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CHAPTER 11 OF NAFTA: WHAT ARE THE IMPLICATIONS FOR SOVEREIGNTY?

Donald S. Macdonald^{*}

I. INTRODUCTION

Arguably the most innovative feature of the NAFTA investment provisions, however, is the establishment of dispute settlement processes based on arbitration according to international arbitral rules, in particular those of ICSID, the International Convention on the Settlement of Investment Disputes. The NAFTA Parties consent to submission to arbitration of investment disputes under Chapter 11, at the request of the private investor itself. This makes NAFTA the first comprehensive international trade treaty to provide to private Parties direct access to dispute settlement as of right.¹

In entering into Chapter 11 of the North American Free Trade Agreement (NAFTA), the chapter relating to investment, the government of Canada was confirming its departure from two long-established treaty-making customs. The two changes of direction were not unprecedented. In both cases, a limited number of precedents in Canadian state practice could be found for each of these steps. But Chapter 11 of the NAFTA represents a change potentially of much greater scope than the previous cases, and these two aspects particularly attract my comment in discussing Chapter 11.

What are the two changes? The first is the undertaking to make comprehensive international commitments to protect foreign investment. For reasons that I shall discuss, the government of Canada in the past has been loath to enter into either bilateral or multilateral treaties guaranteeing investment. The second is that Canada has adhered to the more traditional view that nation-states, and, under some circumstances, international organizations, are the appropriate persons to make claims based on international law in interna-

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¹ MICHAEL J. TREBILCOCK & ROBERT HOWSE, *THE REGULATION OF INTERNATIONAL TRADE* 297 (Routledge, London & New York, 1995). The authors of this book note that the Treaty of Rome does recognize such rights, but observe that it is much more than a *trade agreement*. It is a treaty leading to much broader co-operation between governments, and the co-ordination of a wider range of policy.

tional tribunals, but that nationals, either individual or corporate, are not. By addressing these two points, I hope to enlighten you on Canadian international practice and domestic law, and also on the politics behind the previous national policies.

II. INVESTMENT PROTECTION

Over the past thirty years, there has been a clear trend towards protecting the rights of investors in other states by bilateral international treaties. Some, but not all of that process, was driven by international organizations such as the Organization for Economic Cooperation and Development (OECD), of which Canada is a member. Relative to other developed countries, Canada has been slow to accept the obligations of such treaties.²

Canadian reluctance was in no sense because of hostility to international investment. From the very beginnings of European settlement in our part of North America, Canadian prosperity has been driven by investment from abroad, both public and private. It is not investment itself which has been the source of the Canadian reluctance, although there has always been a spirited national debate as to the potential risk of loss of control that investment might bring. Rather, it is the structure of the Canadian constitution, specifically the distribution of powers between the national and provincial governments, which has caused the government of Canada to hesitate in making international commitments to protect foreign investment.

In the words of a leading authority on Canadian constitutional law, "[t]he provincial Legislatures . . . probably have a general power to expropriate property in the province, simply by virtue of their legislative power over 'property and civil rights in the province.'"³ The constitutional changes of 1982 put important restraints on the freedom of action of both the federal and provincial governments in the field of civil rights. But, they did not impose rights comparable to those of American constitutional law in favour of the owners of property. The Canadian Charter of Rights, section 7, assures that "everyone has the right to life, liberty and security of the person . . .," but it does not go on, as do the Fifth and Fourteenth Amendments of the United States Constitution with respect to the powers of Congress or the States, to assure the right to "property."⁴

² Canada entered into its first bilateral investment promotion and protection treaty in 1989 with the former Union of Soviet Socialist Republics. *See* CAN. Y.B. INT'L. L. 1991, 373-89.

³ Canadian Constitution, § 92(13), *quoted in* PETER W. HOGG, *CONSTITUTIONAL LAW OF CANADA*, 396 (Carswell, Toronto, 2d ed. 1995).

⁴ Constitution Act of 1982, Canadian Charter of Rights and Freedoms § 7. There is a long history of case law under the 14th Amendment of the U.S. Constitution. *See, e.g.,*

You may ask, what are the politics behind the non-protection of property under Canadian constitutional law? For a variety of reasons, political ideology, history, or just plain parochialism, the provincial governments that met with the federal government to negotiate the 1982 amendments were not able to agree on the protection of property rights. Nor, judging by a recent press report, have the provinces changed their views, even though they may have changed the governing parties and the personalities in charge:

‘It’s got to be up to the provinces to decide whether or not they’re going to participate in the MAI [Multilateral Agreement on Investment]. And the federal government has to accommodate that situation,’ said Noel Schacter, a senior B.C. trade official. ‘I think almost every province that we know of to date feels that way.’⁵

An American listener may comment that, whatever the limitations on the protection of property within Canada, surely the government of Canada must be able, under its treaty-making power, to carry out treaty obligations to foreign countries to protect property as the United States could do under Article II, section 2 of the U.S. Constitution. The answer is that there was no provision for a domestic treaty ratification process comparable to that of the United States included in the Canadian constitutional arrangements of 1867, and governments in Canada have been unable to agree to include one since then, even though in the interval there has been an important change in Canada’s place within the world. The Canadian government has the power to enter into treaties with foreign states on behalf of Canada as a whole, but the Canadian Parliament has no power to carry such treaties into effect within the country where the subject matter of the treaty and the enactment falls within the jurisdiction of the provincial governments. As the presiding judge in the leading case on this matter stated in his reasons for judgment:

Chicago, Burlington & Quincy Road Co. v. Chicago, 166 U.S. 226 (1897). The predecessor of the Canadian Charter in the rights field was the Canadian Bill of Rights (1960), 8-9 Eliz. II, c. 44, an enactment of the Parliament of Canada which recognized “the right of the individual to life, liberty, security of the person and enjoyment of property,” but the last words were not carried forward into the Charter. The Canadian Bill of Rights is binding only on the federal government, and it survives the enactment of the Charter.

⁵ GLOBE & MAIL (Toronto) Feb. 18, 1998, at B7.

While the ship of state now sails on larger ventures and into foreign waters she still retains the water-tight compartments which are an essential part of her original structure⁶

...

In other words, the Dominion [as the national government was then described] cannot, merely by making promises to foreign countries, clothe itself with legislative authority inconsistent with the constitution which gave it birth.⁷

It was because of those constitutional limitations that the government of Canada was reluctant to enter into international agreements which would require enforcement within the provincial area of jurisdiction. In stating that, I speak not just from surmise based on external observation, but from participation in the government process, both as a Minister and in several capacities with the Department of External Affairs (as it then was).

Why then, it might be asked, did the cautious bureaucrats and Ministers from two successive Canadian Ministries throw caution to the winds and commit Canada to NAFTA to the wholehearted protection of foreign investment? Here I do engage in surmise, for I was not privy to those negotiations. I think that the government of Canada was prepared to take its constitutional chances because the investment provisions were included within a trade agreement. To continue the constitutional discussion, section 91(2) of the Canada Act of 1867 gives to the Parliament of Canada the power to make laws in relation to "the regulation of trade and commerce."⁸ The scope of that otherwise extensive phrase has been much cut down by judicial interpretation within Canada, but there has not, so far as I know, ever been an effective challenge of a trade agreement with a foreign country, an agreement negotiated and signed by the government of Canada pursuant to its executive powers and justified on the basis of the trade and commerce power. If challenged, the government of Canada could do no better than to adopt the arguments set out by Daniel Price in an article that he wrote a year ago, when he put it succinctly as follows: "Trade and investment flows are interdependent. To achieve the benefits of economic liberalization, investment barriers must be addressed as comprehensively as trade barriers."⁹

⁶ Attorney-General of Canada v. Attorney-General of Ontario [1937] A.C. 326 (P.C.) [hereinafter *Labour Conventions Case*].

⁷ *Id.*

⁸ Canada Act of 1867, § 91(2).

⁹ Daniel M Price, *The Benefits of a Multilateral Agreement on Investment*, ECON. PERSPECTIVES, USIA ELECTRONIC J. 1-3, Apr. 1997.

So is Chapter 11 immune from attack within Canada, or if attacked, can it successfully be defended? There are a number of provincial governments in Canada of a social democratic persuasion that do not have the same view of the market or of private property as the rest of us. There are other governments that may feel that, on a certain issue, picking a fight with the national government is good local politics. I cannot say that an attack will not be made against Chapter 11, nor even that a court may not be so unwise as to declare it to be *ultra vires* of the government of Canada. So far as the foreign complainant is concerned, dispute resolution proceedings would stand, and a successful award under those proceedings would stand. It would merely be that the government of Canada, rather than a particular provincial government, would have to pay the bill for damages and costs.¹⁰

III. THE CLAIM OF ETHYL CORPORATION

The common law in Canada relating to compensation for expropriation of property has recently been re-stated and, in relation to the Charter, in a judgment of the Ontario Court of Appeal.¹¹ The suit in question was an action for a declaration that certain landowners were entitled to compensation from the provincial government as a result of residential rent regulations which avoided provisions for future rent increases to the landowners (Ontario continues to have in effect a partial rent-control regime). The plaintiffs' claim was founded upon both the Charter of Rights and common law jurisprudence concerning the expropriation of property.

Under Canadian common law, there is a recognized rule for the construction of statutes that, unless the words of the statute clearly so demand, a statute is not to be construed so as to take away the property of the subject without compensation. For the rule to apply, there must, in the view of the court, be a taking or an expropriation of the property; regulation of use of property without taking would not entitle the claimant to compensation. In holding that the provincial statute did not constitute expropriation in the case in question, but regulation, Judge Goudge of the Court of Appeal stated the principles as follows:

The 1991 Act is not an act of expropriation by the Crown. Rather, it is an exercise of its regulatory authority. There is no principle of statutory interpretation that would presume that those adversely affected by a statute regulating their affairs are entitled to compensa-

¹⁰ Since entering into the NAFTA, Canada has entered into a trade agreement with Chile. Articles G-01 *et seq.* of that Agreement are substantially in the terms of Chapter 11 of NAFTA.

¹¹ *A & L Investments Limited v. Ontario*, [1997] 36 O.R.2d 127.

tion unless the statute says otherwise. No policy basis is readily apparent for such a rule. Indeed, such a principle would severely hamper the operation of the modern state where most regulatory legislation, however remedial, adversely affects someone. Moreover, if regulatory legislation voiding, but not expropriating, property rights triggered a presumed right to compensation from the state, the effect would be to give property rights the equivalent of the protection accorded by section 7 of the Charter despite the clear exclusion of such rights from the Charter of Rights and Freedoms by its drafters. In other words, an individual would have the right not to be deprived of his property by regulatory legislation except with compensation or with an explicit override of that right by legislative language. This would seem to do indirectly something the framers of the Charter declined to do.¹²

Of considerable interest to the press, and to international lawyers, has been a claim brought by Ethyl Corporation against the government of Canada under Chapter 11 of the NAFTA.¹³ Ethyl Corporation is the manufacturer and the exclusive distributor in Canada of MMT, which is a fuel additive intended to increase the octane level of automotive fuels. It has been alleged on one side that the additive is a danger to health, an allegation that has been contested by Ethyl Corporation. Outside commentators have suggested that the dispute is really about who should pay for automobile pollution controls, the automakers or the oil companies, and in that sense, the government of Canada has been caught in the middle.¹⁴

Whether rightly or wrongly, the government of Canada introduced a bill into Parliament to enact "the Manganese-based Fuel Additives Act," which would have restricted the right to import MMT into Canada or distribute it in inter-provincial commerce.¹⁵ The wholly owned Canadian subsidiary of Ethyl Corporation imports the chemical, reformulates it, and distributes it throughout Canada. In face of the proposed enactment, the parent corporation launched an application under Articles 1116 and 1120 of NAFTA arguing that, in the proposed legislation, Canada was in default of its obligations un-

¹² *Id.* at 135.

¹³ *Groups See Danger from Ethyl Suit*, 14 INT'L TRADE. REP. 1248 (July 16, 1998).

¹⁴ *An unhealthy remedy for dealing with the MMT dispute*, FIN. POST, Feb. 6, 1997.

¹⁵ Bill C-29, Second Session, 35 Parliament. Royal Assent, Apr. 25, 1997, but not yet proclaimed.

der Articles 1102 (National Treatment), 1110 (Expropriation and Compensation), and 1106 (Performance Requirements).¹⁶

Whatever the merits of the technical arguments, I would anticipate that one of the arguments of the government of Canada would be that the effect of the statute was not “expropriation,” but rather “regulation” for the protection of public health and, therefore, would be beyond the jurisdiction of Chapter 11. My understanding is that the issue of “expropriation” or “regulation” has been much litigated in the United States under the Bill of Rights, and I would not presume to state what the law is in the United States. My understanding is that U.S. law would be somewhat different from the law in effect in Canada as indicated by the recent decision of the Ontario Court of Appeal.

Conceivably, the arbitrators in the Ethyl case will have to wrestle with the differences in the laws of Canada and the United States on whether a regulatory scheme created by the legislature that adversely affects the property rights of a claimant would constitute “expropriation” under Article 1110 of NAFTA. The tribunal’s decision could have particular significance in light of the current debate within Canada about the Multilateral Agreement on Investment (MAI).

Debate has been focussed by opponents of the MAI on the proposition that the treaty would prevent “regulatory legislation” as described in the judgment of Judge Goudge;¹⁷ for example, that creating publicly supported health care, or measures taken in support of Canadian media and endeavours in the arts, two aspects of public policy-making where Canadian aspirations differ radically from those in the United States. If measures in Canada to give pre-eminence to public institutions as providers of health care, or to guarantee the continuation of media of communication that assure Canadian content, were to be classified as “expropriation” of foreign interests with consequent costs in damages, then national policies with widespread public support would be in jeopardy. For the moment, governments will not be pursuing the signature and ratification of the MAI, ironically, at the behest of the United States. The decision in the Ethyl case may have ramifications wider than the fuel additive business.

¹⁶ I am advised by Mr. Barry Appleton of the firm of Appleton & Associates of Toronto, counsel for the Complainant, that further details of the proceeding are not available during the continuation of the arbitration pursuant to Rule 15 of THE RULES OF PROCEDURE FOR THE INSTITUTION OF CONCILIATION AND ARBITRATION PROCEEDINGS (International Centre for the Settlement of Disputes, Rules entered into force Oct. 14, 1996). “The deliberations of the Tribunal shall take place in private and shall remain secret.” Ethyl Corporation has, however, made available to the press information on its case. See 13 INSIDE U.S. TRADE (Nov. 24, 1995); 14 INSIDE U.S. TRADE (Sept. 20, 1996); GLOBE & MAIL (Toronto) Oct. 27, 1997.

¹⁷ A&L Investments Limited v. Ontario, *supra* note 10, at 135.

The second aspect in which Chapter 11 of NAFTA departs from customary Canadian international practice has been the recognition of the rights of private persons, whether individual or corporate persons, to have status in international proceedings. In general, the Canadian approach would have been in accord with the following statement:

Although there is no rule that individuals cannot have procedural capacity before international jurisdictions, the assumption of the classical law that only states have procedural capacity is still dominant and affects the content of most treaties providing for the settlement of disputes which raise questions of state responsibility, in spite of the fact that, frequently, the claims presented are in respect of losses suffered by individuals and private corporations."¹⁸

Speaking from my own experience, both within and outside government, officials responsible for claims against foreign governments have found themselves caught in a dilemma. First, as Canadian nationals go increasingly out into the world, they are going to get into disputes with foreign governments. The Department of Foreign Affairs and International Trade would prefer not to have to bear the increased burden of espousing cases on behalf of nationals. As every legal practitioner knows, not every claimant is noble, and not every claim is meritorious, and the process of determining which are and which are not can be expensive, both in time and substance. And, secondly, some claims have a capacity to become national or even international incidents, and governments cannot afford to be seen to be indifferent to the interests of the national or nationals in question. Perhaps intervention at an earlier stage leading to noble failure would save the officials much grief later on.

Chapter 11 will not totally exempt governments from criticism in the future about not espousing these kinds of claims against a foreign government. But the kind of disputes involved in Chapter 11 are mainly about money, rather than the liberty of the subject or other basic human rights. The procedure will not assist with smaller claims, but claims such as those in the Ethyl case are better dealt with in this way.

¹⁸ IAN BROWNLIE, *PRINCIPLES OF PUBLIC INTERNATIONAL LAW* 578 (3d ed. Oxford, 1979).