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PRIVATE INVESTMENT CLAIMS AGAINST STATE AND PROVINCES - THE IMPACT OF NAFTA CHAPTER 11 ON SUB- FEDERAL GOVERNMENT AGENCIES

James McIlroy

Thank you very much for that introduction.

I am here this morning to present a Canadian perspective on “private investment claims against states and provinces- the impact of the North American Free Trade Agreement (NAFTA) Chapter 11 on sub-federal government agencies.” We are asking a very provocative question this morning. That question is: "Chapter 11, a significant curbing of environmental regulatory powers or a mere correction of highly discriminatory or expropriatory behavior?" I think that question captures the controversial nature of Chapter 11.

First, I would like to start you off with the big picture, before we get into any technical details. In particular I want to look at why Chapter 11 has become so controversial. As you know, there are ten thousand people in the streets in Quebec City this weekend and one of the things they are protesting is Chapter 11.

The second thing I would like to do is to look at what is actually in Chapter 11 of the NAFTA and to try to determine whether this controversy and these protests are justified.

The third thing I want to do is discuss the future of Chapter 11 of the NAFTA, and, in particular, I want to look at whether it will be extended beyond the trilateral NAFTA between Canada, the U.S. and Mexico into the proposed regional Free Trade Area of the Americas, which, as you know, will involve three dozen countries in the western hemisphere- and perhaps beyond, into the World Trade Organization (WTO) which, as you know, has about one hundred forty members.

You may recall that the Organization for Economic Co-Operation and Development (OECD) proposal for a Multilateral Agreement on Investment (MAI) recently floundered. One of the reasons it failed to materialize was because of the controversy created by the MAI's proposed investor-state dispute provisions, which were similar to the provisions found in NAFTA.

So with this road map in mind, let us look at my first point, which is to give you the big picture of NAFTA Chapter 11.

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In a nutshell, Chapter 11 deals with the settlement of disputes between a NAFTA party and an investor of another NAFTA party. What do we have here?

First of all, we have a dispute; there is a disagreement. Second, there are parties to this dispute. Third, there are rights and obligations that are in dispute. And the fourth thing we have is a decision-making body and a process that settles and decides the dispute.

Let me start off with the parties. Remember I mentioned that in your materials we have a recent Chapter 11 arbitration decision, Pope and Talbot, Inc. versus the Government of Canada. So what we have here is a publicly traded, American corporation, incorporated under the laws of the State of Delaware in the U.S. It is called Pope and Talbot, Inc., and it has a wholly owned Canadian corporation incorporated under the laws of British Columbia, Pope and Talbot, Limited, which qualifies as an investment under the NAFTA. In other words, the claimant is an American investor, a private entity, launching a claim against a public entity, the federal government of Canada.

Now, this is one of the reasons many of the ten thousand protestors in the streets of Quebec City find Chapter 11 distasteful. They ask: how can a profit-seeking, foreign multinational corporation have the right to sue a duly elected government that is there to protect and promote the public interest? That is a good question, because in the past, under customary international law, if a foreign investor wanted to pursue the government in a country in which it had invested, the foreign investor's government usually was the party to the dispute.

For example, even today in the WTO, disputes are between governments. It is not investor/state it is state/state. If the Dole banana company has a problem with the European Union, then the Government of the U.S. pursues that WTO dispute against their European counterpart.

What NAFTA Chapter 11 does is it eliminates the need for a state to intercede on behalf of its national. In the past private parties could not launch an action against sovereign foreign states, because private parties did not have the required standing.

One of the key steps away from this state-to-state dispute resolution towards investor/state disputes was the establishment of the International Center for the Settlement of Investment Disputes (ICSID) in 1965. The problem with ICSID was that not all countries, including Canada, agreed to be bound by the ICSID because they refused to sign the Convention on the Settlement of Investment Disputes between States and Nationals of other States.

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In addition to the 1965 ICSID, countries like the U.S. pursued bilateral investment treaties (BITs), under which American companies could pursue disputes with foreign governments to panels under the rules of ICSID or the arbitration rules of the United Nations Commission on International Trade Law (UNCITRAL). Canada also included provisions for settling disputes between an investor and the host contracting party in the bilateral investment treaties that we signed with governments of other countries. We call these agreements Foreign Investment Protection Agreements (FIPA). Just so you know, there are more than a thousand bilateral investment treaties around the world and most have investor/state dispute resolution provisions.

The point I am trying to make is the NAFTA's Chapter 11 did not invent investor/state dispute resolution; it has been around for a long time. However, one of the reasons that NAFTA's Chapter 11 is so controversial is that it is seen as a first step to go beyond one-on-one treaties between one country and another country, and to multilateralize investor/state provisions in blanket treaties.

As I mentioned earlier, when early attempts were made to extend Chapter 11 beyond the trilateral NAFTA to the MAI, which was negotiated under the auspices of the Organization for Economic Cooperation and Development, OCED, the MAI hit a brick wall and never came into force. One of the reasons it hit the brick wall was the controversy surrounding investor/state dispute provisions.

My point is, NAFTA's Chapter 11 is controversial because it is seen as extending the rights of private, multinational, profit-seeking corporations to attack duly elected governments that are there to promote and protect the public interest.

It is no secret that many of the folks at the Free Trade Area of the Americas (FTAA) demonstrations in Quebec City think that multinational corporations are bad and that governments are good, so I think you understand where they are coming from.

Myself, having grown up in the 1960s with the Vietnam War and all of that, I remember, I did not think that governments were the good guys, but I guess the times have changed.

The bottom line is that Chapter 11 is controversial because it is seen as a clash of good versus bad. On the one hand the national interest, on the other hand, multinational corporations; on the one hand national sovereignty versus foreign-owned enterprises; and on the one hand the public interests, and on the other hand private capital, private property.

Let me conclude our discussion of the big picture by spending a few moments discussing the Canadian perspective on private property.
I want to make sure you understand this: I think anyone who wishes to understand the Canada/U.S. relationship must appreciate that Canada and the U.S. do not view private property the same way.

Let us look at the fundamentals: The U.S. Constitution protects private property rights and there is a considerable body of U.S. jurisprudence that addresses the question of when a government regulation amounts to a taking of private property that triggers rights and obligations regarding compensation.

In Canada things are different. Under Canada's Charter of Rights and Freedoms, that only came into force about twenty years ago, Canada deliberately excluded property rights. So the constitutional protection of property found in the U.S. is not reflected in Canada's laws or political culture. Under Canadian law a legislator may enact a statute that expropriates private property without compensation as long as its does so with clear language.

Most provincial statutes provide for compensation when real property, land, is expropriated, but they do not have to. In the Pearson airport terminal case, the Government of Canada cancelled a private investment and then tried to limit a court's ability to provide compensation. So much for the separation of the executive powers, legislative powers and judicial powers in Canada.

The bottom line is that Chapter 11 is especially controversial in Canada because it provides U.S. and Mexican investors with more property rights in Canada than Canadians have.

It is reverse discrimination, where foreigners have more rights than nationals. I recall when I was before the Senate and I told the Senate I found it ironic that an elected body in Canada would provide better rights to foreigners than to nationals, an elderly Senator replied to me, "Well, we are trying to attract foreign investment, are we not?"

Let us not forget that a country's concept of private property and the role of the individual and state, are highly controversial international issues. After all, we spent several decades during the cold war clashing over these key issues.

The fact that Canada and the U.S. have different views regarding private property rights and the role of the state lies at the heart of several emotional disputes between our countries.

Let us look at three recent examples quickly: With respect to resources, we had the Natural Energy Program (NEP) in the 1980s, which U.S. petroleum corporations in Washington, and, for that matter, Alberta, saw as expropriation.

Second, let us look at investment. Many U.S. companies view the Foreign Investment Review Agency (FIRA) and Canada's current investment
controls as restrictions on their ability to manage their investments and do business in Canada.

Third, let us take another form of property: Intellectual property. Until recently Canada maintained pharmaceutical patent compulsory licensing provisions, which the U.S. repeatedly attacked. More recently two WTO decisions found that Canada had violated its intellectual property obligations under the Trade-Related Aspects of Intellectual Property Rights (TRIPS) agreement.

Now that we have a feel for the big picture of Chapter 11, I would like to spend a few moments discussing whether all of this controversy is justified or whether it is much ado about nothing.

Let us take at what is actually in NAFTA Chapter 11, and briefly discuss some of the arbitration decisions.

I do not intend to walk you through all thirty-nine of Chapter 11's articles, but I would like to draw your attention to the scope of Chapter 11 and also briefly discuss its expropriation provisions.

Article 1101 starts off by saying, "This chapter applies to measures adopted or maintained by a party relating to investors of another party." 2

There are four key points here: First, Chapter 11 applies to measures. The key term "measures" is defined in another article of the NAFTA, to include any law, regulation, procedure, requirement or practice. 3 So Chapter 11's scope is broad and it is targeted at the means by which governments affect our behavior- laws and regulations.

Second, Article 1101 says Chapter 11 applies to measures adopted or maintained, which is code language that means, first, measures to be adopted in the future are covered and, second, measures that are already in place, that are maintained, are also covered. 4 In other words Chapter 11 applies retroactively to measures already in place, as well as prospectively to measures to be adopted. There is no grandfathering.

Third, Article 1101 applies to the measures of a party. 5 The term "party" prompts a couple of questions, particularly in light of the theme of this conference. Does party just mean the three national governments that signed the NAFTA or does it include sub-national entities like Canadian provinces and

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3 Id. at art. 201.

4 Id. at art. 1101.

5 Id.
American and Mexican states. If it does include sub-national entities, who pays compensation if states or provinces violate Chapter 11, the national government or the states and provinces? When we discuss the Metalclad decision in a moment, we will see that Chapter 11 covers the provinces and the states and national governments are responsible for paying compensation.  

The fourth key point is with respect to the term "investors of another party." Article 1139 of Chapter 11 defines the term investor state party as: "Investor of a party means a party or state enterprise thereof or a national or an enterprise of such party that seeks to make, is making or has made an investment."  

So what is an investment? The definition of this term is broad. For example, Paragraph E states, "An interest in an enterprise that entitles the owner to share in income or profits of the enterprise."  

So let us be clear, we are not just talking about expropriating beachfront property here, this is a very broad term. This is not just real property, which most people think of when they think of the term expropriation.  

Now that we understand the basic scope of Chapter 11, which, of course, is subject to several exceptions and refinements, let us look at the provision that has created so much angst for the anti-globalization movement, and that is Article 1110. This is the provision that upsets so many people. It says, "No party may directly or indirectly nationalize or expropriate an investment of an investor of another party in its territory or take a measure tantamount to nationalization or expropriation of such an investment except: A, for a public purpose; B, on an nondiscriminatory basis; C, in accordance with due process of law and Article 1105 (1); and D, on payment of compensation in accordance with Paragraphs 2 through 6." In other words, under Article 1110 there is no outright ban on expropriation; instead, if a party expropri-
ates, it must comply with all four conditions, including the payment of compensation.

The reason Article 1110 is so controversial is that no one is certain about exactly what the term "expropriation" means. You will notice this term is not defined in Article 1139, unlike the word "investment" which has a lengthy definition.

A recent case shed some light on the term expropriation. That is the interim Pope & Talbot award.

Before I briefly discuss some cases, keep in mind that Article 1136 of the NAFTA states, "An award made by a tribunal shall have no binding force except between the disputing parties and in respect to the particular case." In other words, this is not binding jurisprudence, but it is better than nothing.

The Pope and Talbot interim award rejected an American investor's claim that Canada's softwood lumber Export Control Regime violated NAFTA's Article

1110. This award is very noteworthy for a couple of reasons: First, the arbitrators held that the scope of Article 1110 had not been expanded by the words tantamount to nationalization or expropriation. The arbitrators held, "Tantamount means nothing more than equivalent. Something that is equivalent to something else cannot logically encompass more." Second, the Pope and Talbot award grappled with the distinction between a valid regulation and a taking. That is where all the concern is in the streets in Quebec City.

Canada attempted to argue that, since its Export Control Regime was a set of nondiscriminatory regulations that applied equally to everyone in Canada, they were not covered by Article 1110. But the tribunal rejected Canada's argument and held, that, "Indeed much creeping expropriation could be conducted by regulation, and a blanket exception for regulatory measures would create a gaping loophole in international protections against expropriation." The decision further states, and this is the core of the issue, that, "This is not to say that every regulatory restraint can be likened to expropriation. The restatement recognizes the distinction between taking and regulation is not always clear, but may rest on the degree of interference with the property interest ... A state is responsible for expropriation of alien property

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11 See NAFTA, supra note 2, at art. 1136.
13 Id.
14 Id. at para. 104.
15 Id. at para. 99.
without just compensation even if property of nationals is treated similarly.\textsuperscript{16}

As I noted earlier, Chapter 11 creates additional obligations that go beyond the way Canada must treat Canadian investors under our domestic law. As a result of Chapter 11, Canada must treat American and Mexican investors better than we treat Canadian investors.

The third thing Pope and Talbot did was decide that Article 1110 is not violated unless there is a substantial deprivation.\textsuperscript{17} Even if the tribunal accepted the investor's allegations regarding diminished profits, the tribunal held that Canada's Export Control Regime was not a substantial deprivation. As a result, the tribunal rejected the U.S. investor's claims under Article 1110 and did not award the three hundred eighty-two million U.S. dollars damages claim.

Does this decision demonstrate that Chapter 11 allows private investor rights to trump the public interest? I do not think so. I think the controversy over Chapter 11 is, at best, premature and, at worst, blown far out of proportion.

Let us look at the facts. How many Chapter 11 cases have there actually been since NAFTA came into force a little over six years ago?

Even counting several cases that never really went anywhere and could be characterized as nuisance cases, the number of Chapter 11 cases filed in Canada, Mexico and the U.S. since 1995 is less than twenty. Hardly an avalanche, but the cases are sexy.

Take the Metalclad decision for example. Metalclad is an American corporation that successfully argued that Mexico, through its sub-national governments, had interfered with Metalclad's development and operation of a hazardous waste landfill. The tribunal awarded Metalclad sixteen point seven million U.S. dollars and Mexico has appealed this award in Vancouver, British Columbia.\textsuperscript{18}

Here is another case with an environmental measure at stake: S.D. Myers, an Ohio-based hazardous waste disposal company, claimed twenty million U.S. dollars in compensation from the Government of Canada due to a sixteen-month temporary ban on the export of polychlorinated biphenyls (PCBs) from Canada. What did the tribunal find? They found Canada had violated Chapter 11's national treatment and minimum standard of treatment obligations. However, they did not find a violation of Article 1110's expropriation

\textsuperscript{16} \textit{Id.} n. 73.

\textsuperscript{17} \textit{Id.}

\textsuperscript{18} \textit{See Metalclad, supra} note 6.
provisions. The tribunal has not made a finding of damages in the S.D. Myers decision yet, but Canada has asked the Federal Court of Canada to set aside the decision.

In light of these decisions, I am not prepared to conclude that Chapter 11 is the calamity that some say that it is.

I want to conclude by discussing whether Chapter 11 was a flash in the NAFTA pan or whether it will be replicated in other treaties like the WTO or the FTAA. The quick answer is: Over Canada's dead body. Canada's Minister for International Trade has repeatedly stated Canada does not want to see NAFTA's investor-state provisions replicated.

Canada is also trying to narrow the scope of Chapter 11's existing provisions, but, so far, Mexico and the United States have not shown much interest in sitting down and negotiating this issue.

In addition, Canada has adopted a new strategy recently: They are now appealing arbitration decisions. They have appealed S.D. Myers and joined in Mexico's Metalclad appeal.

Now, let us not forget there has already been an attempt to multilateralize the NAFTA investor-state provisions and move them into a broader treaty, that was the OECD's MAI and, as we all know, the MAI never got off the ground.

Whether Canada's views prevail remain to be seen. In the meantime, next time someone tells you that the sky is falling because of NAFTA's Chapter 11, my advice to you would be to take it with a grain of salt.

Thank you very much.

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19 S.D. Myers v. Government of Canada, Partial Award in a NAFTA Arbitration under the UNCITRAL Arbitration Rules (November 13, 2000) (On October 30, 1998 the Ohio-based waste disposal company S.D. Myers filed a Claim to Arbitration charging that Canada's fifteen-month temporary ban on exporting PCBs violated NAFTA by prohibiting S.D. Myers from conducting its business in Canada. The corporation claimed damages of twenty million dollars (U.S.) in lost potential sales. In November 2000, a tribunal ruled in favor of S.D. Myers determining that there was "no legitimate environmental reason for introducing this ban." The tribunal determined the Canadian Environmental Minister implemented the temporary ban as a protectionist measure to give the work to a domestic facility in Alberta. Canada is appealing the case.)

20 See Metalclad, supra note 6.