission's action was an interpretation.

The next step was then to determine whether the Tribunal's award of April 2001 was incompatible with the Interpretation.<sup>56</sup> Such incompatibility, in the Tribunal's view, would exist only if it were determined that the "concept behind the fairness elements under customary international law is different from those elements under ordinary

standards applied in NAFTA countries."<sup>57</sup> In order to rule on this matter, the Tribunal had to determine the content of customary international law concerning the protection of foreign property. The Tribunal rejected Canada's view that under customary international law a country would violate Chapter 11's minimum standard of treatment provision only if the treatment accorded to investors amounted to gross misconduct, an outrage, bad faith, wilful neglect of duty or to insufficiency of governmental action so far short of international standards that every reasonable and impartial person would readily recognize its insufficiency.<sup>58</sup> According to the Tribunal, Canada's argument was based on a view of customary international law standards from the 1920s. Since then, customary international law has evolved and the range of actions subject to international concern has broadened beyond "international delinquencies" to include the concept of fair and equitable treatment.<sup>59</sup> Despite these findings, the Tribunal based its ruling on the fact that even if Canada's proposed standard were adopted, there would still be a violation of Canada's obligations as a result of the verification review. The Tribunal found that the conduct of the SLD in that episode was egregious and would shock and outrage every reasonable citizen of Canada.<sup>60</sup>

Some argue that the Tribunal's interpretation of Article 1105 is inconsistent with the minimum standard of treatment in international law. However, one can't help but observe that international tribunals, like domestic Courts, do not much care for high-handed and objectionable conduct on the part of litigants that appear before them, and are understandably inclined to find a remedy where the conduct in question offends the basic principles of justice and fair play. To the extent that the Chapter 11 panels have raised the bar with respect to Article 1105,<sup>61</sup> this is arguably a positive development.<sup>62</sup>

In May 2002, the Tribunal awarded Pope & Talbot US\$461,500, a relatively small award considering the original claim of US\$508 million (or 0.0909 percent of the original damages claimed). Thus, only a fraction of the amount claimed was awarded. There is nothing in this case that illustrates the erosion of public interest regulation at the expense of a foreign investor.

### Metalclad<sup>63</sup>

Metalclad, a California-based corporation, developed a hazardous waste disposal facility in the Mexican state of San Luis Potosi. All the required federal and state permits for the construction and operation of the site were issued to COTERIN, which was later bought by Metalclad, by August 1993, and construction of the facility began in May 1994.

In October 1994, however, local officials ordered that construction of the facility cease due to the absence of a municipal construction permit. The Mexican federal government then told Metalclad that such a permit was not required. Relying on this assertion, Metalclad resumed construction of the facility. Work on the new facility was completed in March 1995, but at this point local authorities opposed the opening of the facility on environmental grounds. Demonstrators, sponsored by the state and local governments, abruptly interrupted the ceremony of inauguration of the landfill. After this episode, in an effort to ensure the opening of the site, Metalclad maintained constant dialogue with the federal government.

Negotiations between Metalclad and federal environmental authorities resulted in an agreement in which Metalclad agreed, *inter alia*, to make certain modifications to the site; take specified conservation steps; recognize the participation of a technical scientific committee and a citizen supervision committee; employ local manual labour; and make regular contributions to the

social welfare of the municipality, including limited free medical advice.

Despite the agreement, and in the absence of any evidence of inadequacy of performance by Metalclad, the municipality denied Metalclad's construction permit in a process which was closed to Metalclad. The municipal government refused to permit operation of the plant on the grounds that local geology made it likely that the waste treated at the plant would contaminate local water supplies. In addition, after Metalclad had initiated a Chapter 11 arbitration proceeding, the governor of San Luis Potosi issued, in September 1997, an ecological decree declaring the area of the landfill to be a natural area for the protection of rare cacti. The decree foreclosed any hope of operation of the facility.

In its Statement of Claim, Metalclad sought compensation of US\$43 million plus damages based on the assertion that the actions of the Mexican government violated the expropriation (Article 1110) and minimum standard of treatment (Article 1105) provisions of Chapter 11.

In its Article 1105 claim, Metalclad argued that the actions of the federal, state and municipal governments, including the lack of transparency of the requirements for authorization of the site, constituted a denial of fair and equitable treatment. The Tribunal accepted Metalclad's argument and ruled that the Mexican government had indeed violated its obligations. A significant finding, which would also play an important role on the Tribunal's finding of expropriation, was that the claimant was entitled to rely on the representation of the federal officials who stated that a municipal construction permit was not a requirement. According to the Tribunal, Mexico failed to provide "a transparent and predictable framework for Metalclad's planning and investments."<sup>64</sup> The absence of a clear rule concerning construction permit requirements in Mexico amounted, according to the Tribunal, to a "failure on the part of Mexico to

ensure the transparency required by NAFTA.<sup>65</sup>

*Metalclad* is the *only* NAFTA Chapter 11 case in which a Tribunal made a finding of expropriation. The Tribunal adopted a relatively expansive interpretation of expropriation, stating that

[E]xpropriation under NAFTA includes not only open, deliberate and acknowledged takings of property, such as outright seizure or formal or obligatory transfer of title in favour of the host State, but also incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use or reasonably-to-be-expected economic benefit of property even if not necessarily to the obvious benefit of the host State.<sup>66</sup>

The facts in this case made for an easy determination that an expropriation had taken place. The Tribunal held that the inequitable treatment of *Metalclad* by local Mexican authorities — with the tolerance of the federal government — the violation of representations made and the lack of basis in refusing a permit, which would bar the use of the landfill permanently, amounted to indirect expropriation.

In October 2000, Mexico filed a petition before the Supreme Court of British Columbia challenging the Tribunal's ruling. This appeal was brought in British Columbia because the hearings had been located in Vancouver.

As noted above, Chapter 11 of NAFTA does not provide for appeal or other forms of challenging a Tribunal award. Justice Tysoe of the British Columbia Supreme Court ruled, however, that Mexico's claim should be analyzed under the *British Columbia International Commercial Arbitration Act* (BCICAA). Justice Tysoe noted that, under the BCICAA, the Court was not allowed to review points of law decided by the arbitral tribunal. The issue rather was "whether the Tribunal made decisions on matters beyond the scope of the submission to arbitration by deciding upon matters outside Chapter 11."<sup>67</sup> In other words, the Court could set aside only

the decisions of the NAFTA Tribunal which were beyond the scope of its jurisdiction.

Despite Justice Tysoe's determination that the Court could not, under the BCICAA, review points of law, his analysis of the arbitral award essentially amounted to the same thing.

First, the Court determined that Chapter 11's "fair and equitable treatment" requirement must be interpreted in accordance with international law. The Court found that the Tribunal erred in basing its decision on the lack of transparency in the Mexican domestic legal process for approving hazardous waste sites. Instead, the Court ruled that a lack of transparency is neither a violation of customary international law nor of Chapter 11. Accordingly, the Court determined that the Tribunal's finding of such a violation, based on lack of transparency, was beyond the scope of the submission to arbitration.<sup>68</sup>

In addition, the Court found that the Tribunal had also improperly issued a finding of expropriation on the same mistaken basis. The finding of expropriation, however, was not totally set aside, since the Court considered that there was no error impugning the Tribunal's finding that the state government's Ecological Decree constituted expropriation under Article 1110.<sup>69</sup> In the end, the Court refused to set aside the Tribunal's award *in toto*, determining only that the interest portion of the award be calculated from the date of the Ecological Decree, rather than from the day of the actions which had led to the finding of unfair treatment.<sup>70</sup>

### S.D. Myers

In October 1998, S.D. Myers, an Ohio-based waste disposal company, which performed PCB (polychlorinated biphenyl) remediation<sup>71</sup> activities, claimed that Canada had breached its Chapter 11 obligations, thereby damaging S.D. Myers' investment in Canada. S.D. Myers had no PCB remediation facilities in Canada and its invest-

ment in Canada consisted essentially of obtaining PCBs for treatment by its US facility.

S.D. Myers' main complaint was that Canada breached its obligations under Chapter 11 as a result of a 1995 Interim Order banning the export of PCB waste to the United States. The US border had, since 1980, been closed to the import of PCBs and PCB waste for disposal; but, in October 1995, S.D. Myers received special permission from the US Environmental Protection Agency to import PCBs and PCB waste from Canada for disposal. The permission was valid from November 15, 1995 to December 31, 1997. The Interim Order was in force from November 1995 to February 1997 (at which time Canada reopened its border by an amendment to the PCB Waste Export Regulations). According to S.D. Myers, Canada acted to protect its PCB treatment facility, Chem-Securities of Swan Hills, Alberta.

S.D. Myers presented four claims. First, it asserted that the measure discriminated against US waste disposal firms that sought to operate in Canada, by preventing them from exporting PCB contaminated waste for processing in the US.<sup>72</sup> Second, S.D. Myers alleged that Canada had failed to accord treatment in accordance with the minimum standard of international law. Third, the claimant asserted that, by requiring it to dispose of PCB contaminated waste in Canada, the Interim Order imposed performance requirements (i.e., that PCB disposal operators accord preferential treatment to Canadian goods and services and achieve a given level of domestic content). Finally, S.D. Myers claimed that Canada had indirectly expropriated its investment.

The Tribunal accepted S.D. Myers' claim that the ban on the export of PCBs favoured Canadian nationals over non-nationals, violating Chapter 11's national treatment obligations (Article 1102). In fact, even before examining the specific allegations against Canada, in its analysis of the legislative history of the PCB ban, the Tribunal concluded

that the regulation was "intended primarily to protect the Canadian PCB disposal industry from the US competition" and that "there was no legitimate environmental reason for introducing [it]."<sup>73</sup>

According to the Tribunal, the interpretation of "like circumstances" between foreign and domestic investors and investments, that give rise to the national treatment obligation, must take into account two important factors: first, the "general principles that emerge from the legal context of NAFTA, including both its concern with the environment and the need to avoid trade distortions that are not justified by environmental concerns," second, "the circumstances that would justify governmental regulations that treat [foreign investors] differently in order to protect the public interest."<sup>74</sup> With this statement the Tribunal recognized that environmental factors may provide a legitimate basis for finding circumstances to be "unlike." The legal context for Article 1102 was determined to include the various provisions of NAFTA, its side agreement, the North American Agreement on Environmental Cooperation (NAAEC), and its principles.<sup>75</sup> Emerging from this context are, according to the Tribunal, the following principles:

- States have the right to establish high levels of environmental protection. They are not obliged to compromise their standards merely to satisfy the political or economic interests of other states;
- States should avoid creating distortions to trade; and
- Environmental protection and economic development can and should be mutually supportive.<sup>76</sup>

Accordingly, the Tribunal analyzed Canada's environmental obligations and concerns and decided that the bilateral or multilateral treaties governing the disposal of hazardous waste did not justify favouring domestic suppliers over S.D. Myers. In addition, the Tribunal rejected Canada's

defence that the Order was designed to secure the economic strength of the Canadian industry in order to ensure Canada's ability to process PCBs within its territory in the future (taking into consideration that the US could, at any time, close its border again).

The Tribunal agreed that ensuring the economic strength of the Canadian industry was a legitimate objective, but condemned Canada's means of achieving it. It also applied a least-restrictive-means test to determine whether the specific measure chosen by Canada to achieve that objective was, despite its adverse impact on foreign investors, consistent with NAFTA. The Tribunal found that there were several legitimate ways by which Canada could have achieved that goal, but imposing a ban on the export of PCB was not one of them.<sup>77</sup> The Tribunal largely based its ruling on documentary and testimonial evidence that Canada's policy was motivated by the intention to protect and promote the market share of Canadian-owned enterprises.<sup>78</sup>

In comparing like circumstances, the Tribunal went beyond comparing the S.D. Myers investment in Canada, which provided marketing services, to other Canadian-based providers of PCB marketing services.<sup>79</sup> Instead, it applied the national treatment obligation to the full business line of S.D. Myers, including operations in the home and the host countries (the US and Canada, respectively).<sup>80</sup>

The Tribunal also accepted S.D. Myers' claim that Canada had breached the minimum standard of treatment (Article 1105). The only reason the Tribunal presented for this finding was that on the facts of the case a "breach of Article 1102 essentially established a breach of Article 1105 as well."<sup>81</sup> On this point, Arbitrator Chiasson dissented, noting that the breach of another provision cannot establish a violation of Article 1105; a violation of this provision must be based on a demonstrated failure to meet the fair and equitable require-

ments. The Tribunal, nevertheless, made some interesting remarks on the scope of Article 1105. According to the Tribunal:

[A] breach of Article 1105 occurs only when it is shown that an investor has been treated in such an unjust or arbitrary manner that the treatment rises to the level that is unacceptable from the international perspective. That determination must be made in light of the high measure of deference that international law generally extends to the right of domestic authorities to regulate matters within their own borders.<sup>82</sup>

Regarding S.D. Myers' claim of expropriation, the Tribunal noted that the "general body of precedent usually does not treat regulatory action as amounting to expropriation" and, therefore, regulatory action is "unlikely to be the subject of a legitimate complaint under Article 1110 of NAFTA."<sup>83</sup> This statement, however, was weakened by the Tribunal's note that it did not rule out the *possibility* of regulatory action giving rise to a legitimate action under that article. The Tribunal also noted that, when determining whether a measure constitutes expropriation, a tribunal must look at the *substance* of a measure and not only at the *form*. In addition, tribunals "must look at the real interests involved and the purpose and effect of the government measure."<sup>84</sup>

Under this analysis, the Tribunal noted that regulations may be found to be expropriatory. To make such a determination, both the purpose and the effects of the measure must be analyzed. As for the purpose, the Tribunal ruled that the measure was designed with the objective of preventing S.D. Myers from carrying on its business. However, the effects of the measure were found not to be expropriatory. According to the Tribunal, due to its temporality, the effect of the measure was only to delay an opportunity.

Another important finding of the S.D. Myers Tribunal was that the phrase "tantamount to expropriation" in Article 1110 did not expand the mean-

ing of expropriation in the NAFTA beyond customary international law.<sup>85</sup>

As well, the Tribunal did not support S.D. Myers' claim that Canada had breached the article on performance requirements. Examining its wording, the majority of the Tribunal found that the Canadian government had imposed no such requirements on S.D. Myers.

In February 2001, Canada filed an application before the Federal Court of Canada to set aside the Tribunal's Partial Award. Canada based its application on the *Commercial Arbitration Act*,<sup>86</sup> alleging that elements of the NAFTA Tribunal's award exceeded the Tribunal's jurisdiction and that the ruling conflicts with the public policy of Canada. As of November 2002, the Federal Court had not rendered its decision.

In October 2002, the Tribunal ruled that the damages incurred by S.D. Myers amounted to over C\$6 million plus interest. These damages amount to approximately 30 percent of the damages sought by amount to S.D. Myers (\$20 million).

### Methanex

On December 3, 1999, Methanex, a Canadian company with a US subsidiary, brought a Chapter 11 complaint against the United States, claiming that an Executive Order providing for the removal of a gasoline additive known as MTBE violates US obligations under Chapter 11. The impugned directive was based in large part on a study by the University of California which concluded that there are significant risks associated with MTBE, as it leaks into ground and surface water via leaking underground fuel tanks.<sup>87</sup>

Methanex claimed that the ban is not based on credible scientific evidence; and that the University of California report is flawed in several aspects. In addition, the claimant alleges that the ban went far beyond what was necessary to protect any legitimate public interest, and that the government failed to consider less restrictive alter-

native measures to mitigate the effects of gasoline releases into the environment. Methanex contends that the real problem to address is the leaking gasoline tanks.

Methanex does not manufacture MTBE, it produces and markets methanol, the principal ingredient of MTBE. Methanex fears that the measures taken by California will effectively end its methanol sales in California. Thus, Methanex argues, the California measure constitutes a substantial interference with and taking of Methanex's US business and its investment in Methanex US, thus violating the expropriation provision of Chapter 11 (Article 1110).

Methanex has also claimed that the California measure violates the non-discrimination provision of Article 1102, as the ban was the result of a lobbying effort by the US ethanol industry, specifically by Archer Daniels Midland, an ethanol producer. Methanex asserts that the discriminatory purpose can be seen on the face of the Executive Order, which not only banned MTBE, but also sought to establish an ethanol industry in California. Moreover, the subsequent regulations that implemented the MTBE ban specifically name ethanol as the replacement product.

Methanex also has claimed that the manner in which the legislative measure was established constitutes a violation of Chapter 11's minimum standard of treatment provisions (Article 1105). According to the company, because of the US ethanol industry's lobbying, the California measures were arbitrary, unreasonable and not in good faith.

Between August and October of 2000, four environmental NGOs submitted petitions requesting the Tribunal's permission to submit *amicus curiae* briefs, to make oral submissions and to have observer status at oral hearings. Methanex opposed any *amicus* participation on three grounds. First, the Tribunal had no jurisdiction to add a party to the proceedings without the agreement of the parties that already had standing. Second, Article 1128 (participation by a



member-state) of NAFTA already ensured the protection of the public interest, and if the petitioners were to appear as *amici curiae*, the parties to the dispute would have no opportunity to cross-examine the factual basis of their contentions. Third, were the petitioners allowed to participate, there would be a breach of the privacy and confidentiality of the arbitration process. Mexico also submitted a response to the *amicus* application, asserting that NAFTA did not provide for the involvement of persons other than the disputing parties and the other NAFTA signatory in matters related to the interpretation of Chapter 11.

The Tribunal analyzed separately each of the requests made by the NGOs. First, it declined the request to attend oral hearings of the arbitration, since Article 25(4) of the UNCITRAL Rules provides that the oral hearings must be held *in camera* unless the parties agree otherwise. Second, it concluded that it had no power to accept the petitioners' request to receive materials generated within the arbitration, since confidentiality was determined by the agreement of the parties to the dispute. Third, the Tribunal considered that allowing a third person to make an *amicus* written submission could fall within its procedural powers over the conduct of the arbitration, within the general scope of Article 15(1) of the UNCITRAL Arbitration Rules.<sup>88</sup> This decision was based on the fact that there is no provision in Chapter 11 that expressly prohibits the acceptance of *amicus* submissions. Although the Tribunal concluded that it had the power to accept such submissions, it decided not to issue an order for the participation of the *amici* in its January decision.

In August 2002, the Tribunal issued a preliminary award on jurisdiction, that is, whether it was entitled to hear the case in the first place.<sup>89</sup> This ruling did not involve a consideration of any of the merits of the substantive claims before it, but nonetheless it did not seem to offer Methanex much encouragement.

The rules of Chapter 11 apply only to measures adopted or maintained by another Party *relating* to investors of another Party, or investments (e.g., subsidiaries) of investors of another Party. Without establishing that a measure in question *relates* to either it or its investment, a foreign investor will not be able to pursue a claim under NAFTA.

In its award, the Tribunal ruled that there "was no legally significant connection between the measure [the ban on MTBE] and the investor or nature of the investment."<sup>90</sup> The fact that Methanex is a producer of only one component of the additive to MTBE, which was the subject of the California regulation, was viewed as too indirect a connection between the measure and the investor/investment. The scope of impact of the measure was viewed as too broad to be the subject of challenge. A measure that merely affects the investor does not automatically mean that they are necessarily "related."

At the same time, the Tribunal ruled that to require that a measure be "primarily aimed at" a foreign investor would be too high a hurdle for a foreign investor to bring a claim under Chapter 11. The only avenue left open for Methanex to submit a claim would be to establish that the measures in question were intended to discriminate against it in favour of a domestic competitor. This would be sufficient for the Tribunal to rule that the case could proceed.

## Reforming Chapter 11: The Issues

### Has NAFTA Seriously Undermined Public Regulation?<sup>91</sup>

**T**he central concern of NAFTA has been to what extent NAFTA has imposed substantive limits on the ability of governments to adopt *bona fide* regulatory and legislative measures taken for public welfare pur-

poses. Do the decisions to date support the concern about these provisions, or have critics overstated the risk?

This is a critical issue because it speaks to the ability of governments to regulate in the public interest. No part of Chapter 11, and especially not the article on expropriation, was intended to subvert the ability of governments to undertake legitimate public welfare measures. However, given the potential for self-interested parties to use environmental or other measures for protectionist purposes or to transfer economic benefits for reasons not related to the common good, it is important that investors maintain the ability to protect themselves against the abuse of regulatory power. Having said that, there is a good argument that Chapter 11 does respect a state's police powers; that is, the state's right to protect the environment, consumers, public health, etc., and that the cases decided to date under Chapter 11 have not demonstrated a restriction on governments to act in the public interest.

### *Regulatory Chill*

Critics of NAFTA have argued that the very fact that compensation has been paid to foreign investors has resulted in "regulatory chill."<sup>92</sup> The meaning of the term "regulatory chill" is not clear. Does it mean that regulators are so fearful of a possible Chapter 11 challenge that they cease to adopt any new regulations and that the entire environmental regulatory framework grinds to a halt? Or does it mean, rather, that regulators must be mindful of not violating certain obligations when developing new regulations? Not only is the term regulatory chill imprecise, but it is pejorative, thereby leading one to conclude that regulatory chill exists as a negative force on regulators without any analysis or even understanding what the term means. To the extent that regulators are required to take care in designing regulation so as not to unduly discriminate against foreign investors,

etc., that will not necessarily diminish the quality, quantity or effectiveness of public regulation. Indeed, such constraints are entirely consistent with a range of similar existing constraints imposed on regulators by, for example, the Government of Canada's Regulatory Policy.<sup>93</sup> It is hard to imagine that, based on the cases to date, regulators would be inhibited from proposing *bona fide* environmental regulation. The cases to date have only punished what tribunals considered to be outrageous behaviour on the part of government officials, and only three cases have resulted in awards in favour of the investor: *Metalclad*, *S.D. Myers* and *Pope & Talbot*. In each of these cases, the investor led significant evidence to the effect that the government had engaged in high-handed and capricious conduct to the detriment of the investor. In all three cases, the objectionable conduct was found sufficient to trigger liability on the basis of the minimum standard of treatment (and in *Metalclad*, liability for expropriation as well).

In examining the cases, it is important to ask what environmental regulation or value is at stake. A close examination of the cases leads to the conclusion that the so-called "environmental cases" are not really environmental cases at all. In *Metalclad*, for example, a Mexican state governor used a sham environmental measure to prevent a hazardous waste-disposal site from opening, despite the fact that it had been built in compliance with all applicable legal requirements.

There was significant evidence pointing to the fact that the governor was using, or rather abusing, environmental regulation as a manipulative tool for self-serving and parochial interests. This type of capricious action on the part of a subnational government is exactly the type of behaviour that NAFTA was designed to constrain.

The panel fully addressed the evidence regarding the arbitrary nature of the alleged "environmental" measure in that case. *Metalclad* confirms that the mistreatment of foreign investors can take

many forms, including the form of an environmental regulation. It does not support the proposition that *bona fide* environmental regulation can form the basis of a compensation award.

Similarly, in *S.D. Myers*, there was much evidence presented that the Canadian measure responded to protectionist interests, rather than those of environmentalists. There was no valid environmental justification for closing the border to the export of PCB waste, but there was a valid economic reason for doing so: to eliminate the competition to less efficient Canadian businesses. Again, this type of capricious, discriminatory and high-handed behaviour is what NAFTA Chapter 11 sought to address.

And what about the precedential value of these cases? Has *bona fide* environmental regulation been threatened by Chapter 11? No. Rather, the cases demonstrate that discriminatory and unfairly protectionist measures are threatened by Chapter 11 — very threatened. Tribunals have not been afraid to “call it as they see it,” despite the fact that the measure in question concerns an ostensible environmental, health or safety measure. In other words, “egregious conduct begs a remedy, and that Tribunals will be inclined to find a remedy where the conduct in question offends basic principles of justice and fair play.”<sup>94</sup>

As noted above, to date there has only been *one* finding of expropriation since the advent of NAFTA. Tribunals have not made findings of expropriation lightly — there must be a substantial deprivation for such a finding to be made. Tribunals have stated that the diminishment of profits is not sufficient for finding expropriation, rather, there must be a measure that, in effect, renders an operating business inoperable, whatever form that measure may take. These cases have demonstrated that incidental interference with an investment is not sufficient to substantiate a claim, even where it has a negative financial impact on the investment. Rather, there must be

unreasonable interference for a sustained period of time that results in a *substantial and fundamental deprivation* of an investor’s property rights.<sup>95</sup>

The focus on the effect of NAFTA Chapter 11 on public regulation also obscures the fact that other important values are at stake. It is important to be mindful that the ability to regulate in the public interest is not the only value important to the functioning of a democratic society. As explored above, the principles contained in Chapter 11 are not new. Arguably, it is important to consider all of the values at stake, which includes the fair treatment of investors, that governments be accountable for their actions and that a government’s discretionary powers not be abused.

Environment Canada has listed on its website all of the new federal environmental acts and regulations enacted since NAFTA was passed in 1994, it is responsible for administering. Included are 46 new acts or regulations administered by Environment Canada, eight new regulations under the *Canadian Environmental Assessment Act* and one regulation under the *Fisheries Act*. These include the *Migratory Birds Convention Act* (1994), the *Alternative Fuels Act* (1995), the *Canada Marine Act* (1998), the *Mackenzie Valley Resource Management Act* (1998) and the *Oceans Act* (1996).<sup>96</sup> As the volume of new legislative instruments continues to expand, we can presume that the environmental regulatory framework continues to function in Canada (as it does in Mexico and the United States), despite the alleged “chill” that Chapter 11 has caused.

The literature supporting the contention that regulatory chill does exist is largely anecdotal and has not been adequately substantiated. Those who assert that regulatory chill is inhibiting new environmental regulation should keep in mind that more work could be usefully done on researching the degree, if any, to which Chapter 11 may have created a regulatory chill at federal, provincial or state levels in Canada and the US.

### *Deregulatory Chill*

Concerns about NAFTA have also extended to “deregulatory chill” — a phenomenon potentially inimical to economic efficiency and growth.<sup>97</sup> Schwanen posits that governments have faced increased political difficulties with deregulation and privatization politically since NAFTA, since a government’s ability to unwind, or roll back, any deregulation or privatization initiative may be seen as compromised as a result of NAFTA.<sup>98</sup>

Johnson has explored this phenomenon most recently in the context of Canada’s public health-care system.<sup>99</sup> While some Chapter 11 obligations are subject to reservations for the public health system,<sup>100</sup> such as NAFTA Articles 1102, 1103, 1006 and 1107, other Chapter 11 provisions are not. The Chapter 11 provisions not subject to reservations are, most notably, the expropriation provisions (Article 1110) and the minimum standard of treatment provisions (Article 1105). While the status of measures subject to reservations is not totally clear, Johnson concludes that their potential inhibiting impact on government actions is “reduced substantially” by the reservations. On the other hand, however, with respect to those obligations that are not subject to reservations, Johnson concludes that the expropriation provisions of NAFTA would have “a major impact if the public component of the system were expanded in any way that adversely affects the business of private firms.”<sup>101</sup> Johnson similarly concludes that the minimum standard of treatment provisions may “affect any expansion of the public component of the system that is coupled with a denial of recourse to the courts by private firms.”<sup>102</sup>

While this may seem undesirable at first glance, Chapter 11 does not really impose onerous obligations on governments wishing to deregulate. In a sense, the effect of these provisions is really just to require governments to treat foreign investors fairly and reasonably. If, by virtue of a government’s decision to deregulate

or privatize, a private firm makes an investment to operate a business, that firm *should* be compensated in the event of a sudden reversal of policy. There is nothing in the expropriation provisions that *prevents* a government from taking the regulatory action it desires, but rather it must compensate a firm for that if the action is tantamount to expropriation. Similarly, the minimum standard of treatment provisions do not prevent a government from adopting any regulation or policy, but rather, require that government to treat firms with due process, e.g., a government could not deny a foreign investor access to the court system, as this would constitute a denial of justice.

### NAFTA As An “Evolving Regime”<sup>103</sup>

Thus far this paper has mainly examined the impact of the substantive rules of Chapter 11 and resulting pressures for change. However, there is also considerable pressure for change in the area of Chapter 11 process and procedure. What has emerged from the various decisions is a rather uneven patchwork of rulings on the issues of transparency, openness, public participation and appellate review. These areas are probably most ripe for reform by NAFTA Parties.

### *Transparency*

Central among the pressures for change is the transparency of the Chapter 11 process. The lack of transparency of the panel process mandated by Chapter 11 is viewed by many as undesirable, since Chapter 11 does address issues of broad public concern. It is notable that none of the elements of a case is required to be made public, that is, there is no right of public access to the pleadings, the transcripts of the hearing or the reasons for judgment. This stands in contrast to current practice under other sections of NAFTA and the rules of the World Trade Organization (WTO). Rulings under NAFTA’s two other dispute-settlement mecha-

nisms — Chapter 19 (for antidumping and countervailing duty challenges) and Chapter 20 (for general state-to-state breaches of NAFTA) — as well as those under the WTO, are publicly available and accessible.

To some extent, the concerns with respect to transparency have been alleviated by the Free Trade Commission's interpretation of July 2001 (see Box 3). Therefore, the issues with respect to transparency are not as pressing as they were prior to the interpretation. However, in March 2002, the Pope & Talbot Tribunal ruled on the investor's request that the Tribunal urge Canada not to release protected documents. Canada was seeking to make public transcripts of the hearings under the Canadian *Access to Information Act*. The Tribunal noted that *Procedural Order on Confidentiality No. 5* prohibited Canada from disclosing transcripts of the hearings. In addition, the ruling noted that the UNCITRAL Rules require *in camera* hearings. The Tribunal rejected Canada's claim that the notes of interpretation issued by the NAFTA Free Trade Commission on July 31, 2001 required such disclosure under the *Access to Information Act*. In the Tribunal's view, the Commission's Interpretation recognized the validity of *Order No. 5* as binding on Canada. Accordingly, the Tribunal concluded that making the documents available violated not only *Procedural Order on Confidentiality No. 5*, but also NAFTA itself.<sup>104</sup>

In any event, the parties could go further in developing more precise rules which address the transparency of documents, pleadings, transcripts and hearings. This would bolster the legitimacy of the NAFTA dispute settlement process. At the same time, however, it is important to maintain certain safety valves which protect the confidentiality of sensitive business information. The demand for openness must also be balanced with protection of confidential or privileged information.

### *NGO Participation*

There also have been ongoing calls for other institutional reforms to Chapter 11. Most significant has been the demand for participation in the Tribunal proceedings themselves, by becoming a party to the litigation itself, and through the submission of *amicus* briefs and oral arguments.

NAFTA Article 1120 provides that whichever arbitral rules are chosen by the investor "shall govern the arbitration except to the extent modified" by NAFTA Chapter 11. NAFTA Article 1131(1) also provides that a tribunal "shall decide the issues in dispute in accordance with [the NAFTA] and applicable rules of international law." Accordingly, any tribunal asked to consider participation by a non-party in a given arbitration must look first to the designated arbitration rules and then to any applicable NAFTA provisions or "rules of international law" that may be relevant to the dispute if the parties are not able to come to an agreement on such participation. To date, both the Methanex and the UPS Tribunals have ruled that they have the power to accept *amicus* submissions, although both Tribunals have yet to actually formally allow specific submissions to be made.

Participation by interested parties raises a number of complex issues.<sup>105</sup> On the one hand, interested parties may possess specialized knowledge on a particular issue and, given the public nature of these disputes, the participation of certain NGOs may enhance the perceived "legitimacy" of the process. On the other hand, however, just because a certain group claims to represent broad public interests, that is not necessarily so, and arguably it is a democratically-elected government that is best equipped to represent the public interest in Chapter 11 litigation. Moreover, the addition of parties to a dispute, or the requirement to read and reply to briefs submitted, can add significantly to the time and cost of the arbitration.

However, where there is a public interest value at stake, there is no compelling reason why interested

parties should not be able to, at a minimum, submit briefs for a tribunal's consideration. This was the opinion of the Methanex Tribunal, which recently stated:

There is an undoubtedly public interest in this arbitration. The substantive issues extend far beyond those raised by the usual transnational arbitration between private parties. This is not merely because one of the Disputing Parties is a State...The public interest in this arbitration arises from its subject matter, as powerfully suggested in the Petitions. There is also a broader argument, as suggested by the [United States] and Canada: The Chapter 11 arbitral process could benefit from being perceived as more open and transparent, or conversely be harmed if seen as unduly secretive.<sup>106</sup>

However, the Tribunal also recognized that:

There are other competing factors to consider: the acceptance of *amicus* submissions might add significantly to the overall cost of the arbitration and, as considered above, there is a possible risk of imposing an extra burden on one or both of the Disputing Parties.<sup>107</sup>

However, attempts to make NGOs party to the actual dispute have not been successful. In October 2001, the UPS Tribunal delivered an award deciding against the Canadian Union of Postal Workers and the Council of Canadians' petitions for standing as parties to the Chapter 11 proceedings. The petitioners argued that they have a direct interest in the subject matter of this claim, and it would be contrary to the principles of fairness, equality and fundamental justice to deny them the opportunity to defend their interests in the proceedings.

Analyzing the petitioners' request for standing as parties, the Tribunal determined that Chapter 11 does not confer authority to add parties to the arbitration.<sup>108</sup> As a tribunal has only the authority conferred on it by the agreement under which it is established, the Tribunal found that it had no power to add a third party to the proceedings. Fur-

thermore, Article 15(1) of the UNCITRAL Rules, as a procedural provision, cannot grant the Tribunal any power to add further disputing parties to the arbitration.

Article 15(1) does, however, allow a tribunal to receive submissions offered by third parties (*amici curiae*) with the objective of assisting it in the arbitral process. In other words, acceptance of written submissions is only appropriate at the merits stage of an arbitration. Accordingly, the Tribunal denied the petitioners' request to make submissions concerning the place of arbitration and the jurisdiction of the Tribunal. However, the Tribunal found that the requirement of equality and the parties' right to present their case limit the Tribunal's power to admit *amicus* submissions if these are unduly burdensome for the parties or unnecessarily complicate the Tribunal process.<sup>109</sup>

Referring to Article 24(5) of the UNCITRAL Rules, which provides that the hearings are to be held *in camera* unless the parties agree otherwise, the UPS Tribunal denied the petitioners' requests to participate in the hearings without the consent of the parties.<sup>110</sup> In July 2002, however, the UPS hearings were made completely open to the public.

It is clear that further development of the rules which govern NGO participation through the submission of *amicus* briefs is required. There would be much to be gained from a consistent set of rules governing the submission of such briefs in an agreed-upon and predictable manner. For example, further work and analysis could usefully be done to define the circumstances in which it would be appropriate for such submissions to be made.<sup>111</sup> However, it would be important that these rules limit any attempts by intervenors to widen the dispute between the parties. This is a real risk that has been recognized in the context of the WTO. It may be prudent to limit submissions to issues on which an intervenor possesses specialized information, and only in the context of the merits of the case.<sup>112</sup> In addition, one must be

mindful of the time and cost that the submission of *amicus* briefs will impose on the parties to the dispute, as well as the arbitrators. Significant work would have to be undertaken to define the rules and procedures which would govern third-party participation and the effect such participation would have on the confidentiality of the arbitral process.

*Appeals from NAFTA Chapter 11 Decisions*

There is also pressure for clarification of the process relating to the appeal of tribunal awards.

The possibility of a permanent appellate body, much like the WTO Appellate Body, should be explored in further detail. A permanent appellate body could provide a sense of consistency and permanence currently lacking in the Chapter 11 process. The current patchwork of appeal processes, with different rules in different jurisdictions, has led to jurisdiction shopping and a sense of uneven application of the rules among different parties to an arbitration. This is poor policy. It is submitted that a permanent appellate body could be useful in bolstering the perceived legitimacy of Chapter 11 as an ad hoc process. As well, in the event that a rogue tribunal did interpret the substantive provisions of Chapter 11 in such a way that did go significantly beyond international law, the fear articulated by many NGOs, a permanent appellate body could rein in such excesses.

## The Challenge of Clarifying Substantive Law<sup>113</sup>

**D**espite the widespread calls for NAFTA clarification, legal clarification is not always something that can be pulled “off the shelf” as an answer to the uncertainty over a given legal issue. The common law tradition of judicial interpretation necessarily

allows for an adjudicator to interpret the law in the context of specific facts. This section examines the challenges in clarifying the NAFTA, first by examining the procedure for clarification, and second, by examining substantive issues inherent in clarifying legal rules, using the expropriation provision as a case study.

*Amendment or Clarification?*

Wilkie notes that treaties are “living documents that often have to respond to different constituencies in a number of jurisdictions with different concerns and policy priorities.”<sup>114</sup> Nowhere is this more evident than in the context of the GATT/WTO, where ongoing clarification is part of how the GATT/WTO operates in practice.<sup>116</sup> Before the establishment of the WTO, from time to time, GATT interpretations were made in short statements by the chairs of the contracting parties. Sometimes this was done on the basis of a “consensus view” of the contracting parties and sometimes it was done simply on the basis of there being no objection from any contracting party. As for the status of such interpretive statements with regard to future disputes, Jackson suggests that it was, in the language of the Vienna Convention on the Law of Treaties, one of “practice...establishing agreement.”<sup>116</sup>

Under Article XXV of the GATT, legally binding interpretations may be made by representatives of contracting parties who may “meet from time to time for the purpose of giving effect to those provisions of this Agreement which involve joint action and, generally, with a view to facilitating the operation and furthering the objectives of the Agreement.” Whether this includes the power to interpret, especially in a case where only a majority of contracting parties agreed, remained an open question. Practice suggested that Article XXV did include such a power.

The creation of the WTO appears to have clarified matters. Article IX, paragraph 2 of the *Mar-*

*rakesh Agreement Establishing the World Trade Organization* appears to provide for an official authorization of the creation of notes of interpretation. It states:

The Ministerial Conference and the General Council shall have the exclusive authority to adopt interpretations of this Agreement and of the Multilateral Trade Agreements. In the case of an interpretation of a Multilateral Trade Agreement in Annex 1, they shall exercise their authority on the basis of a recommendation by the Council overseeing the functioning of that Agreement. The decision to adopt an interpretation shall be taken by a three-fourths majority of the Members. This paragraph shall not be used in a manner that would undermine the amendment provisions in Article X.

The NAFTA Commission is in the process of an ongoing clarification exercise to “give future tribunals clearer and more specific understanding of Chapter 11’s obligations, as originally intended by the drafters.”<sup>117</sup> It is currently examining different ways in which certain aspects of NAFTA can be clarified. On the current agenda is the possibility of clarifying the expropriation provisions of NAFTA and some institutional areas, such as the submission of *amicus* briefs.

This can be achieved by way of a formal amendment or a binding interpretive note issued by the NAFTA Commission. A formal amendment of the text of NAFTA<sup>118</sup> is probably not a politically realistic option, however, given the considerable political energy which would be required to conclude an amendment to a trade agreement.<sup>119</sup> A more realistic approach is for the NAFTA Commission to issue an interpretive note.

The question that follows is what kind of interpretive note would resolve the perceived inadequacies of Chapter 11? Pierre Pettigrew stated recently,<sup>120</sup>

We want the investor-state dispute settlement process to be more open and transparent, to make it work better. Indeed, Canada has

already taken steps to make this process more transparent. The Department of Foreign Affairs and International Trade website contains all the publicly available documents related to Chapter 11 arbitrations involving the Canadian government. We would like to make all documents public — while accepting certain limitations to protect commercially confidential information — and to open the hearings to the public.

We are also seeking to clarify some of the provisions of NAFTA Chapter 11, such as expropriation disciplines, to ensure they properly reflect the original intent of the NAFTA Parties in the dispute settlement process.

However, there are limits to what a clarification provision can achieve. Weiler notes there are two reasons why the ministers’ statement may not work:

First, it is an open question as to whether any of the ministers’ proposed changes can be considered to be mere “interpretations” of the NAFTA text, as opposed to outright amendments. Second, even if a particular tribunal determines that it must obey the ministers’ “interpretation” under Article 1131(2), the changes may simply not have gone far enough to have the desired effects.<sup>121</sup>

A future tribunal may not necessarily follow the clarification to Chapter 11, if it finds that it has narrowed the scope of protection under that section. As noted above, the Tribunal in *Pope & Talbot* did not automatically accept that the interpretation was a clarification rather than an amendment, although it eventually declined to make this determination. This underscores the point that clarifications, or interpretations, will not necessarily be accepted as such by a tribunal, potentially making them ineffective tools for reform.

### Expropriation<sup>122</sup>

In trying to define a regulatory expropriation, NAFTA negotiators attempted to include language in the text of NAFTA to distinguish legitimate regulation from a taking (another term for expropri-



ation) but, in the end, were unable to.<sup>123</sup> As one negotiator stated, “if the US Supreme Court could not do it in over 150 years, it was unlikely that we were going to do it in a matter of weeks...”<sup>124</sup>

As a case study, the following section examines a number of options for an interpretive note for the clarifications of NAFTA’s expropriation provisions. This section demonstrates that such a note will not be easy to draft. In fact, significant risks are involved with such a clarification, not the least of which is undermining investor protection. This section reviews five of the options that were reviewed last year in a working group led by the Government of Ontario in order to determine what form (if any) such an interpretive note would take.<sup>125</sup>

### The “Domestic Law” Approach

Under the “Domestic Law” approach, the NAFTA Commission would mandate that tribunals reviewing a claim under Article 1110 must take into consideration the domestic law of expropriation of the respondent party in their interpretation of NAFTA’s expropriation provisions.

Supporters of this approach argue that the domestic law of expropriation of all the parties is well established and would thus provide a greater framework of predictability to both investors and governments implementing new measures. It would also serve to impose a discipline on investors’ “reasonable expectations.” Tribunals would be able to presume that investors had taken the limits of domestic expropriation law into account prior to making their investment decisions.

A central issue with this approach, however, is that it undermines the rationale for including the rules regarding expropriation in NAFTA. One of the stated objectives of NAFTA is to “increase substantially investment opportunities in the territories of the parties.” Presumably, the drafters were of the view that domestic law alone was not sufficient to accomplish this goal. As noted above, an

international standard for expropriation articulated in an international treaty provides investors some assurance with regard to their investment beyond that of a domestic legal regime.

Moreover, linking the international standard to the domestic law creates a risk that the expropriation provisions would cease to function properly to protect foreign investors. Even if a domestic law regime currently provides adequate protection for expropriation, governments could enact new laws with discriminatory expropriation standards.

### The “Safe Harbour” Approach

The “Safe Harbour” approach would do just that: create a safe harbour for reasonable regulation by the state. An interpretive note providing it would state that any claim for expropriation shall not include reasonable interference by a party with the operation, enjoyment, management, maintenance, use or disposal of an investment of an investor. This approach would create an explicit exemption from compensating expropriation if the impugned measure was “reasonable.” This approach would justify certain regulatory actions taken by governments that do not constitute a complete deprivation of ownership interests and that are not taken to benefit the government.

The central issue with this approach is simply that it is too vague. It leaves considerable discretion in the hands of the Tribunals, as it does not define what would constitute a “reasonable interference.”

Moreover, this proposed interpretation does not differ substantially from the law on expropriation as it currently stands, which also does not require compensation for reasonable regulation by the state. The international law of expropriation recognizes police powers, that is, the sphere in which a government may regulate without being required to compensate an investor.<sup>126</sup> The legitimate or reasonable use of “police powers” by a government (e.g., measures which are supported by domestic regulatory processes) has not created a situation

whereby governments are required to pay compensation awards under Chapter 11. What it does do is prevent the use of police powers to masquerade discriminatory regulation, that is, a disguised restriction on foreign investment. In this way, the Safe Harbour approach is superfluous and would not solve any problem that actually exists.

### The “Large Safe Harbour” Approach

The “Large Safe Harbour” approach provides that safeguards against expropriation do not apply to such things as general policy measures, i.e. a change in the public interest rate; industrial policy (excluding those measures whose aims are to protect domestic industry); environmental policy and consumer protection.

This approach would remove certain areas of government regulation completely from any potential expropriation claim, thereby creating a safe harbour for specifically agreed-upon measures. The problem with this approach is that it essentially eviscerates the protection afforded by Article 1110, as any measure could be easily designed to fall within one of the enumerated categories (e.g., industrial policy). Investors would have no recourse against discriminatory measures adopted by NAFTA governments within these specified categories. This approach is arguably one step short of removing “Expropriation” from the text of NAFTA altogether.

### The “Factors for Evaluation” Approach

This approach would establish a set of factors that a panel must consider when interpreting Chapter 11 on expropriation. One possible formulation of such an interpretive note would first establish whether an impugned measure passed a threshold test that would allow a tribunal hearing. For example, the interpretive note would state that a claimant must establish the following:

(i) The measure in question has or is likely to affect the value of the investment.

(ii) It is appropriate to adjudicate the matter under international law, i.e. there has been a breach thereof. Once this threshold is met, the Tribunal would then consider the following factors to determine whether a measure constitutes an expropriation:

(iii) The measure in dispute is designed to deprive the investor of the value of the investment.

(iv) The measure has the effect of depriving the investor of economically beneficial or productive use of the investment.

(v) The measure is a *bona fide* general taxation, regulation or other action of the kind that is generally accepted within the police powers of states.

(vi) The investor adversely affected by the measure had a reasonable expectation of non-interference by the party.

The advantage of having an initial threshold is that it functions to weed out frivolous and vexatious claims. However, Chapter 11 already contains a number of safeguards to eliminate such claims. For example, Article 1116 states that an investor can only bring a claim if the party has breached an obligation and the investor “has incurred loss or damage by reason of, or arising out of, that breach.” As noted above, Article 1121 states that in order to bring a claim, an investor must waive its right to initiate or continue before any court any proceedings with respect to the measure that is alleged to be the breach.

After the threshold is established, this approach provides substantial guidance to an arbitral tribunal as to what constitutes a taking, reflecting principles that have been developed in domestic and international law. However, no guidance is offered as to whether or not the factors listed are dispositive nor is there any guidance as to how these factors relate to each other. It is also unclear whether tribunals will be able to look at other relevant factors or if these are the only legitimate factors that can be considered.

More seriously, this approach introduces the requirement of intent on the part of the government adopting the measure. This would drastically narrow the scope of Chapter 11 to include only those acts that are aimed at specific investments. By requiring specific intent, such an interpretive note would actually provide foreign investors with less protection than domestic investors. Again, this would eviscerate the protection in the NAFTA and potentially discourage foreign investment.

### The "Guidance to Panels" Approach

This approach is similar to "Factors for Evaluation." The main difference is that this type of interpretive note would provide principles to guide tribunals rather than enumerate factors that must be considered. In this way, tribunals could include any number of factors particular to the cases they are adjudicating, and could exclude factors that are not. A "Guidance to Panels" interpretive note could state that panels should only be guided by the following clarifications:

- (i) NAFTA was not intended to create new forms of expropriation.
- (ii) Expropriation is the taking of property rights by government for its own use or benefit or for the use or benefit of a third party.
- (iii) Indirect expropriation and measures tantamount to expropriation are intended to capture expropriation by other than direct means and are not intended to create new forms of expropriation.
- (iv) Property rights may be restricted by government measures for a public purpose without compensation, even when there is a loss of property or diminution of value of property, for example, in order to enforce laws which require forfeiture for criminal activity; to raise revenue; or to protect health, safety, the environment or the public welfare.

- (v) The purpose and effect of the measure must be judged in light of reasonable expectations of a property owner about the degree of government regulation of that economic sector or activity.
- (vi) There is a presumption that governments are regulating, and not expropriating, when they say they are regulating. But neither the government's intent nor its characterization of its measures is determinative. The onus is on the disputing investor to prove on a civil standard (not just a *prima facie* case) that the measure is an expropriation.
- (vii) Other NAFTA provisions (such as Articles 1101[4], 1110[7] and [8], 1114[1], 1410, 1502 and 2103) do not create any presumption with respect to expropriation for any other government measure.

The first and third points are simply an attempt to make clear that the phrase "tantamount to expropriation" does not create a *lex specialis* (special law) that differs from the international law of expropriation. This would essentially support the conclusions of the Tribunals in *Pope & Talbot* and *S.D. Myers*.

The second point would make it explicit that, to constitute an expropriation, a measure must both deprive the investor of ownership rights and pass those benefits on to the government (or a third party). Requiring that the government or another third party benefit from the expropriation may narrow Article 1110 as a remedy, as such benefits will be difficult to prove practically. The effect of these first three points would appear to endorse the interpretations found in *Pope & Talbot* and *S.D. Myers* (as opposed to the findings of the Tribunal in *Metalclad*).

The fourth point is little more than a restatement of the "Safe Harbour" approach. As stated above, this type of statement is unnecessary and could lead to unintended consequences that severely undermine the underlying goals of NAFTA. This could effectively eliminate any con-

cept of indirect expropriation from its scope. It would also represent quite a radical shift in the international law of expropriation and would deny the kind of protection that is necessary to encourage foreign investment.

The sixth and seventh points are two further examples of attempts to fix problems that do not exist. To my knowledge, there has been no case in which the investor has attempted to argue that the onus is not on it to demonstrate that, on the balance of probabilities, the measure in question constitutes an expropriation, nor has a tribunal made such a ruling. Similarly, no attempt has been made to use the articles listed in the seventh point to create any type of presumption with respect to expropriation.

This suggested approach contains too much ambiguity and not enough clarity. For every interpretive question it answers, it seems to raise more questions. It addresses too many non-issues and suggests too many interpretive principles that have already been employed by the panels.

## Conclusion: Toward a Better Understanding

**L**ooking forward, it is important to be mindful that arbitral tribunals have ruled in only five cases. As VanDuzer notes, “Most of the noise surrounding Chapter 11 has been generated by the arguments advanced by counsel for complaining parties, by interest groups who appear to feel threatened by review of the issues placed before arbitral tribunals, or by governments forced to defend questionable policy choices.”<sup>127</sup> Simply put, none of the decisions to date has confirmed the worst case scenarios. To quote VanDuzer again, “while the broadly worded substantive obligations of NAFTA stated in Chapter 11 may be capable of being applied in a manner that

would impose significant constraints on sovereignty, they have not been applied to do so. So far, only egregious state actions which were either arbitrary, clearly unfair or overtly protectionist have been found to be contrary to obligations under Chapter 11.”<sup>128</sup>

It is premature for the Commission to adopt an interpretive note relating to any of the substantive provisions of NAFTA. Again, it is important to focus on what is actually broken before we attempt to fix it. For the most part, the substantive provisions of NAFTA have not been expanded beyond their meaning in international law. As well, moving too early on reforming Chapter 11 seriously risks undermining the investor protection benefits it affords. A solid case for reform based on the jurisprudence to date needs to be established before substantive reform should be undertaken. This has not been done to date.

As demonstrated above, interpretive notes can be tricky. If they go too far, they become amendments, and absent being incorporated into NAFTA by way of the formal amending process, they risk being disregarded by tribunals.

In terms of Chapter 11’s substantive provisions, one of the current concerns regarding Article 1105 is that it is being used as a “catch-all” for arguments under Chapter 11. Article 1105 arguments were presented successfully by the claimants in *Pope & Talbot*, *Metalclad* and *S.D. Myers*. In each of these cases, government entities behaved in a discriminatory and unfair way toward the investor. However, some concerns remain with respect to the interpretations to date, which has been dealt with for the time being by the NAFTA Commission’s interpretive statement. It is not likely that the NAFTA Parties will revisit the issue any time soon, although this may depend on how future tribunals take account of the interpretive statement.

Regarding Article 1102 (national treatment), some NGOs have argued that the term “like circumstances” should be clarified in order to specify what

types of operations will be compared to determine ‘no worse’ treatment.”<sup>129</sup> There has been one ruling to date which has found a violation of Article 1102, *S.D. Myers*. As noted above, in comparing like circumstances, one would think that the Tribunal would compare similar operations located in the host country.<sup>130</sup> However, in this case, the Tribunal did go beyond comparing the investment in Canada of *S.D. Myers*, which provided marketing services to other Canadian-based providers of PCB marketing services. The Tribunal instead applied the national treatment obligation to the full business line of *S.D. Myers*, including operations in the home and the host countries (the US and Canada, respectively).<sup>131</sup> However, a decision to reform Article 1102 on the basis of one ruling on this point is premature.

Regarding the prohibition against performance requirements in NAFTA Article 1106, some NGOs have argued that this provision risks becoming a “wide open back door for firms to litigate trade-related obligations in an investment agreement.”<sup>132</sup> This argument is speculative, as not one Tribunal has found that a measure has violated NAFTA Article 1106 to date. In this instance, it is definitely too early to take any action.

Based on the interpretations adopted to date with respect to NAFTA’s expropriation provisions, there is no clearly established need for change. Two of the three tribunals have been relatively conservative in their approach. In *Metalclad*, while the Tribunal adopted a more expansive interpretation of the expropriation provisions, the facts strongly supported a finding of expropriation.

It is vital to remain mindful of why Chapter 11 was included in the NAFTA. The parties felt it was important to encourage investment, particularly in Mexico. It would be wrong to obliterate the substantive protections afforded by Chapter 11 based on the case law to date because of “early jitters.” Despite the lack of *stare decisis* in international law, the Tribunals do look to the judgments of pre-

vious tribunals for guidance. Eventually, trends will emerge, and carefully thought out action may be appropriate at a later date.

However, there is scope for reform in the process by which Chapter 11 cases are adjudicated. Reform in this area probably has the most scope for success, as it is important that the rules of the game are as fair as possible. In this vein, a more robust set of rules governing transparency and NGO participation would be useful. As well, the parties should seriously consider the possibility of a permanent NAFTA appellate body as a way to provide consistency in the appeal process from tribunal decisions.

A permanent appellate body could also provide consistency, to some extent, in the application of the substantive rules of Chapter 11 in a much more effective manner than would clarification of NAFTA provisions by the FTC. An appellate body could rein in any possible future rulings by tribunals that interpreted the provisions of Chapter 11 in a way that went far beyond international law, thereby addressing the concerns that Chapter 11 decisions not impinge on the ability of governments to regulate in the public interest.

## Annex: Chapter 11 Cases Cases Filed Against the Government of Canada under NAFTA Chapter 11

Complaining Party	Subject	Claim	Proceedings	Final Status
Signa S.A. de C.V. (Mexican corporation)	Corporation with interests in the pharmaceutical industry	Unknown	Notice of Intent to Submit a Claim to Arbitration filed March 1996	Notice never made public, arbitration did not commence  Claim abandoned
Ethyl Corp. (Canadian subsidiary of a Virginia corporation)	Canadian government banned import and interprovincial transport of MMT, ostensibly for health reasons. Ethyl Corp. is sole importer of MMT (Articles 1102, 1106, 1110)  Submitted claim under UNCITRAL Arbitration Rules	Ch. 11 breach relating to: national treatment, the prohibition of performance requirements, and expropriation April 14, 1997	Notice of Intent to Submit a Claim to Arbitration filed September 10, 1996  Notice of Arbitration filed  Award on Confidentiality issued November 28, 1997  Award on Place of Arbitration issued November 28, 1997  Award on Jurisdiction issued June 24, 1998 denying Canada's jurisdictional challenges	Settled: C\$19.3 million for expenses and lost profits  Government issued statement that there was no evidence MMT, in small doses, is harmful to human health or damages on-board diagnostic systems in cars
S.D. Myers, Inc. (Ohio corporation)	Canada banned the export of PCB wastes to the US for 18 months.  Submitted claim under UNCITRAL Arbitration Rules	Ch. 11 breach relating to: national treatment, the minimum standard of treatment, expropriation, and the prohibition of performance requirements (Articles 1102, 1105, 1110, 1106)	Notice of Intent to Submit a Claim to Arbitration filed July 21, 1998  Notice of Arbitration filed October 30, 1998  Partial Award on the Merits issued November 13, 2000  Separate, concurring opinion November 13, 2000  Application for judicial review filed with the Federal Court of Canada on February 8, 2001	Tribunal found for investor regarding Article 1102 and 1105 claims. In a separate opinion, Arbitrator Schwartz also found that Canada had breached Article 1106  February 2001, Canada applied to Federal Court in Ottawa to set aside partial award on basis that Tribunal exceeded its jurisdiction and award is contrary to public policy

## Cases Filed Against the Government of Canada under NAFTA Chapter 11 (cont.)

Complaining Party	Subject	Claim	Proceedings	Final Status
Sun Belt Water, Inc. (California corporation)	Sun Belt participated in joint venture with Canadian corporation with licence to export water in bulk from BC  Subsequently, BC enacted law prohibiting such exports and negotiated cash settlement with Canadian joint venture partner, but not Sun Belt  Submitted notice under UNCITRAL Arbitration Rules	Ch. 11 breach relating to: national treatment, the minimum standard of treatment, and expropriation (Articles 1102, 1105, 1110)  Vienna Convention on the Law of Treaties breach: Articles 26 and 27  Various torts by ministers and employees of federal and BC governments, and judges	Notice of Intent to Submit a Claim to Arbitration filed November 27, 1998  Notice of Claim and Demand for Arbitration filed October 12, 1999	Claim does not appear to have progressed to arbitration
Pope & Talbot, Inc. (US investor on behalf of Canadian subsidiary)	Canada established quota scheme for producers of softwood lumber to fulfill obligation under Softwood Lumber Agreement with US. Scheme allocated each producer a quota of lumber it could export duty free  Submitted claim under UNCITRAL Arbitration Rules	Softwood Lumber Agreement breaches Ch. 11 relating to: national treatment, the minimum standard of treatment, the prohibition on performance requirements, and expropriation (Articles 1102, 1105, 1106, 1110)	Notice of Intent to Submit a Claim to Arbitration filed December 24, 1998  Notice of Arbitration filed March 25, 1999  Award on Interim Measures Motion issued January 7, 2000  Award Denying Motion to Dismiss re: Whether Measures "Related to" the Investment issued January 26, 2000  Award Denying Motion to Dismiss re: Claim for Consequential Loss by Investor issued February 24, 2000  Interim Merits Award issued June 26, 2000	June 26, 2000, Tribunal issued partial award dismissing investor's claims under Articles 1106 and 1100.  April 10, 2001, Tribunal issued award in favour of investor regarding Article 1105, but rejected Article 1102 claim  May 31, 2002, Tribunal issued award (Article 1105 breach) for US\$461,500  Separate phase will have Tribunal determine issues relating to costs of arbitration. Parties are requested to each submit, by June 30, 2002, a written proposal for dealing with costs

Cases Filed Against the Government of Canada under NAFTA Chapter 11 (cont.)

Complaining Party	Subject	Claim	Proceedings	Final Status
<p>Pope &amp; Talbot, Inc. (cont.)</p>			<p>Award Denying Motion to Strike Claims re: Changes Made by Canada to Measure issued August 7, 2000</p> <p>Award on Crown Privilege and Solicitor-Client Privilege issued September 6, 2000</p> <p>Decision on Confidentiality issued September 27, 2000</p> <p>Award on Merits on Phase 2 issued April 10, 2001</p> <p>Interim Order on Confidentiality issued March 5, 2002</p> <p>Second Decision on Confidentiality issued March 11, 2002</p> <p>Decision Concerning Investor's Motion to Change the Place of Arbitration issued March 14, 2002</p> <p>Decision and Order Concerning Negotiation Texts Relating to the Drafting of NAFTA Article 1105 issued March 21, 2002</p> <p>Award on Damages issued May 31, 2002</p>	
<p>United Parcel Service of America (UPS) (US service provider operating through Canadian subsidiary)</p>	<p>Alleges Canada Post Corporation (CPC) is a monopoly engaging in anticompetitive practices; especially CPC unfairly uses its</p>	<p>Ch. 11 breach relating to: national treatment and the minimum standard of treatment (Articles 1102, 1105)</p>	<p>Notice of intent filed January 19, 2000</p>	<p>October 2001 Tribunal held it had power to allow participation of third parties as amici curiae in arbitration</p>



Cases Filed Against the Government of Canada under NAFTA Chapter 11 (cont.)

Complaining Party	Subject	Claim	Proceedings	Final Status
UPS of America (cont.)	postal monopoly infrastructure to reduce costs of delivering its nonmonopoly courier and parcel services	Other obligations breached under NAFTA: to supervise a "government monopoly" and "state entity" and to ensure that a government monopoly doesn't engage in anticompetitive conduct when competing outside its permitted monopoly (Articles 1502[3][a], 1503[2])	Notice of Arbitration filed April 19, 2000 Decision of the Tribunal on the Place of Arbitration issued October 17, 2001 Decision of the Tribunal on Petitions for Intervention and Participation as Amici Curiae issued October 17, 2001	proceeding. Tribunal determined it would make final decision on whether to accept amicus briefs at merits stage of proceedings in consultation with parties
Ketcham Investments, Inc. and Tsya Investments, Inc. (State of Washington corporations—lumber industry)	In order to fulfill obligations under Softwood Lumber Agreement with US, Canada established quota scheme for producers of softwood lumber. The scheme allocated each producer a quota of lumber it could export duty free	Softwood Lumber Export Regulations (re: quota allocations) breach Ch. 11 relating to: national treatment, the most-favoured-nation treatment, the minimum standard of treatment, the prohibition of performance requirements, and expropriation (Articles 1102, 1103, 1105, 1106, 1110)	Notice of intent to Submit a Claim to Arbitration filed December 22, 2000	No arbitration has commenced
Trammell Crow Company (Delaware-incorporated public company—real estate management services)	Trammell Crow Canada formed joint venture with FM One Alliance Corp. (FM One) to prepare competitive bid for supply of real estate services to state enterprise—Canada Post Corporation (CPC) September 1, 1994: CPC renewed Service Agreement with 2 other Canadian suppliers of real estate services without submitting services to be provided to a competitive procurement process	Ch. 11 breach relating to: the minimum standard of treatment (Article 1105)	Notice of Intent to Submit a Claim to Arbitration filed September 7, 2001	CITT recommended CPC issue public solicitation regarding Service Agreements in a manner consistent with NAFTA July 30, 2001, CPC informed CITT it did not intend to implement recommendations April 2002, case settled

Cases Filed Against the Government of Canada under NAFTA Chapter 11 (cont.)

Complaining Party	Subject	Claim	Proceedings	Final Status
<p>Crompton Corp. (New Jersey corporation— manufacturer of products containing lindane)</p>	<p>In Canada, Crompton is the major manufacturer of products containing lindane for treatment of canola seeds</p> <p>As of July 1, 2001, Canadian Pest Management Regulatory Agency prohibited use of lindane- seed-treatment product for canola and sale and planting of lindane-treated canola seeds</p>	<p>Ch. 11 breach relating to: national treatment, the minimum standards of treatment, performance requirements, and expropriation (Articles 1102, 1105, 1106, 1110)</p>	<p>Notice of Intent to Submit a Claim to Arbitration filed November 6, 2001</p>	<p>Process pending</p>

## Cases Filed Against the USA under NAFTA Chapter 11

Complaining Party	Subject Matter	Claim	Proceedings	Final Status
<p>The Loewen Group, Inc. and Raymond L. Loewen (Canadian corporations involved in funeral services industry)</p>	<p>In 1995 and 1996, Loewen was involved in litigation relating to a commercial dispute with a local competitor</p> <p>Loewen's claim relates to the conduct of the litigation, the damage award made, and the bond requirement of 125% of the judgment in order to proceed with an appeal of the decision, all of which it feels are excessive</p> <p>Submitted claim under ICSID additional facility rules</p>	<p>Ch. 11 breach relating to: the minimum standard of treatment and expropriation (Articles 1105, 1110)</p>	<p>Notice of Intent to Submit a Claim to Arbitration filed July 29, 1998</p> <p>Notice of Arbitration/Notice of Claim filed October 30, 1998</p> <p>Award on Jurisdiction issued January 5, 2001</p>	<p>January 2002, US objected to continuing competence of Tribunal over claim, on grounds that corporate reorganization of Loewen Group, Inc. has resulted in discontinuity of attributes necessary for claimant to maintain claim under NAFTA Ch. 11</p> <p>US continues to argue under continuous nationality rule: allege Loewen claims against US are now owned by a US national, which should result in the loss of the Tribunal's jurisdiction over a NAFTA claim</p>
<p>Mondev International Ltd. (Canadian real estate development corporation)</p>	<p>Alleges Massachusetts limited partnership it owns and controls has suffered losses as a result of actions by the City of Boston and the Boston Redevelopment Authority</p> <p>Allegedly, when Mondev sued for compensation it was denied recovery, partially due to a Massachusetts law found to protect the City and the Boston Redevelopment Agency against liability for intentional torts</p> <p>Submitted claim under the ICSID Additional Facility Rules</p>	<p>Ch. 11 breach relating to: national treatment, the minimum standard of treatment, and expropriation (Articles 1102, 1105, 1110)</p>	<p>Notice of Intent to Submit a Claim to Arbitration filed May 6, 1999</p> <p>Notice of Arbitration filed September 1, 1999</p>	<p>Process pending</p>

Cases Filed Against the USA under NAFTA Chapter 11 (cont.)

Complaining Party	Subject	Claim	Proceedings	Final Status
Methanex Corp. (Canadian methanol distributor)	Challenging executive order by governor of the state of California requiring removal of gasoline additive from gasoline by 2002 in interests of protecting health and the environment. Methanol is an ingredient in this additive  Submitted claim under UNCITRAL Rules	Ch. 11 breach relating to: the minimum standard of treatment, and expropriation (Articles 1105, 1110)	Notice of Submission of a Claim to Arbitration filed December 3, 1999  Decision of Place of Arbitration issued December 31, 2000  Decision of the Tribunal on Petitions by Third Parties to Intervene as amici curiae issued January 15, 2001	Various environmental institutes seek to intervene in arbitration, arguing they provide distinctive perspectives and increase public acceptance of Ch. 11  Tribunal will make final decision on acceptance of amicus briefs at merits stage of proceedings, in consultation with parties  Both parties continue to file submissions on jurisdiction and "NAFTA FIC Statement on Article 1105," most recently on February 11, 2002
ADF Group Inc. (Canadian corporation that designs, engineers, fabricates, and erects structural steel)	Claim damages for alleged injuries resulting from the federal Surface Transportation Assistance Act of 1982 and the Department of Transportation's implementing regulations, which require federally funded state highway projects to use only domestically produced steel  Submitted claim under the ICSID Additional Facility Rules	Ch. 11 breach relating to: national treatment, the minimum standard of treatment, and the prohibition against performance requirements (Articles 1102, 1105, 1106)	Notice of Arbitration filed July 19, 2000  Decision on Place of Arbitration issued July 11, 2001	Process pending
Canfor Corp. (Canadian corporation involved in softwood lumber industry)	Allege US competitors of Canfor (and investments) are unjustifiably treated better than Canfor in a variety of instances	Ch. 11 breach relating to: national treatment, most-favoured-nation treatment, the minimum standard of treatment, and	Notice of Intent to Submit a Claim to Arbitration filed November 5, 2001	Process pending

## Cases Filed Against the USA under NAFTA Chapter 11 (cont.)

Complaining Party	Subject	Claim	Proceedings	Final Status
Canfor Corp. (Canadian corporation involved in softwood lumber industry) (cont.)	Allege Byrd Amendment in present circumstances denies Canfor (and investments) the best treatment available to investors and US investments of investors	expropriation (Articles 1102, 1103, 1105, 1110)	Notice of Arbitration and Statement of Claim filed July 9, 2002	
Kenex Ltd. (Canadian corporation involved in manufacturing, marketing and distributing industrial hemp products)	Acting on directions from DEA, US customs seized and confiscated truckload of non-germinating, sterilized hemp seed. US Customs also ordered recall of 15 earlier shipments already delivered to US customers  Eventually DEA released shipment and rescinded recall. By then shipment had become worm-infested	Ch. 11 breach relating to: national treatment, most-favoured-nation treatment, and the minimum standard of treatment (Articles 1102, 1103, 1105)	Notice of Intent to Submit a Claim to Arbitration filed January 14, 2002	Process pending
Doman Industries Ltd. (Canadian logging and wood processing operation)	Allege the US and its recently implemented Byrd Amendment have breached numerous articles under Section A of Ch. 11 of NAFTA	Ch. 11 breach relating to: national treatment, most-favoured-nation treatment, minimum standard of treatment, and expropriation (Articles 1102, 1103, 1104, 1105, 1110)	Notice of Intent to Submit a Claim to Arbitration filed May 1, 2002  Notice of Arbitration August 2, 2002	Process pending
Tembec	Unknown	Unknown	Notice of Intent to Submit a Claim to Arbitration filed May 4, 2002	Process pending
US in the Matter of Cross-Border Trucking Services	Mexico contended the US was violating NAFTA by failing to phase out US restrictions on 1) cross-border trucking and 2) Mexican investment in US trucking industry	Ch. 11 breach relating to: national treatment and most-favoured-nation treatment (Articles 1102, 1103)  Also breach of NAFTA Articles 1202 and 1203	Chapter 20 (state-to-state) Arbitration Panel Report interpreting Chapter 11 and 14 obligations issued February 6, 2001	Unanimous panel decision that the US restrictions are a breach of its obligations under Articles 1102, 1103, 1202, and 1203 of NAFTA

## Cases Filed Against the United Mexican States under NAFTA Chapter 11

Complaining Party	Subject	Claim	Proceedings	Final Status
Halchette Distribution Services	Operates airport concessions in Mexico	Unknown	Notice of intent to Submit a Claim to Arbitration filed August 1995	Notice never made public Claim abandoned
Azinian et al. (shareholders of Mexican company, Desona)	Investors claimed City of Naucalpan terminated contract awarded to Desona to operate landfill and waste management system for the city, without cause Submitted claim under ICSID additional facility rules	Ch. 11 breach relating to: minimum standard of treatment and expropriation (Articles 1105, 1110)	Notice of intent to Submit a Claim to Arbitration filed December 16, 1996 Notice of Arbitration filed March 10, 1997 Final award issued November 1, 1999	November 1, 1999, Tribunal issued award in Mexico's favour on all issues Tribunal makes no award of costs. Each side bears own expenditures
Metalclad Corp. (US waste disposal company)	Although hazardous waste facility built by Metalclad had been approved by federal officials, municipality denied Metalclad construction permit and refused permission to operate facility Submitted claim under ICSID additional facility rules	Ch. 11 breach relating to: minimum standard of treatment and expropriation (Articles 1105, 1110)	Notice of Arbitration filed January 2, 1997 Final award issued September 2, 2000 Canadian judicial review decision issued May 2, 2001 Supplemental judicial review decision issued October 31, 2001	State government issued ecological decree creating ecological preserve, including site of Desona's facility August 2000, Tribunal found in favour of investors (breach of Article 1105, indirect expropriation contrary to Article 1110). Also concluded ecological decree was additional and separate basis for finding of expropriation (Article 1110). Award—US\$16.7 million Mexico petitioned BC Supreme Court on grounds Tribunal exceeded jurisdiction and award enforcement violated public policy

Cases Filed Against the United Mexican States under NAFTA Chapter 11 (cont.)

Complaining Party	Subject	Claim	Proceedings	Final Status
Metalcilad Corp. (cont.)				BC Supreme Court set aside award relating to Article 1105 and indirect Article 1110, but upheld Article 1110 based on environmental decree
Marvin Roy Feldman Karpa (CEMSA) (US citizen on behalf of foreign trading company and exporter of cigarettes)	Allege CEMSA has been denied certain tax refunds available to exporters  Also allege Mexico refuses to implement 1993 Mexican Supreme Court decision in favour of CEMSA to receive refund of taxes paid  Submitted under ICSID additional facility rules	Ch. 11 breach relating to: the minimum standard of treatment, free transfer of funds related to the transfer of its investment, and expropriation (Articles 1105, 1109, 1110)	Notice of Intent to Submit a Claim to Arbitration filed February 18, 1998  Notice of Arbitration filed April 20, 1999  Preliminary Award on Jurisdiction issued December 6, 2000	Prior to claims being submitted to arbitration, US and Mexico agreed, in accordance with NAFTA Article 2103(6), the measure may not be found to be an expropriation  December 2000, Tribunal issued interim decision rejecting certain preliminary jurisdictional issues  July 2001, Tribunal held hearing on the merits
Waste Management, Inc. (US waste disposal company; submitted on behalf of itself and its Mexican subsidiary, Acaverde)	Allege state of Guerrero and municipality of Acapulco failed to comply with payment and other obligations set forth in a 15-year concession agreement granted in 1995, despite Acaverde's full performance under the agreement  Also allege Mexican state-owned bank refuses to honour unconditional payment guarantee agreed to previously  Submitted under ICSID additional facility rules	Ch. 11 breach relating to: the minimum standard of treatment and expropriation (Articles 1105, 1110)	Notice of Arbitration filed September 29, 1998  Final Award (Dismissing on Jurisdiction) issued June 2, 2000  New Notice of Arbitration filed September 27, 2000  Award on Jurisdiction issued June 26, 2002	January 31, 2000 jurisdictional hearing held. Tribunal dismissed investor's claim for lack of jurisdiction. Arbitrator Hight dissented  Resubmitted case is allowed to proceed  Tribunal reserves to a later stage questions relating to costs and expenses up to present stage of proceedings

Cases Filed Against the United Mexican States under NAFTA Chapter 11 (cont.)

Complaining Party	Subject Matter	Claim	Proceedings	Final Status
Adams et al. (B. Adams and a number of US citizens (the "Investors"))	Mexican Superior Court judgment required that certain real estate (in which the Investors had invested) be transferred back to the former owners of the property  Adams et al. seek relief from this judgment  Submitted under UNCITRAL arbitration rules	Ch. 11 breach relating to: national treatment, the minimum standard of treatment, and expropriation (Articles 1102, 1105, 1110)	Notice of Intent to Submit a Claim to Arbitration filed November 11, 2000  Notice of Arbitration filed February 16, 2001	Notice of Intent has not been made public  Process pending
Calmark Commercial Development, Inc.	Allege that the conduct of a number of Mexican courts (criminal, civil and state) pertaining to criminal proceedings for alleged crimes against Calmark constitutes a failure to prosecute the defendants and a denial of justice to Calmark	Ch. 11 breach relating to: the minimum standard of treatment, the fee transfer of funds related to the transfer of its investment, and expropriation (Articles 1105, 1109, 1110)	Notice of Intent to Submit a Claim to Arbitration filed December 24, 2001	Process pending
Fireman's Fund (US insurance company)	Allege Mexico facilitated purchase of Mexican-investor-owned debentures denominated in Mexican pesos, but not Fireman's-Fund-owned debentures denominated in US dollars  Both series of debentures were issued at same time by same Mexican financial services corporation for same total amount  Submitted under ICSID additional facility rules	Ch. 11 breach relating to: national treatment, the minimum standard of treatment, and expropriation (Articles 1102, 1104, 1110)  Ch. 14 breach relating to: national treatment obligation applying to financial institutions (Article 1405)	Notice of Arbitration filed January 15, 2002	Process pending



### Cases Filed Against the United Mexican States under NAFTA Chapter 11 (cont.)

Complaining Party	Subject Matter	Claim	Proceedings	Final Status
GAMI Investments, Inc. (US investment corporation with 5 Mexican sugar mills)	Allege GAMI is treated less favourably than Mexican investors in numerous different ways with respect to enforcement of the sugarcane decree	Ch. 11 breach relating to: national treatment; the minimum standard of treatment, and expropriation (Articles 1102, 1105, 1110)	Notice of Arbitration filed April 9, 2002	Process pending

Source: Adapted from the Appendix in Dawson (2002).

## Notes

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- 1 Hart and Dymond (2002, p. 132).
- 2 Kirton (1998, pp. 181-194).
- 3 México, Secretaría de Economía (2001a and 2001b).
- 4 Drabek and Payne (2001).
- 5 Abbott (1999).
- 6 A measure is quite broadly defined to include "any law, regulation, procedure, requirement or practice" (NAFTA Article 201).
- 7 For further detail on the rules of Chapter 11, see Johnson (1997). See also Wilkie (2002, pp. 6-38).
- 8 Wilkie (2002, p. 15).
- 9 Wilkie (2002, p. 15).
- 10 Browne (2002, pp. 39-43).
- 11 Daly (1994).
- 12 In addition, the obligation not to differentiate between domestic and foreign investors has been controversial and represents a departure from traditional practice on the part of governments. This is particularly true in the case of Canada and Mexico who have in the past been wary of some of the implications of high levels of foreign investment in the domestic economy and have used foreign ownership restrictions as a means by which to regulate and set policy. For example, Canada has used foreign ownership restrictions in the past to protect its cultural and broadcasting industries and Mexico has used such restrictions to maintain control over its electricity and oil sectors. See Daly (1994).
- 13 Hart and Dymond (2002, p. 130).
- 14 NAFTA Article 1120 provides that an investor may choose from among the ICSID Convention, the ICSID Additional Facility Rules and the UNCITRAL Arbitration Rules for making its claim. However, as neither Canada nor Mexico has ratified the ICSID Convention, this option is currently not available to investors. Approximately half of the eighteen or so arbitrations that have been commenced thus far have been under the ICSID Additional Facility Rules (a heretofore unused resource). The other half have proceeded under the somewhat more ad hoc UNCITRAL Rules.
- 15 Rodrik (1997, p. 2).
- 16 Rodrik (1997, p. 2).
- 17 See, for example, Mann (2001).
- 18 Unlike the general rule in the Canadian court system which provides that proceedings are public unless a judge rules otherwise, NAFTA does not provide a *positive* obligation on the tribunals to make any part of the arbitration process open to the public, although parties to the dispute remain free to agree otherwise if they so choose.
- 19 Ostry (1998, p. 1). As will be addressed later in this paper in further detail, in response, Canada has since made the decision to publish Notices of Intent to Commence Arbitration (NAFTA Article 1119), thereby giving the public some advanced notice of what claims may eventually be filed.
- 20 Tollefson (2002, pp. 142-191).
- 21 See Annex summarizing these cases.
- 22 The interpretive statement provided (i) that each Party shall make available to the public in a timely manner all Chapter 11 documents (subject to certain exceptions); and (ii) a clarification of what minimum standard of international law governs foreign investments under NAFTA. See *infra*.
- 23 Pettigrew (2001).
- 24 Pettigrew (2001).
- 25 Thomas (2002, p. 127).
- 26 *Metalclad*, Award on the Merits *infra*.
- 27 See Articles 38 and 59 of the *Statute of the International Court of Justice*.
- 28 *Pope & Talbot Inc. v. The Government of Canada Award on the Merits of Phase 2* (2001).
- 29 Price (2000).
- 30 *Azinian et al. v. United Mexican States* (1999) [hereinafter *Azinian*].
- 31 *Azinian*, at para. 87.
- 32 *Azinian*, at para. 97.
- 33 *Azinian*, at para. 100.
- 34 *Azinian*, at paras. 83-84.
- 35 *Azinian*, at para. 92.
- 36 *Canada-United States: Softwood Lumber Agreement*, Canada and the United States, 29 May 1996, 35 I.L.M. 1195 (1996).
- 37 *Pope & Talbot, Inc. and The Government of Canada*, NAFTA/UNCITRAL Tribunal, Final Award on the Merits (April 10, 2001), at para. 42 [hereinafter *Pope & Talbot Final Award*]; *Pope & Talbot, Inc. and The Government of Canada*, NAFTA/UNCITRAL Tribunal, Interim Award on the Merits (26 June 2000) [hereinafter *Pope & Talbot Interim Award*].
- 38 Softwood lumber is the subject of a long-standing dispute between Canada and the United States and remains unresolved to date. The SLA was a politically negotiated settlement between the countries, completely outside the context of NAFTA's trade remedy rules. For Canadian exporters, the SLA was better than the alternative, namely, unilateral action by the US in the form of severely punitive tariffs and quotas. It is interesting to note that, absent the US threat, there would be no SLA and *Pope & Talbot* investors would not have a basis for a Chapter 11 complaint. Ironically, the investor is using a provision in a free trade agreement against Canada, precisely because a co-signatory (the US) refuses to allow free trade in this area.
- 39 *Pope & Talbot, Inc. and The Government of Canada*, NAFTA/UNCITRAL Tribunal, Award by the Tribunal on Preliminary Motion by Government of Canada (26 January 2000) at para. 26 [hereinafter *Pope & Talbot Award on Preliminary Motion*].
- 40 *Pope & Talbot Award on Preliminary Motion*, *supra*, at para. 34.

- 41 Under this standard, justifying differences in treatment requires showing that the differential treatment bears a reasonable relationship to rational policies not motivated by preference of domestic over foreign owned investments. *Pope & Talbot* Final Award, *supra*, note 37 at para. 79.
- 42 *Pope & Talbot* Final Award, *supra*, note 37 at para. 78.
- 43 *Pope & Talbot* Final Award, *supra*, note 37 at para. 110.
- 44 The filing by Pope & Talbot of the Notice of Intent to Submit a Claim to Arbitration under Article 1119 of NAFTA triggered a review by the SLD of the investor's claim that its investment had not received the quota allocation to which it was entitled.
- 45 *Pope & Talbot* Final Award, *supra*, note 37 at paras. 173-175.
- 46 *Pope & Talbot*, Final Award, *supra*, note 37 at para. 181.
- 47 *Pope & Talbot* Interim Award, *supra*, note 37 at para. 96.
- 48 *Pope & Talbot* Interim Award, *supra*, note 37 at para. 99.
- 49 *Pope & Talbot* Interim Award, *supra*, note at para. 96. Under customary international law, the term "police powers" generally includes measures taken by a government under normal or common functions of governments to protect the environment, human health, consumer protection, regulate hazardous products and so on. However, there does remain a degree of uncertainty as to what exactly falls within the police powers rule, much as there remains uncertainty as to what falls within the rule on expropriation itself.
- 50 *Pope & Talbot* Interim Award, *supra*, note at para. 102.
- 51 *Pope & Talbot* Interim Award, *supra*, note at para. 100.
- 52 See *infra* and *supra*.
- 53 *Pope & Talbot, Inc. and The Government of Canada*, NAFTA/UNCITRAL Tribunal, Award on Damages (31 May 2002) at para. 23 [hereinafter *Pope & Talbot* Award on Damages]. Pursuant to Article 1131 (2), the NAFTA Commission may issue an interpretation of a provision which is binding on a Chapter 11 tribunal.
- 54 *Pope & Talbot* Award on Damages, *supra*, at para. 46.
- 55 *Pope & Talbot* Award on Damages, *supra*, at para. 47.
- 56 According to the Tribunal, the Interpretation should be understood as requiring "each Party to accord to investments of investors of the other Parties the fairness elements as subsumed in, rather than additive to, customary international law." *Pope & Talbot* Award on Damages, *supra*, at para. 54.
- 57 *Pope & Talbot* Award on Damages, *supra*, at para. 56.
- 58 *Pope & Talbot* Award on Damages, *supra*, at para. 57, n. 40; 42.
- 59 *Pope & Talbot* Award on Damages, *supra*, at para. 60.
- 60 *Pope & Talbot* Award on Damages, *supra*, at para. 68.
- 61 See Thomas (2002).
- 62 See Thomas (2002, p. 121), who notes that an award of costs combined with a strong statement of disapproval would have been a better course of action to follow than the Tribunal's decision under Article 1105.
- 63 *Metalclad Corporation v. The United Mexican States* [unreported, ICSID Case No. ARB (AF)/97/1 (August 30, 2000), hereinafter *Metalclad* Award on the Merits].
- 64 *Metalclad* Award on the Merits, *supra*, at para. 99.
- 65 *Metalclad* Award on the Merits, *supra*, at para. 88. It is important to note that Chapter 11, however, does not contain any specific transparency obligation; its existence was inferred on the basis of NAFTA's Article 102 and Chapter 18. Accordingly, the ruling holds that lack of transparency and assurances by the federal government, which were relied upon by the foreign investor to its detriment, constituted denial of fair and equitable treatment to *Metalclad*.
- 66 *Metalclad* Award on the Merits, *supra*, at para. 103.
- 67 *United Mexican States v. Metalclad*, 2001 BCSC 664 at para. 67 (2001) [hereinafter B.C. Judgment].
- 68 B.C. Judgment, *supra*, at para. 73.
- 69 B.C. Judgment, *supra*, at para. 84; 91.
- 70 B.C. Judgment, *supra*, at paras. 133-134.
- 71 PCB remediation consists of analysing equipment and oil to assess the level of contamination, the transportation of the oil or equipment to a facility and the extraction of the PCBs from the materials so transported. The decontaminated components of the equipment and the oil are recycled. The extracted PCBs and PCB waste material then is destroyed.
- 72 *S.D. Myers, Inc. and The Government of Canada*, NAFTA/UNCITRAL Tribunal, Award on the Merits (13 November 2000) at paras. 131-132 [hereinafter *S.D. Myers* Award on the Merits].
- 73 *S.D. Myers* Award on the Merits, *supra*, at paras. 194-195.
- 74 *S.D. Myers* Award on the Merits, *supra*, at para. 250.
- 75 Even before delivering a final decision on whether the Interim and Final Orders violated Canada's obligation under Section A of Chapter Eleven, the *S.D. Myers* Tribunal had already discussed general principles for interpreting NAFTA in the context of environmental concerns. The Tribunal's discussion of the relationship between the NAFTA and the NAAEC led to the conclusion that "where a state can achieve its chosen level of environmental protection through a variety of equally effective and reasonable means, it is obliged to adopt the alternative that is most consistent with open trade." *S.D. Myers* Award on the Merits, *supra*, at para. 221.
- 76 *S.D. Myers* Award on the Merits, *supra*, at para. 247.
- 77 *S.D. Myers* Award on the Merits, *supra*, at para. 255.
- 78 *S.D. Myers* Award on the Merits, *supra*, at para. 162. The following are some of the evidences presented by the Tribunal in its ruling. Several documents prepared by officials in the Department of the Environment highlighted the benefits of opening the border from the Canadian side. According to those officials, such a policy would represent a technically and environmentally sound solution to the destruction of some of Canada's PCBs. Nevertheless, the position of the Minister of the Environment, especially after a meeting with senior officials of Canadian operators of hazardous waste facilities, was that PCB waste should be disposed of in Canada by Canadians (statement made in the House of Commons).
- 79 International Institute for Sustainable Development & World Wildlife Fund (2001).

- 80 World Wild Life, *supra*, at 27.
- 81 *S.D. Myers Award on the Merits, supra*, at para. 266.
- 82 *S.D. Myers Award on the Merits, supra*, at paras. 262-263.
- 83 *S.D. Myers Award on the Merits, supra*, at para. 281.
- 84 *S.D. Myers Award on the Merits, supra*, at para. 285.
- 85 *S.D. Myers Award on the Merits, supra*, at para. 285.
- 86 *Commercial Arbitration Act*, R.S.C. 1985, c.17 (2nd Supp.).
- 87 In addition, the study pointed out the possibility of health risks to the population resulting from the presence of MTBE in the environment. According to the study, it is an animal carcinogen with the potential to cause cancer in humans. However, the state of scientific knowledge with respect to MTBE's human health effects remains incomplete.
- 88 *Methanex and United States of America*, NAFTA/UNCITRAL Tribunal, Decision on Authority to Accept Amicus Submissions (15 January 2002) at para. 31 [hereinafter *Methanex Amicus Decision*].
- 89 *Methanex and United States of America*, Preliminary Award on Jurisdiction and Admissibility, August 7, 2002.
- 90 *Methanex and United States of America*, Preliminary Award on Jurisdiction and Admissibility, August 7, 2002, at para. 139.
- 91 This section draws on Mann and Soloway (2002).
- 92 See, for example, Mann (2001).
- 93 See Government of Canada Regulatory Policy, November 1999, Privy Council Office which requires, for example, that regulatory authorities demonstrate both that a problem or risk exists and that federal intervention is justified; that the benefits and costs of regulatory interventions under consideration be assessed and that benefits justify the costs; that intergovernmental agreements be respected; etc.
- 94 Barutciski (2002).
- 95 A NAFTA tribunal cannot require that a measure's repeal: it can only award damages against the federal government once an unlawful expropriation is established. Governments remain free to adopt any environmental, health or safety measure they deem appropriate.
- 96 See statement by Stephen Brereton, Director, Investment Trade Policy Division, Foreign Affairs and International Trade Canada at the "Workshop on Investor Protection in the NAFTA and Beyond: Private Interests and Public Purposes," sponsored by the C.D. Howe Institute and the Munk Centre for International Studies, University of Toronto, May 3, 2002.
- 97 Schwanen (2002, pp. 44-46).
- 98 Schwanen (2002, pp. 44-46).
- 99 Johnson (2002).
- 100 See NAFTA Annex I for reservations for provincial measures grandfathering all measures in effect at the time NAFTA entered into force on January 1, 1994 and NAFTA Annex II for sectoral reservations, which includes social services (i.e. health).
- 101 Johnson (2002, p. 17).
- 102 Johnson (2002, p. 17).
- 103 Molot (2002).
- 104 *Pope & Talbot, Inc. and The Government of Canada*, NAFTA/UNCITRAL Tribunal, Second Decision on Confidentiality (11 March 2002) at para. 18 LAW.ORG [hereinafter *Pope & Talbot Second Decision on Confidentiality*].
- 105 From a legal perspective, it is arguable that NAFTA did not provide for the involvement of anyone beyond the parties to the dispute themselves. Under Article 1128, the NAFTA Parties have the right to make submissions in any dispute on questions of interpretation only. If the submission of *amicus* briefs were allowed, then the *amici* would have greater rights than the NAFTA Parties themselves.
- 106 *Methanex Amicus Decision, supra*, note 88 at para. 49.
- 107 *Methanex Amicus Submission, supra*, at para. 50.
- 108 *United Parcel Service of America Inc. and Government of Canada*, NAFTA/UNCITRAL Tribunal, Decision of the Tribunal on Petition for Intervention and Participation as Amici Curiae (17 October 2001) at para. 36 [hereinafter *UPS Award on Amici Curiae Petition*].
- 109 *UPS Award on Amici Curiae Petition, supra*, at para. 69.
- 110 *UPS Award on Amici Curiae Petition, supra*, at para. 68.
- 111 See Bjorklund (2002).
- 112 See Bjorklund (2002).
- 113 Parts of this section are based on Soloway and Broadhurst (2002).
- 114 Wilkie (2002, p. 25).
- 115 Jackson (1999, p. 122).
- 116 Jackson, (1999, p. 123).
- 117 Pettigrew (2001).
- 118 The Amendment provisions of NAFTA are set out in Article 2202. Any amendment would have to pass the formal treaty ratification process of all three parties.
- 119 Obtaining agreement for such an amendment from the US Congress may be particularly difficult, as the US Congress has consistently refused to grant enhanced negotiating authority (or so-called "fast-track" authority) to the executive branch. Although the House of Representatives has recently granted President George W. Bush "fast-track" authority, the Bush administration was forced to agree to a series of protectionist measures and negotiating positions. Similar restrictions are expected in the future if the legislation is to pass in the Senate. See Alden (2001).
- 120 Pettigrew (2001).
- 121 See Weiler (2002).
- 122 This section relies on Soloway (2002).
- 123 Price (2000).
- 124 Price (2000).
- 125 Ontario Ministry of Economic Development and Trade (2001).
- 126 Wortley (1959).
- 127 Hart and Dymond (2002, p. 157).

- 128 VanDuzer (2002).
- 129 IISD, "Notes on NAFTA Commission's July 31, 2001 Initiative to Clarify Chapter 11 Provisions."
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# NAFTA's Chapter 11: The Case for Reform

Chris Tollefson

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**I**n a provocative and timely piece, Julie Soloway contends that the furor that has come to surround NAFTA's most controversial provision is largely unjustified. In her view, the Chapter 11 jurisprudence to date supports the conclusion that the Chapter does nothing to undermine or constrain the right of NAFTA governments to enact measures to protect public health and the environment. She claims that in every case in which a NAFTA government has been held liable under the Chapter, tribunals have quite appropriately sought "to punish outrageous behaviour on the part of governmental officials." Nor, in her view, is there reason to believe that the Chapter has contributed to a regulatory chill that might stifle or fetter domestic policy development. It is thus premature, in her view, to be seriously contemplating ways to fix Chapter 11. So far, she asserts, the Chapter is working much as it was intended; reforming the Chapter, as the NAFTA governments presently seem to be inclined to do, would do more harm than good.

Three elements of Soloway's analysis deserve closer scrutiny: her contention that Chapter 11 has had no demonstrable chilling effect on regulatory activity; her contention that, in any event, regulators have no legitimate reason to be concerned about the impact of the Chapter on their activities; and, finally, her contention that the Chapter 11 jurisprudence is entirely consistent with the conclusion that the Chapter poses no real threat to legitimate, non-discriminatory environmental

protection measures. In my view, a careful look at the architecture of, and jurisprudence under, the Chapter suggests conclusions quite different from those that she has reached. In particular, I will argue that the discretion the Chapter reposes in tribunals is ill-defined and overbroad; a discretion that has already led in several cases to highly questionable interpretive results. To illustrate this phenomenon I will consider in some detail the tribunal decision in *Metalclad*. Finally, I will contend that as momentum for reforming the Chapter builds, Canada must redouble its efforts to ensure that investor rights do not unnecessarily compromise domestic policy autonomy, whether under the NAFTA or future trade and investment agreements.

## Perceptions of Chapter 11 and the Regulatory Chill Hypothesis

**S**oloway is right that the rhetoric of some of the Chapter's critics has at times been hyperbolic. To some extent, however, this rhetoric is explicable by the pervasive secrecy surrounding the process; a secrecy that is strikingly at odds with the way that many citizens have come to expect government, let alone judicial or quasi-judicial decision makers, should operate.<sup>1</sup> In this regard, it is encouraging that she supports reforms aimed at making the process more transparent and open to citizen participation.

Negative perceptions about the Chapter have also been fostered by the high level of uncertainty surrounding the legal meaning of the Chapter and its implications for domestic policy making and administration.<sup>2</sup> The discretion conferred on NAFTA tribunals to interpret the extraordinarily broad language of the Chapter is breathtaking both in its scope and the degree to which it is insu-



lated from appellate or judicial review. Unlike domestic courts, Chapter 11 tribunals are not bound by the doctrine of precedent. This means that, in effect, such tribunals not only apply but also regularly make law. Moreover, also unlike courts and other international dispute resolution bodies, they are not subject to appellate review for errors of law or fact. Finally, tribunals are not even bound by official interpretive statements offered by the NAFTA Free Trade Commission as to the meaning of the Chapter's provisions.<sup>3</sup>

Despite the clouds of uncertainty surrounding the Chapter and the evident incentives it provides to litigate the propriety of public policy decisions, Soloway insists that "it is hard to imagine" that the Chapter might inhibit regulators from enacting legitimate, non-discriminatory environmental laws or regulations. In support of this claim, she points out that since NAFTA came into force, the Government of Canada has passed several dozen new environmental laws and regulations, asserting that the environmental regulatory framework "continues to function" in all three of the NAFTA countries.

However, drawing conclusions about the Chapter's impact on, or irrelevance to, the appetite of governments to engage in policy innovation based on the volume, as opposed to the content, of regulatory measures is hazardous. Were one to systematically tackle the challenge of discerning the Chapter's impact on environmental regulation, one would need to look far beyond the regulatory docket of Environment Canada. Exploration of this question would necessitate a rather sweeping analysis of decision and policy making authority across a wide spectrum of agencies and departments vested with environment-related responsibilities in such areas as public health, resource management, consumer protection and land use planning. Such an analysis would, of course, need to examine not only federal institutions, but also provincial and local decision-makers whose actions can also trigger Chapter 11 liabilities.

Once the myriad of government bodies to be examined were identified, one would then be faced with the equally challenging prospect of establishing with any certitude why governments might forgo particular policy options. Given the tremendous difficulties involved in such an analysis, I would submit that simply because the reality of such a regulatory chill has yet to be definitively established does not mean that we should assume that it does not exist.

Soloway also dismisses the argument that governments' predilection to "deregulate" is also being adversely affected by the existence of Chapter 11. In this regard Schwanen contends the Chapter makes privatization and deregulatory initiatives less attractive for governments.<sup>4</sup> He argues that in contemplating such initiatives governments are mindful of the potentially costly compensation requirements that will be triggered should such an initiative subsequently falter and they are forced back onto the scene to pick up the pieces. Soloway's response to this concern is essentially a normative one: that we should not worry about this result because it is one that achieves fairness for firms whose investments may be adversely affected by such a policy change.

This rejoinder seems to concede Schwanen's key assertion: that when deregulating or privatizing, governments must factor into the equation the cost of policy reversals. It follows that such a costing may well tilt the balance against policy innovation. But the rejoinder also misses an even more salient point. Under Canadian law, property rights are not presumed to trump government's right to regulate in the public interest. This basic principle was reaffirmed in 1982 when Parliament decided not to enshrine property rights in the Constitution. This does not mean that governments routinely ignore the claims of investors or businesses for compensation. What it does mean is that governments reserve to themselves the right to determine the nature and amount of compen-

sation that should be provided, having regard to not only investor fairness but also broader public interest considerations. Chapter 11 takes this determination out of the hands of government, vesting it with tribunals that are under no obligation, and are poorly positioned, to take these public interest considerations into account.

## Should Regulators Be Worried? Reflections on the Chapter's Architecture and Jurisprudence

**W**hether a regulatory (or deregulatory) chill actually exists is one thing; whether regulators have legitimate cause for concern is another. Soloway is firmly of the view that they do not. She claims that the Chapter 11 jurisprudence suggests tribunals have carefully balanced the public and private rights that are invariably implicated in such cases and arrived at the right results. I will offer a less sanguine assessment of the jurisprudence shortly.

Before doing so, however, it is important to be mindful of a key architectural feature of Chapter 11, not mentioned by Soloway, that is highly relevant to the question at hand. Unlike the GATT, Chapter 11 does not contain a generally applicable provision that prescribes how competing public and private interests are to be balanced when they come into conflict in cases of this kind. Under the GATT, this balancing function is performed by Article XX (General Exceptions). This provision allows a state to justify a measure that would otherwise be inconsistent with its GATT obligations on the basis that it is “necessary to protect human, animal or plant life or health.” As such, Article XX provides the WTO with a vehicle to balance the goal of trade liberalization against domestically defined policy preferences in the realms of environment and health.<sup>5</sup>

There is no comparable balancing provision in Chapter 11. The closest analogue is Article 1114, which states: “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 ensure investment activity in its territory is undertaken in a manner sensitive to environmental concerns” [emphasis added]. The permissive nature of this language — in particular the caveat that such environmental measures must be “otherwise consistent with this Chapter” — has prompted many trade experts to discount Article 1114 as merely aspirational and of no legal consequence.<sup>6</sup> To date while several governments have invoked Article 1114 as a defence against Chapter 11 claims (most notably in the *Metalclad* case, as will be discussed later), for the most part tribunals have chosen not to directly respond to such arguments.

Some civil society critics contend that the absence of a GATT-like justification provision, combined with the permissive language of Article 1114, means that NAFTA governments cannot defend against an investor claim on the basis that its actions were motivated by bona fide health or environmental concerns. I do not share the view that the architecture of NAFTA compels this conclusion. Such an outcome would do serious violence to the preambular language in NAFTA and its environmental side agreement that affirm that environmental protection and economic development can and should be mutually supportive. Nonetheless, it is highly uncertain whether in any given case legitimate, non-discriminatory environmental or public health measures will survive a Chapter 11 challenge.

If one turns from Chapter 11's architecture to its jurisprudence, I would argue that NAFTA governments should be even more worried about the implications of the Chapter. Foremost among these is the extent to which the Chapter vests in tribunals the discretion to interpret its provisions

in anomalous and inappropriate ways, and to ignore relevant legal arguments and evidence without meaningful appellate scrutiny.

When Chapter 11 came into force it was generally believed that tribunals would interpret its provisions in a manner consistent with customary international law. To the surprise of many, recent rulings suggest that tribunals are interpreting its disciplines much more broadly. This phenomenon is illustrated by rulings in relation to Article 1105 (fair and equitable treatment) and Article 1110 (expropriation).

Within international law, the notion that a state owes a duty of fair and equitable treatment has to date generally been considered to provide foreign interests with a reasonable expectation that they will not suffer egregious abuses of state power. In *Metalclad*, however, the Tribunal said that Article 1105 went much further. In its view, the Article not only protected against egregious excesses but also imposed an affirmative “transparency” obligation on host states to relieve investors of all legal uncertainties that might adversely affect their investments. In reaching this extraordinary conclusion, the tribunal imported into Chapter 11 “transparency” obligations articulated in distinct provisions in Chapter 18 of the NAFTA (on publication, notification and administration of laws), without offering any authority that “transparency had become part of customary international law.”<sup>7</sup>

On judicial review, the tribunal’s decision to transplant transparency obligations that were neither part of international law nor found in Chapter 11 was definitively overturned.<sup>8</sup> According to the review court, the tribunal’s decision in this regard was not only legally wrong but so seriously wrong as to deprive the tribunal of jurisdiction. On the heels of this review, the NAFTA Parties — through the Free Trade Commission — sought to confirm the approach taken on review by issuing an interpretive statement aimed at precluding future tribunals from reading the Article as creat-

ing state obligations beyond those found in international customary law.<sup>9</sup> Despite this interpretive statement, however, in a subsequent decision a tribunal has sought to resurrect the approach to Article 1105 discredited by the review court in *Metalclad*, positing that it is not bound to “accept... whatever the Commission has stated to be an interpretation” if, in its wisdom, it deems the interpretation to amend the Chapter.<sup>10</sup>

Tribunals have exhibited a similar willingness to embark on interpretive adventures in relation to the Chapter’s expropriation provisions. Under customary international law and under the domestic law of the NAFTA Parties, it has generally been accepted that governments are entitled to take regulatory action that adversely affects the value of a property as long as they are acting in good faith. Thus, non-discriminatory local bylaws, taxation measures and environmental laws that reduce a property’s value are not normally considered to create a right to compensation unless such measures render the property entirely devoid of value.<sup>11</sup> The standard rationale for this result is that to do otherwise would make it impossible for governments to carry out their legitimate functions and derogate seriously from domestic sovereignty.<sup>12</sup>

In *Metalclad* and *Pope & Talbot*, however, tribunals took a radically different approach. According to these tribunals, the principle that governments are entitled to enact non-discriminatory regulation aimed at protecting the public interest without incurring an obligation to compensate affected property owners has no application to claims under Chapter 11. Indeed, in *Metalclad* the tribunal insisted, without offering jurisprudential authority, that an obligation to compensate under Article 1105 arises whenever an investor suffers “a covert or incidental interference with use of property which has the effect of depriving the owner in whole or in significant part, of the use or reasonably-to-be-expected economic benefit of property,”<sup>13</sup> regardless of whether

the measure complained of benefits the host state. As I have noted elsewhere, what is most striking about this formulation is that it purports not only to protect investors against measures in the nature of expropriation, but also against any measures that interfere with property rights, regardless of the stated or actual purpose of such measures. This interpretation of the scope of the Article has, not unexpectedly, generated significant controversy and is vulnerable to serious challenge in terms of its legal soundness and its ramifications for the fiscal capacity, political appetite and legal ability of governments to regulate in the public interest.<sup>14</sup>

The Court charged with reviewing the decision in *Metalclad* was clearly mindful of the radical implications of the tribunal's interpretation of the scope and nature of Article 1110. It observed that the tribunal's definition of expropriation was "exceedingly broad" and concluded that it would easily embrace "a legitimate rezoning of property by a municipality or other zoning authority."<sup>15</sup> Despite this, however, the Court concluded that it lacked jurisdiction to overrule the tribunal's purported definition as the legal correctness of this definition was a question of law and, as such, was immune from judicial review.

In these and other respects, the picture that emerges from the Chapter 11 jurisprudence should rightly cause the Parties to be concerned, quite apart from how that jurisprudence has been received in civil society. In discharging their function, tribunals seem remarkably ready to push the interpretive envelope, offering decisions that go well beyond established norms of customary international law. Moreover, in the one instance where such a decision has come under judicial scrutiny, the reviewing court adopted a largely deferential attitude on the basis that such decisions should not be reviewed for their correctness in law; a posture that is in keeping with established norms surrounding private international arbitration. Finally, to the extent that the parties seek to clar-

ify the applicable law through use of interpretive statements, there is reason to believe that their efforts may well be thwarted by the tribunals' power to characterize such clarifications as non-binding amendments to the Chapter.

Soloway seems to concede that the legal analysis offered by Chapter 11 tribunals has been at times shaky and that the jurisprudence on the whole is a "rather uneven patchwork."<sup>16</sup> However, she argues that if one takes "a realistic look" at the facts of the cases to date, the tribunals have, without exception, arrived at the correct result. Even as measured against this generous standard, I would argue that the jurisprudence to date does not pass muster. A careful analysis of the tribunal's decision in *Metalclad* strongly reinforces this impression.

## Are Tribunals Getting It Right? The Troubling Case of *Metalclad v. United Mexican States*

Soloway characterizes *Metalclad* as a case in which the American investor was subjected to "high-handed and capricious" treatment by local authorities that insisted it secure a municipal construction permit before opening a hazardous waste landfill site. She also contends that the investor's rights were violated by a "sham environmental measure" promulgated by the state government aimed at preventing the site from opening, "despite the fact that it had been built in accordance with all applicable legal requirements."<sup>17</sup> I will argue that the actual facts of the case are much more complex, interesting and, ultimately, troubling than Soloway has contended.

Soloway's depiction of the case appears to be based on the rather sparse set of facts recited in the tribunal's decision. Indeed, much of the academic

commentary on this and other Chapter 11 cases has been rather perfunctory and anecdotal.<sup>18</sup> If one takes a closer look at the evidence that was before the tribunal, particularly evidence submitted by the Government of Mexico but not addressed in the tribunal's decision, a strikingly different picture of the Metalclad story begins to emerge.<sup>19</sup>

The dispute in this case centred on a proposal to build a hazardous waste disposal landfill in La Pedrera, a remote community in the municipality of Guadalcazar, located in the state of San Luis Potosi. The municipality is sparsely populated, impoverished and largely desert-like.

At all material times, the operation in question was owned by a Mexican company known as COTERIN. The saga commences in 1990, when COTERIN received federal approval to operate a hazardous waste transfer station in Guadalcazar. Contrary to the terms of this permit, it soon became apparent that COTERIN was illegally storing untreated hazardous waste in barrels that were left outside and exposed to the elements. Subsequent investigations by federal authorities and the Mexican Commission on Human Rights revealed that over 20,000 tonnes of waste (some 55,000 barrels) were being stored in this manner, giving rise to serious concerns about groundwater contamination. Just 18 months after the facility opened, the federal government therefore ordered COTERIN to cease operations and formally sealed the station's entrance.

Over the next two years, COTERIN applied on two occasions to the municipality for permission to turn the transfer station into a hazardous waste landfill site. Local officials denied these applications, citing community opposition and the company's refusal to clean up the illegally stored waste.

In 1993, the owners of COTERIN were introduced to senior management of Metalclad by Humberto Rodarte Ramon (Rodarte), who was

then a senior advisor to the head of Mexico's federal environmental authority.<sup>20</sup> COTERIN and Metalclad subsequently negotiated a deal under which Metalclad obtained an option to purchase COTERIN once either local approval for the landfill had been received or a definitive judgment from the Mexican courts that such an approval was unnecessary had been secured. Upon completion of the deal, Rodarte stood to receive a commission from the vendor.<sup>21</sup> In September 1993, even though neither of these conditions had been met, Metalclad exercised its option to purchase COTERIN, supposedly on the faith of representations made by Mexican officials, including Rodarte, that local approvals were unnecessary.<sup>22</sup>

During 1994 and 1995, COTERIN proceeded with construction of the landfill facility, even though it had not secured a local construction permit. A protracted battle between the municipality and COTERIN ensued. In June and again in October of 1994, the local government issued stop-work orders, which were apparently ignored.<sup>23</sup> While COTERIN managed to secure various federal and state approvals for the project, the local government continued to refuse to give its approval to the project on the basis of environmental concerns and COTERIN's refusal to address existing pollution issues.

In March 1995, with construction now completed, Metalclad sought to "inaugurate" the site, even though it was still subject to the federal closure order issued in 1991.<sup>24</sup> It was at this juncture that the demonstration by locals referred to by Soloway took place. When this closure order was lifted in early 1996, the municipality secured an injunction preventing the facility from receiving further waste until the site was remediated.<sup>25</sup> Metalclad also went to court to challenge the municipality's right to reject its permit application. When this challenge was dismissed as having been filed in the wrong court, Metalclad commenced proceedings under Chapter 11.

While the arbitration of this claim was underway, the state governor issued an ecological decree (the “Decree”) that covered an area of almost 190,000 hectares, including the 814-hectare area on which the landfill was located (only 5 percent of which was to be utilized by landfill operations).<sup>26</sup> The Decree was based on scientific research that had been underway in the region dating back to the 1950s. This research suggested that the region possessed some of the highest concentrations of cactus species in the world, including several endemic and threatened species. The Decree explicitly preserved existing permits and allowed new businesses to be established as long as sustainability of the cacti, and compliance with all applicable laws and regulations, was ensured.

In holding that the course of events prior to the Decree constituted a violation of Metalclad’s rights under Chapter 11, the tribunal made two key legal findings: (1) that the federal government had assured Metalclad local approvals were unnecessary and (2) that under Mexican law, no such approvals were indeed necessary.

The only direct evidence from Mexican officials that Metalclad had been given such assurances were written statements by Rodarte who, by the time of the arbitration, had resigned from government and was working for a Metalclad subsidiary.<sup>27</sup> Rodarte’s version of events was vigorously disputed by oral testimony given by Mexican officials at the hearing. They contended that at no time had Metalclad been advised that local approvals were unnecessary.<sup>28</sup> When Mexican government lawyers sought to cross-examine Rodarte on his written statements, they were told he was under criminal investigation for corruption and had exercised his right not to give evidence.<sup>29</sup>

The tribunal also heard considerable evidence with respect to whether, under Mexican law, local governments had a constitutional right to refuse

to grant construction permits based on environmental considerations.<sup>30</sup> In support of its contention that local governments possessed this jurisdiction, the Mexican government filed two legal opinions: one by the Institute of Legal Research of the Autonomous University of Mexico, and a second prepared by two former justices of the Mexican Supreme Court and a senior Mexican legal scholar. The lead author of the report relied on by Metalclad was a University of Arizona law school graduate enrolled in a Master of Laws program at a Mexican university. The tribunal also heard evidence that Metalclad had been informed in 1993 by its own Mexican lawyers that a municipal permit “may be needed for construction.”<sup>31</sup>

The tribunal’s ruling with respect to the Decree also raises troubling questions about the manner in which it discharged its adjudicative and fact-finding functions. In determining that the Decree constituted an unlawful expropriation, the tribunal concluded that the Decree “had the effect of barring forever the operation of the landfill.” This conclusion flies directly in the face of the express language of the Decree, which preserved existing permits and authorizations and allowed for the establishment of new businesses as long as such enterprises did not compromise protection of the cactus species. Moreover, in its reasons the tribunal completely ignored the Mexican government’s attempt to justify the Decree by relying on Article 1114 which, as described earlier, purports to protect the right of host states to adopt any measure that it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental concerns.

## Conclusion

**B**ased on the *Metalclad* decision, the NAFTA architecture and the virtually unfettered and unreviewable discretion Chapter 11 vests in tribunals, I must respectfully disagree with Soloway's suggestion that it is "hard to imagine" that Canadian regulators "might be inhibited from proposing bona fide environmental regulation" based on concerns about the Chapter's implications. On the contrary, it seems difficult to imagine that they would not.

Some might argue that we should write off decisions such as *Metalclad* as unfortunate train wrecks on the rails to a more integrated, sustainable and prosperous North America. However, whether ill-defined and open-ended investor protections move us towards this goal remains very much an empirically questionable premise.<sup>32</sup> In the face of this uncertainty, we must also be very mindful of the democratic price of erecting and maintaining such sweeping protections. In the case of an unreformed Chapter 11 this price includes vesting in essentially unaccountable tribunals the authority to constitute themselves as courts of appeal with powers to adjudicate key domestic legal issues. This is precisely what occurred in *Metalclad* when the tribunal decided, as a matter of domestic Mexican law, that municipal governments have no right to insist that foreign investors address local environmental and public health concerns, even though this conclusion was strenuously disputed by the Mexican government.

Soloway argues that despite widespread calls to clarify Chapter 11 and rein in the broad discretion it vests in tribunals, the Canadian government should sit back and wait for a "solid case for reform" to be made. I would argue that the case for reform is already compelling and growing stronger. With the Free Trade Area of the Ameri-

cas negotiations underway and various new bilateral trade and investment treaties in the works, Canada has a significant stake in developing proposals aimed at ensuring that rules aimed at promoting trade and investment flows do not unnecessarily compromise domestic policy autonomy.

A highly relevant and useful contribution to this debate has recently been offered by Professor Michael Trebilcock.<sup>33</sup> Trebilcock argues for what he characterizes as a "relatively conservative view of the case for the harmonization or convergence of domestic regulatory policies"; an analysis that suggests we should view with considerable caution trade-related disciplines that go beyond the traditionally recognized duty not to discriminate (as reflected in the national-treatment and most-favoured-nation-treatment concepts).<sup>34</sup> To do otherwise, he contends, creates the potential that trade rules will undermine "regulatory diversity," a concept that in his view is synonymous with providing broad protection for "domestic political sovereignty, distinctive policy preferences, and competitive and accountable governments."<sup>35</sup> He proceeds to argue that Chapter 11 imperils regulatory diversity by conferring on foreign investors far more than the right to complain about discriminatory state action. Indeed, as he points out, Article 1110 stands the national-treatment discipline "on its head" by requiring host countries to treat foreign investors "more favourably than they are required to treat domestic producers whose investments may also be impaired by a change in regulatory policy."<sup>36</sup>

The imperative of focusing on options to reform Chapter 11 is also strongly suggested by recent developments south of our border. An American trade journal has recently reported that the Bush administration is developing new standards for future trade and investment agreements that elaborate, based on principles drawn from US domestic law, in what circumstances foreign investors should be compensated for government regula-

tory action.<sup>37</sup> According to *Inside U.S. Trade*, these proposed expropriation standards are designed to achieve consistency with the objectives of the recently enacted federal trade promotion legislation, in particular its stipulation that foreign investor protections not exceed the rights of domestic investors under the US Constitution.<sup>38</sup> The Bush administration is reportedly investigating options for incorporating these new principles into the NAFTA.

Given the apparent momentum of the current American push to clarify Chapter 11 and the firmness of its commitment not to replicate it in future agreements, Canada can hardly sit on the sidelines of the growing debate about reforming the Chapter and, more broadly, rethinking the whole issue of investor rights. Equally, it would be shortsighted and inconsistent for Canada now to take the position that the provision “doesn’t need fixing.” In fact, for some time now, our trade minister has in effect been saying the opposite. Almost two years ago, long before the current American reform initiatives, Minister Pettigrew stated that Canada would not sign any new free trade deal — including the FTAA — that contains investor protections modelled on the language of Chapter 11.<sup>39</sup> Now is not the time for Canada to abandon either the cause of fixing Chapter 11 or the critical goal of achieving a better balance between investor rights and the domestic policy preferences.



## Notes

The author wishes to acknowledge Nathaniel Amann-Blake, Andrew Newcombe, Cathie Parker and Jamie Woods for their helpful comments on earlier versions of this article.

- 1 Throughout the entire Chapter 11 claim process, up to and including the arbitral award itself, the only mandatory public notification or disclosure occurs when the claimant is required to notify the NAFTA Commission Secretariat of its desire to convene an arbitral panel. Upon receipt of this notice, the Secretariat must publish it on a public registry. See C. Tollefson (2002a, p. 27).
- 2 An excellent primer on these issues is Mann (2001).
- 3 Pope & Talbot, Inc. and the Government of Canada, NAFTA/UNCITRAL Tribunal, Award on Damages (2002).
- 4 Schwanen (2002, p. 46).
- 5 For an extended discussion of Article 1114, see Tollefson (2002a, pp. 152-153). For a discussion of GATT's Article XX see Hoberg (2001) and Charnovitz (2002, pp. 92-101).
- 6 For example, Appleton (1994, p. 195) and Johnson (1998, p. 225).
- 7 *United Mexican States v. Metalclad*, at para. 68.
- 8 *United Mexican States v. Metalclad* 2001 BCSC 664, at para. 68.
- 9 Tollefson (2002b, p. 186).
- 10 See Soloway, p. 10, in the current issue of *Choices*.
- 11 Tollefson (2002a, pp. 159-160).
- 12 Johnson (1998, p. 224); Sornarajah (1994, pp. 299-300).
- 13 *Metalclad Corporation v. The United Mexican States*, at para. 103.
- 14 Tollefson (2002b, p. 215).
- 15 *Supra* note 7 at para. 99.
- 16 See Soloway, p. 20, in the current issue of *Choices*.
- 17 See Soloway, p. 18, in the current issue of *Choices*.
- 18 See Sanford E. Gaines (2002) and David Gantz (2001).
- 19 What follows is an attempt to offer a fuller account of the facts and evidence that were before the tribunal based on my review of briefs of argument submitted by the Petitioner (the United Mexican States) and the Respondent (Metalclad) in connection with the judicial review of the award heard by Mr. Justice Tysoe of the B.C. Supreme Court. Additional background on the case can be found in in Dhooge (2001).
- 20 Petitioner's Outline of Argument filed in Matter of *United Mexican States v Metalclad et al.* (B.C. Supreme Court: No. LOO2904) at para. 443.
- 21 Petitioner's Outline of Argument at para. 443; Respondent's Outline of Argument at para. 447.
- 22 Petitioner's Outline of Argument at paras 457-458.
- 23 Petitioner's Outline of Argument at paras 361-364.
- 24 Petitioner's Outline of Argument at para. 375.
- 25 Petitioner's Outline of Argument at paras 375 and 396.
- 26 Petitioner's Outline of Argument at para. 434.
- 27 Petitioner's Outline of Argument at para. 357 and paras 439.
- 28 Petitioner's Outline of Argument at paras 353-357.
- 29 Petitioner's Outline of Argument at para. 449. Subsequent to the arbitration, while the case was under judicial review, Mexican lawyers led evidence that Rodarte's wife (Ratner) owned shares in a Mexican subsidiary of Metalclad two years before the latter purchased COTERIN. In 1993, Metalclad allowed her to exchange these shares for shares in Metalclad that were valued US\$150,000, under an agreement that provided for further payments upon Metalclad receiving additional federal government approvals for its landfill operation. At the time, Rodarte was a special advisor to the president of the federal environmental permitting authority in Mexico City. See Petitioner's Outline of Argument at para. 442. The Respondent does not dispute that the stock swap took place, but contends that at the time it was unaware that Ratner and Rodarte were married to one another: see Respondent's Outline of Argument at paras. 445-446.
- 30 Petitioner's Outline of Argument at para. 423; Respondent's Outline of Argument at paras. 399-402.
- 31 Petitioner's Outline of Argument at para. 342; Respondent's Outline of Argument at para. 293.
- 32 For references to the literature on the welfare effects of harmonization see Trebilcock (2002, note 4).
- 33 Trebilcock (2002, note 4).
- 34 Trebilcock (2002, notes 1, 2).
- 35 Trebilcock (2002, note 12).
- 36 Trebilcock (2002, note 9).
- 37 See "Administration Proposes Higher Thresholds for Investor Suits" (2002).
- 38 "Administration Proposes Higher Thresholds for Investor Suits" (2002). The *Bipartisan Trade Promotion Authority Act of 2002*, under which the President gained fast track authority, provides *inter alia* that new trade agreements shall "ensur[e] that foreign investors in the United States are not accorded greater substantive rights with respect to investment protections than United States investors in the United States." See also <http://finance.senate.gov/hearings/statements/121201mb.pdf>
- 39 Corcoran (2001, pp. C14-C15). See also McKinnon (2000, pp. B1, B7).

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# Résumé

## NAFTA's Chapter 11: Investor Protection, Integration and the Public Interest

Julie Soloway, suivi d'un commentaire de Chris Tollefson

Les mesures de protection des investisseurs prévues au chapitre 11 de l'ALÉNA continuent de faire l'objet de vifs débats. Le Chapitre vise à créer un environnement sûr et prévisible, propice à la libre circulation des investissements en Amérique du Nord, ce qui, en retour, permet de réaliser des gains économiques substantiels. Les critiques prétendent toutefois que le chapitre 11 comporte de graves lacunes. L'une des lacunes les plus souvent évoquées est que le Chapitre favorise les intérêts des sociétés aux dépens des enjeux publics plus importants et qu'il mine la capacité des gouvernements d'adopter des mesures légitimes pour protéger l'environnement et la santé publique. Dernièrement, les parties à l'ALÉNA ont publié une déclaration pour préciser le sens d'une disposition clé du Chapitre et elles étudient la possibilité d'apporter d'autres précisions ainsi que certaines réformes.

Il est donc pertinent à ce moment d'évaluer le bien-fondé des différentes allégations formulées contre le chapitre 11 et d'examiner les réactions stratégiques appropriées. Dans ce numéro, nous donnons la parole à deux des principaux commentateurs du chapitre 11 au Canada, Mme Julie Soloway et M. Chris Tollefson. Nous leur avons demandé de s'exprimer sur les critiques du Chapitre et de faire part de leurs réflexions sur la possibilité de clarifications ou de réformes.

Mme Soloway soutient que l'allégation voulant que le chapitre 11 ait miné la réglementation environnementale est grandement exagérée. Elle est d'avis que la jurisprudence aux termes du Chapitre ne reflète pas du tout les pires scénarios prévus par certains critiques du Chapitre. Elle affirme que le Chapitre n'a sapé aucun règlement environnemental légitime en vigueur, pas plus qu'il n'est susceptible de refroidir le désir des législateurs de réglementer dans l'intérêt public. Mme Soloway estime que les tribunaux ont rendu des décisions favorables aux investisseurs étrangers seulement dans les cas les plus flagrants de conduite injuste ou discriminatoire de la part d'un gouvernement.

Bien que Mme Soloway convienne de l'existence d'une certaine incohérence dans l'interprétation des dispositions légales de l'ALÉNA, comme celles concernant la norme minimale de traitement (article 1105) et l'expropriation (article 1110), elle soutient que les tribunaux ont appliqué le Chapitre de façon prudente et responsable, dans l'esprit des objectifs pour lesquels il a été créé. En fait, la cause *Metalclad* est le seul cas dans lequel un tribunal a rendu une décision confirmant l'expropriation aux termes du Chapitre.

Mme Soloway fait toutefois remarquer que le régime actuel du Chapitre est peut-être « mûr pour une réforme » sur le plan de la procédure. Soulignant l'écart croissant entre le processus prévu au chapitre 11 et la transparence accrue des processus

de règlement des différends prévus dans d'autres accords commerciaux, elle laisse entendre que l'adoption d'un ensemble cohérent de règles pour régir la présentation de mémoires d'*amicus* pourrait renforcer la perception de légitimité du processus prévu au chapitre 11, en contribuant à une plus grande reconnaissance des différents enjeux publics dans ces instances. Elle précise toutefois qu'il faudrait veiller à ce que ces règles garantissent que la présentation de tels mémoires facilitent le processus plutôt que de le freiner en le rendant inutilement lourd pour les parties à un litige. Elle suggère de se pencher sur la possibilité de créer un organe d'appel permanent pour assurer une application plus cohérente des règles et se prémunir contre les décisions discutables de la part des tribunaux. En revanche, elle s'oppose à une plus grande clarification des dispositions de fond de l'ALÉNA pour le moment en faisant remarquer qu'une telle entreprise est loin d'être simple, car il serait difficile d'éliminer toute incertitude sans miner gravement la protection des investisseurs.

Compte tenu des négociations en cours de la Zone de libre-échange des Amériques et des autres accords à l'étude sur le commerce et les investissements, M. Tollefson soutient, pour sa part, que le Canada doit intervenir fermement, tant dans le cadre de l'ALÉNA que dans d'autres instances, pour s'assurer que les droits des investisseurs ne compromettent pas de façon injustifiée le droit des gouvernements de réglementer dans l'intérêt public.

À l'instar de Mme Soloway, il soutient que la mise en œuvre de réformes de la procédure pour accroître la transparence du régime du chapitre 11 et faciliter la participation des citoyens s'impose. En revanche, il affirme, contrairement à Mme Soloway, que les craintes que le régime pourrait empêcher les législateurs de promulguer des règlements légitimes et non discriminatoires pour protéger l'environnement ou la santé publique ne sont pas injustifiées. Il est d'avis que l'absence d'une disposition, analogue à l'article XX de l'Accord général sur les tarifs douaniers et le commerce, qui permettrait de façon explicite aux gouvernements parties à l'ALÉNA de justifier ces règlements lorsqu'ils sont contestés par des investisseurs est une grave lacune du Chapitre.

M. Tollefson soutient par ailleurs que le pouvoir discrétionnaire que le Chapitre confère aux tribunaux est vague et trop général et qu'il mène parfois à des interprétations légales boiteuses et inappropriées en plus de permettre aux tribunaux de faire fi de témoignages et d'arguments légaux pertinents en l'absence de toute supervision ou responsabilité judiciaire véritable. Il conclut en offrant une analyse détaillée de la décision controversée rendue dans la cause *Metalclad* qui, à son avis, illustre de façon non équivoque la nécessité d'apporter des précisions au chapitre 11 tant sur le plan de la procédure que du fond.

# Summary

## NAFTA's Chapter 11: Investor Protection, Integration and the Public Interest Julie Soloway, with comments by Chris Tollefson

The investor protections in NAFTA Chapter 11 continue to be the focus of intense public debate. The purpose of the Chapter is to create a secure and predictable framework for the unencumbered flow of investment within North America, which, in turn, allows for substantial economic gains. However, critics argue that the Chapter is seriously flawed. Prominent among the critiques is that it favours corporate interests over broader public concerns and that it undermines the ability of governments to adopt legitimate measures aimed at protecting the environment and public health. Recently, the NAFTA Parties have issued a statement clarifying the meaning of a key provision in the Chapter, and they are currently considering additional clarifications and possible reforms.

It is thus timely to evaluate the veracity of the diverse claims against Chapter 11 and consider the appropriate policy responses. In this issue, we feature two of Canada's leading commentators on the Chapter. They have been asked to reflect on the criticisms of the Chapter that have been made, and offer their thoughts on implications for clarification or reform.

Julie Soloway argues that, for the most part, the claim that Chapter 11 has undermined environmental regulation has been overstated. In her view, the jurisprudence under the Chapter does not reflect the "worst-case" scenarios articulated by some of the Chapter's critics. She contends that the Chapter has not undermined any existing legitimate environmental regulation; nor is the Chapter likely to chill the appetite of legislators to regulate in the public interest. In her view, tribunals have only ruled in favour of a foreign investor where there has been egregious conduct on the part of a government that was clearly unfair or discriminatory.

While Soloway concedes that there has been some unevenness in the interpretation of NAFTA's legal provisions, such as the minimum standard of treatment (Article 1105) and the expropriation provisions (Article 1110), she asserts that tribunals have applied the Chapter in a careful and responsible fashion consistent with the purposes for which it was created. Indeed, *Metalclad* is the only case where a tribunal has made a finding of an expropriation under the Chapter.

Soloway notes, however, that procedurally the current Chapter regime may be "ripe for reform." Noting the growing gap between the Chapter 11 process and the increased transparency of the dis-

pute resolution processes in other trade agreements, she suggests that a consistent set of rules governing the submission of *amicus* briefs could bolster the perceived legitimacy of the Chapter 11 process, contributing to a fuller recognition of the various public interests that are at stake in these proceedings. However, she cautions that such rules should ensure that these submissions support rather than hinder the process by making it unduly burdensome for litigants. She suggests that consideration should be given to the possibility of a permanent appellate body that would lend greater consistency in the application of the rules and safeguard against rogue decisions on the part of tribunals. However, she argues against further clarification of the substantive legal provisions of NAFTA at this point in time, observing that such an endeavour would not be simple or straightforward, as it is difficult to eliminate all uncertainty without seriously undermining investor protection.

Chris Tollefson contends that with Free Trade Area of the Americas negotiations underway and with other trade and investment treaties in the works, Canada should be strongly advocating — both within the NAFTA and beyond — to ensure that investor rights do not unjustifiably compromise the right of governments to regulate in the public interest.

Like Soloway, he contends that procedural reforms aimed at enhancing the transparency of the Chapter 11 regime and facilitating citizen participation are necessary. Unlike Soloway, however, he argues that concerns that the regime might inhibit legislators from enacting legitimate, non-discriminatory regulation to protect the environment or public health are not unwarranted. A key defect of the Chapter, in his view, is the absence of a provision, akin to Article XX of the GATT, which would explicitly allow NAFTA governments to justify such regulations when they are challenged by investors.

Tollefson also argues that the discretion the Chapter vests in tribunals is ill-defined and overbroad, leading in some cases to anomalous and inappropriate legal interpretations and allowing tribunals to ignore relevant legal arguments and evidence without meaningful judicial oversight or accountability. He concludes by offering a detailed analysis of the controversial tribunal decision in *Metalclad* which, in his view, provides a compelling illustration of the need to clarify the Chapter both in procedural and substantive terms.