

Protecting Investor Rights and the Public Good: Assessing NAFTA's Chapter 11

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1. INTRODUCTION: FROM INVESTOR PROTECTION TO CHAPTER 11

The controversy surrounding NAFTA Chapter 11 might lead one to think that international foreign investment law is brand new. This is not the case. Rather, it has been developing as an increasingly specialized area of international law for over half a century. Rooted in the philosophy that aliens and their property were subject to the protection of their sovereign states under international law, cases on expropriation began to appear in the 1930's and saw significant growth between the 1950's and 1970's¹.

Since these early roots, investment law has grown in scope. NAFTA's Chapter 11 provides the quintessential model of the key elements that have now found their way into an ever-increasing number of investment agreements:²

- Protection from direct and indirect expropriation;
- Rights to establish an investment;
- Rights to national and most-favoured nation treatment;
- Guaranteed minimum international standards of treatment for foreign investors;
- Special protections against performance and personnel requirements; and
- Rights to repatriate all monies.

In addition to this move to broad investment rights, the ability to enforce these rights has also expanded. Where such enforcement used to take place only between states, and was thus very rare, now foreign investors have the ability to enforce their international rights themselves through the "investor-state" arbitration process. This development reflects the reality that states do not invest in foreign countries, so that international investment law deals with individual investor rights in relation to public authorities of the host country. Accompanying this remedy are "choice of forum" provisions allowing an investor to choose international remedies *in place of* host country domestic remedies.

As the rights and remedies have expanded, so has the willingness of foreign investors to use these tools. Where state-to-state remedies used to be a last resort to enforce an investor's rights, the investor-state arbitrations have now become a preferred venue.³

Protecting the environment and promoting sustainable development typically require government action. They also entail a high degree of uncertainty concerning the most effective path of action, and consequently involve a significant exercise of discretion on the part of public authorities. In most developed countries, environmental law has become the largest body of law; in all countries, implementation of environmental mandates is subject to controversy and litigation as societies seek to balance the need for environmental protection and the reduction of poverty against the prospects for individuals to prosper. All of these areas of public law are potentially affected by international investment law. It is hardly surprising that the environment has become the stalking horse for the broader public debate about the impact of expanded international

¹ Sornajah, M., *The International Law on Foreign Investment*, Cambridge University Press, 1994.

² By the end of 2001, the number of bilateral or multilateral investment agreements exceeded 2000.

³ Luke Eric Peterson, "Changing Investment Litigation, BIT by BIT", *Bridges Between Trade and Sustainable Development*, May 2001, Year 5, No.4, pp 11-12

investment law. This debate has advanced rapidly from the consideration of specific environmental issues to a discussion of investment and sustainable development to a reconsideration of some of the premises of international investment law.

The concerns raised in this paper can be divided into three related themes:

- The impact on promoting sustainable development;
- The impact on the ability of governments to make necessary and effective governance decisions, including but going beyond sustainability issues; and
- The appropriateness of the institutional framework of NAFTA.

Discussion of the first theme begins with the recognition that investment is vital to promoting more sustainable development. But it revolves around a critical assessment of the foundations of current international investment law, which are largely derived from trade liberalization theory and practice. The second theme has two streams: the case law that has developed under Chapter 11 and the impacts on the investor-state process as a model for international dispute resolution. The third dimension considers whether the institutional framework of NAFTA and in particular of the Chapter 11 dispute settlement provisions are adequate to undertake a legitimate balancing of investor rights and public goods.

The paper will conclude with a discussion of options to address the identified problems. These options are developed first within the NAFTA Chapter 11 context, but are then expanded to serve as a guidepost on investment issues for negotiations in the FTAA, WTO and elsewhere.

2. THE QUESTIONABLE FOUNDATIONS OF TODAY'S INVESTMENT AGREEMENTS

The benefits of economic liberalization appear so obvious to those who promote it that negotiations are generally launched without much analysis. In part this is due to the difficulties that are always encountered when new negotiations are launched; the struggle to construct an agenda acceptable to all overrides discussion of whether the agenda that emerges is the “right” one by some agreed standard. This section goes back to that fundamental discussion, pursuing the seldom-asked question: what objectives should we be pursuing in constructing investment agreements?

Three years after the conclusion of NAFTA, its approach to investor rights and remedies became the foundation for the OECD negotiations on the Multilateral Agreement on Investment (MAI) – negotiations that were aborted in 1998. More recently, Chapter 11 has provided the template for the initial stages of the investment negotiations in the Free Trade Area of the Americas process.

What rationale underlies the broadening of international investment law – a broadening that began over fifty years ago, and has culminated in NAFTA⁴? The question is especially salient given the history of the linkages between trade liberalization and investment liberalization. Both were part of the initial efforts to establish the International Trade Organization as part of the reordering of international economic institutions launched at the 1944 Bretton Woods Conference. The Havana Charter that followed in 1948 never entered into force for want of ratification. That left only the trade liberalization process of the GATT in place.⁵

As tariff barriers were removed under successive rounds of GATT negotiation, trade negotiators came to focus their efforts on other possible barriers to trade. In doing so, they found themselves drawn deeper and deeper into the details of domestic regulation. In turn their remit broadened to include all manner of new issues, from intellectual property rights to trade in services, and from investment to protection of the environment. This has been done through a new combination of traditional negative rules – states shall not discriminate or impose quotas – joined to a much deeper and broader set of positive obligations – requiring government measures to conform to disciplines that define how, and often when, governments may regulate.

Given this broader scope of impact, we have now moved beyond the point where the promotion of public welfare associated with liberalization theory can be taken as a given. The dilemma is clearly identified by some trade theorists:

Under the assumption that markets are competitive, economic theory suggests that the reduction of border barriers such as tariffs will benefit both the importing and the exporting nation. Accordingly traditional trade agreements can be presumed to be win-win. But theory does not suggest that this will necessarily be the case for deeper agreements that deal with behind-the-border policies. Indeed, such agreements could well be win-lose. For example, an international agreement to enforce intellectual property rights could on balance harm a country that has little or no domestic innovation and has previously simply copied foreign innovations.⁶

The unquestioned extension of the rationale for trade liberalization to other areas of international economic governance must be examined critically. For fifty years, trade negotiators have fought the battle against special interests and the bastions of hidden protectionism. Covered by the principle of comparative advantage, they comfortably

⁴ For more on the full breadth of Chapter 11 of NAFTA see Howard Mann and Konrad von Moltke, *NAFTA's Chapter 11 and the Environment: Addressing the Impacts of the Investor-State Process on the Environment*, International Institute for Sustainable Development, Working Paper, 1999. Hereinafter, Mann and von Moltke, 1999.

⁵ Konrad von Moltke, *An International Investment Regime? Issues of Sustainability*, International Institute for Sustainable Development, 2000, p. 9-10.

⁶ Nancy Birdsall and Robert Z. Lawrence, "Deep Integration and Trade Agreements: Good for Developing Countries?" in: Inge Kaul, et al., eds., *Global Public Goods. International Cooperation in the 21st Century*. New York: Oxford University Press, 1999, p.147.

assumed that their every effort promoted the public good, even when this inflicted hardship on some constituency. The assumption, in its most simplified form, was: imposing rules that prevent barriers to achieving market efficiency is a good thing to do. Gradually, this reasoning was extended from tariff to non-tariff issues, and into other areas such as intellectual property rights, services and investment. Today, this reasoning has been extended to support the expansion of foreign investors' rights from protection of an investment after it is made to include the right to make investments ("right of establishment"), and rights precluding the imposition of national economic policies (such as local purchasing or hiring requirements) to the operation of the investment.

Now, however, faced with increasing proposals to liberalize international markets that implicate significant behind-the-border policies, negotiators will have to justify their actions in terms of the broad public welfare that is being promoted. Their global impact as well as their differential impact on different countries must be assessed carefully so as to avoid win-lose situations, let alone lose-lose ones.

The public welfare justification to expand traditional international investment law protections to private investment rights has yet to be provided. What ultimately tripped up the Multilateral Agreement on Investment was not just environmental opposition but the cumulative defects that emerged as the draft was submitted to broad public scrutiny as well as the fact that the public welfare benefits to be expected from the agreement were never properly articulated, if indeed they existed.

In so far as a public welfare justification has been made, it has focused on the role of the protection of investors under international law as a means to expand and diversify foreign investment into more states, especially developing states. Whether this objective has ever been achieved is, however, open to some doubt.⁷ The empirical evidence that does exist suggests that the risk reduction element associated with traditional investment protection is at best a marginal factor in business decision-making on FDI. For lasting changes in the risk perceptions of investors a number of factors must come together. Strong domestic institutions rank high, as do resources in all areas that significantly affect an investment, and access to markets for the goods produced. Risk perception will deeply influence the rates of return that an investor requires, but risk itself is a many-faceted phenomenon and the creation of an international framework for investment will not by itself change investment flows.⁸

⁷ K. Scott Gudgeon, "United States Bilateral Investment Treaties: Comments on their Origin, Purposes and General Treatment Standards" *International Tax and Business Lawyer*, Vol.4, 1986, at pp. 111-112; Thomas Walde and Stephen Dow, "Treaties and Regulatory Risk in Infrastructure Investment", 34 *Journal of World Trade*, Vol.2, (2000); A. Perry, "Effective Legal Systems and Foreign Direct Investment: In Search of the Evidence", *International and Comparative Law Quarterly*, Vol. 49, pp. 779-799, 2000.

⁸ Factors such as available resources, educated workforce, market potential in the host country/region, political stability, banking, administrative and physical infrastructures, etc., play a much larger role in these decisions. Indeed, up until the beginning of the Chapter 11 litigation, few investors appear to have even known of the web of bilateral agreements in this field. This appears to be confirmed in recent UNECLAC and UNCTAD studies, where risk management is clearly identified as one, but only one, investment factor. While lawyers focus their advice on risk and remedies, this does not make it the principal focus of the business investor itself. *Foreign Investment Flows in Latin America, 1999*, United Nations Economic Commission for Latin America and the Caribbean, Santiago, 2000; *World Investment Report 2000*, United Nations Conference on Trade and Development, Geneva, 2000.

Mexico has seen significant growth in foreign direct investment since NAFTA came into force in 1994. But the additional investment flows to Mexico following NAFTA are the result of the entire agreement, including the critical rules of origin provisions that allow market access to the United States, together with supporting domestic measures and institutional changes in Mexico. It is impossible to determine whether NAFTA Chapter 11 had a positive role in promoting investment into Mexico, just as it is impossible to determine the opposite. Because of the complexities surrounding investment decisions the easy generalizations that have supported trade liberalization do not apply to investment agreements.

Investment law initially developed to provide an international law route to obtain redress for egregious governmental actions relating to foreign property. The basic rationale was to overcome deficiencies in national legal regimes as they relate to foreign private capital by *supplementing* domestic regimes with an international law backstop. This rationale was established in the context of developed country investors and developing country host states during an era when nationalization was occurring in many countries, in particular former colonies or dependent territories. Recent investment agreements have expanded far beyond this limited purpose and can now impact on any regulatory decisions that investors may consider undesirable.

In addition, the supplemental role of investment agreements has now become one of *substitution*: investors can choose one forum and set of rules over the other, as circumstances suit them. Moreover, investor protections have, as already noted, been expanded to include rights of establishment and to restrict locally imposed performance requirements, even those applicable to domestic investors. Thus, investment agreements now create a series of international law economic rights for private actors, enforceable as a matter of international law under international processes. Again, these new rights seek to overcome domestic law deficiencies or to actually override domestic law barriers, now substituting the domestic regime completely with international law rules.

These newer international investment rights, combined with ongoing unilateral investment liberalization policies in many countries, do create new investment opportunities. It is well understood that the same regimes that may be deficient in the protection of foreign capital are also likely to be deficient in the protection of public welfare concerns: environment, health, resource management, and others. Yet, investment regimes to date have not included any legally binding provisions designed to address *these* deficiencies by supplementing or substituting the domestic regimes with international law obligations for the investors. This is despite the fact the agreements are knowingly and purposefully designed to promote investment into such countries, and that investment in the absence of such protections can lead to net welfare losses.

Promoters of investment agreements argue that the deals do not give license to ignore local laws, so international protections are not necessary. To some extent this proposition is even questionable, given the possible scope of certain provisions in investment agreements. (See section III, below.) But assuming it to be true, *arguendo*, this still does not answer the concern that the regimes in question are often underdeveloped and may lack effective enforcement. This is no different in kind than the concerns raised for the

deficiencies in legal, administrative and judicial processes that exist in these countries in relation to the protection of capital. Simply put, one is deemed to require supplementing and substituting, the other is not.

Studies by the World Bank and others are now documenting the results of the expansion of private economic rights and the exclusion of public welfare protections. They are beginning to identify trends towards net economic losses to host countries as a result of poorly controlled development sparked by investment liberalization in the absence of appropriate public welfare management regimes and processes.

Environmentalists need to be careful in this area. We now know that “pollution havens” – in the conventional sense of jurisdictions that actively seek to attract investment by offering low environmental standards – have not developed to the extent many feared. Investment decisions involve numerous factors, and environmental factors are rarely dominant for productive investments that do not rely directly on the environment for their product—even in the handful of industries, essentially petrochemicals, where environmental protection now represents as much as 10 percent of total investment.⁹ At the same time, however, there is a growing body of literature and empirical evidence that demonstrates a “stuck at the bottom” phenomenon for environmental protection: low levels of environmental protection and enforcement are not increased as needs increase.¹⁰ This observation is based on several case studies in highly liberalized developing countries. It clearly shows the risk of leading to a situation where short-term economic growth has been transformed into medium or long term net losses due to the environmental and human costs of environmental mismanagement. In short, investment liberalization in countries with lower environmental standards may dissipate any economic gains through insufficient attention to the sustainable development dimension of economic growth.

In addition to the growing environmental concern, there are several other problems in the current pattern of investment from the international and public welfare perspectives. Some countries that desperately need investment are unable to attract it in significant

⁹ The evidence against pollution haven investment patterns is compelling for major global corporations that generate and use state of the art technologies. The evidence is less empirically clear, however, in relation to smaller foreign investors, where data simply is less complete. The evidence of sustainable performance in relation to renewable resource industries such as forestry and fisheries is deeply disturbing. See for example the series of World Bank evaluation reports of forest regimes: Uma Lele, et al., *The World Bank Foresatry Strategy. Striking the Right Balance*. Washington, D.C. The World Bank, 2000 (World Bank Operations Evaluation Department).⁹ B. Essama-Nash and James J. Gockowski, *Cameroon. Forest Sector Development in a Difficult Political Economy*. (Evaluation Country Case Study Series). Washington, D.C.: The World Bank, 2000. (World Bank Operations Evaluation Department). Nigel Sizer and Dominiek Plouvier, *Increased Investment and Trade by Transnational Logging Companies in Africa, the Caribbean and the Pacific: Implications for the Sustainable Management and Conservation of Tropical Forests*. Brussels: World Wide Fund for Nature, 2000

¹⁰ Ibid, and see Gareth Porter, “Trade Competition and Pollution Standards: “Race to the Bottom” or “Stuck at the Bottom”?, *Journal of Environment and Development*, Vol. 8, pp. 133-150, 1999; Luba Zarsky, “Havens, Halos, and Spaghetti: Untangling the Evidence about Foreign Direct Investment and the Environment” In *Foreign Direct Investment and the Environment*. Organization for Economic and Cooperation and Development, Paris: OECD, 1999; Thomas, V. et al., *The Quality of Growth*. Washington, DC: World Bank and Oxford University Press, 2000; Per Fredriksson, ed., *Trade, Global Policy, and the Environment*, Washington, DC: World Bank, 1999.

amounts. Some sectors that require investment to promote public welfare, environmental protection among them, do not get additional investment at the level that is required. Yet there is nothing in existing investment agreements to suggest that they are designed to rectify such imbalances. They either assume that the act of liberalizing international markets for investment will somehow automatically contribute to solving these problems, or they assume that addressing such problems is beyond their remit.

The above is not to argue that there is no international agenda for investment. Rather, it represents a powerful argument that a different international agenda for investment must be set. There are certain areas of public policy—environment and sustainable development most prominent among them—that require private investments to achieve well-identified public goods. Governments have long recognized the need to promote such investments, providing subsidies and many other incentives to influence investment decisions. The reduction of risk is one tool among others to support private investments that promote public goods and it has the advantage of not creating distortions that become so internalized into expectations that they cannot be removed.

It is essential to identify the public goods that should be promoted through international investment agreements. If these cannot be achieved, governments may want to reassess their willingness to invest negotiating resources and limit their rights to regulate foreign investors or pursue their development objectives. The importance of identifying the public good is twofold: it provides a standard against which the provisions of an investment agreement can be measured; and it provides a basis for assessing whether the benefits of an investment agreement justify the costs. Specific options in this regard will be returned to in Section 5 of this paper.

3. THE APPLICATION OF THE KEY PROVISIONS OF CHAPTER 11

In the Introduction to this paper, two related categories of concern were noted in the relationship between investment law and sustainable development:

- The impact on promoting sustainable development; and
- The impact on the ability of governments to make necessary and effective governance decisions, including but going beyond sustainability issues.

The NAFTA includes three preambular statements that are relevant to these concerns, affirming that the NAFTA partners are resolved to:

- *Preserve their flexibility to safeguard the public welfare*
- *Promote sustainable development;*
- *Strengthen the development and enforcement of environmental laws and regulations.*¹¹

In practice these preambular statements have had little actual relevance to the design, interpretation and application of NAFTA's Chapter 11. The promotion of sustainable

¹¹ NAFTA, Preamble, paragraphs 12-14.

development in NAFTA is largely based on the assumption that economic growth is good and will in time lead to the correction of any environmental problems it may create. As seen above, rather than enunciating explicit criteria to promote sustainable investments, Chapter 11 relies on the private welfare rationales for investor protections and investor rights.

The remaining two preambular paragraphs relate directly to the ability of governments to make necessary and effective governance decisions to protect the environment. While apparently designed to ensure the ability of governments to take necessary decisions to protect the environment as a public good, these preambular paragraphs have not affected the interpretation of the investor protection provisions of Chapter 11. The result is a growing sense that the provisions of Chapter 11 put at risk the ability of governments to maintain a dynamic environmental management system that can anticipate and forestall environmental and human health damages, as well as ensure redress when such damage occurs. Thus, it is argued, a critical pre-condition identified by both the World Bank and the World Trade Organization for liberalization to contribute positively to sustainable development—the presence of a dynamic and effective environmental management system¹²—is being jeopardized by the operation of Chapter 11. It is to this issue that we turn now.

Chapter 11 contains four key provisions, or disciplines, that relate to the capacity of governments to effectively exercise their environmental management functions:

- National treatment and most favoured nation treatment (non-discrimination), Article 1102, 1103;
- Minimum international standards of treatment, Article 1105;
- Prohibitions on performance requirements, Article 1106; and
- Expropriations, Article 1110.

In addition, the character and legitimacy of the institutional provisions for dispute resolution are of critical importance. These are discussed separately in the next section of this paper.

Before looking at each discipline briefly,¹³ it is worth noting that the Chapter 11 cases to date have made it clear that each of these provisions applies to all government measures, whether they are taken specifically in the context of an individual investment or are measures of general application that apply equally to foreign and domestic investors. Moreover, the range of measures covered is extremely broad, including laws, regulations, administrative decisions on licenses or permits, policies with a direct impact on

¹² Fredrickson, *supra*, n. 9; H. Nordström and S. Vaughan, *Trade and Environment: Special Studies 4*, World Trade Organization, Geneva, 1999.

¹³ More extensive discussions of these provisions can be found in Mann and Von Moltke, 1999 and Howard Mann, *Private Rights, Public Problems: A Guide to NAFTA's Controversial Chapter on Investor Rights*, International Institute for Sustainable Development/WWF, 2001. Recent literature taking different views to the above can be found in e.g., Patrick Dumberry, "The NAFTA Investment Dispute Settlement Mechanism: A Review of the Latest Case-Law", *Journal of World Investment*, Vol. 2, pp. 151-195, 2001; and Daniel Price, "NAFTA Chapter 11 – Investor-State Dispute Settlement: Frankenstein or Safety Valve", *Canada-United States Law Journal*, Supplement, Vol. 26, pages 1-9, 2001.

businesses, or other possible government actions¹⁴. The full range applies without exception to actions taken by local, state or provincial governments, as well as national governments. For federal actions, measures undertaken before Chapter 11 came into force are covered in terms of their continued application.¹⁵ In addition, Chapter 11 includes extensive rights of establishment in the three Parties.¹⁶ As a result, the disciplines noted above apply both before and after an investment is made (to the extent the right of establishment exists or an investor otherwise is permitted to make the investment in question), ensuring that in the course of exercising the right of establishment a foreign investor is not discriminated against or otherwise deprived of any protections. The discussion of the disciplines below should be understood as applying to the decision-making and building phase of investments as well as their subsequent operation.

A second general point of note is that investments and investors are defined about as broadly as possible, covering not just foreign owned production or resource harvesting facilities but also sales offices, portfolio investment, and other non-productive forms of business or financial activity in the host states. As a consequence, it is difficult to establish with any certainty the minimum elements necessary to qualify as an investment.

3.1 . National treatment

A key objective of investor protections is to preclude discriminatory treatment against investors based on their country of origin. Yet, several key aspects of this discipline remain ill defined. For example, the threshold test of what type or extent of differences in treatment will trigger a breach of this article is unclear: Is it any difference, or a difference that has a significant impact on a business? Must it be a difference in law (*de jure*) or simply a difference in effect (*de facto*)? A related question is what standard of treatment is to be chosen against which to compare the investor: the lowest applicable in a jurisdiction, the highest, or some middle ground? How does fairness in an administrative process relate to the assessment of outcomes from that process, or is it only the outcomes that matter, for example in an environmental assessment or permitting process that requires a variety of inputs to be assessed?

In the language of Article 1102, two main issues must be addressed to answer any of these questions: is the investor treated less favourably than another investor, and which investors are “in like circumstances” for the purposes of making this comparison? It is only when investors that are in like circumstances that they must be treated no less favourably one than the other.

¹⁴ There is only one exception to the definition of covered measures, namely those concerning interest rates for purposes of macroeconomic policy. In accordance with standard principles of treaty interpretation, by including a single exception the text effectively affirms that no other measure has been exempted.

¹⁵ Provincial and municipal measures taken before NAFTA came into force have now been grandfathered. However, new decisions under enabling laws or regulations would be covered as new measures.

¹⁶ Under NAFTA, the three countries had to list the sectors they wanted excluded from the right of establishment. In some cases these are fairly extensive, such as the energy sector in Mexico. Any sector not listed is covered by Chapter 11 and is open to investment by investors of the other two NAFTA parties without discrimination.

The cases are just beginning to interpret what these terms mean and how they should be applied. Although the existing case law is not consistent on this issue, context-sensitive analysis will, we believe, be essential to determine whether investors are in like circumstances with others they claim form an appropriate reference group. The absence of a context-sensitive approach means that there is no basis for including or excluding reasons for differences in treatment of investors in an analysis of outcomes. Some sample questions may help illustrate this concern. Would a factory that has to meet newer and tougher air emission standards than a pre-existing factory be in like circumstances to a factory in the same area set up some years earlier? Is a factory located in a watershed that is heavily used in like circumstances to one where water is clean abundant and organic emissions can be readily absorbed? Is a lumber company that locates adjacent to a national park in like circumstances to a similar company located in an area with no such environmentally sensitive sites? Or is an investor who uses a hazardous component in his manufacturing process in like circumstances to an investor using a non-hazardous product towards a similar end? And would an investor with no other assets in a country be discriminated against if required to post a bond for environmental damage or abandoned site insurance purposes, when a company with millions in other domestic assets is not required to do so? All these types of situations could lead to differences in treatment, and some might even prevent entry into a market. Domestic institutions operate under rules that give guidance on such questions, or according to procedures that permit their open and accountable consideration. It seems likely that an international analysis without comparable resources faces almost insurmountable obstacles. We believe that the “in like circumstances” analysis requires the articulation of criteria to make legitimate distinctions, and the use of procedures that ensure accountability.

Trade law has also struggled to deal with the added complications that have attached to concepts that seemed only pleasantly ambiguous before trade law went behind the border. The concept of “like product” is central to the operation of the central principle of “non-discrimination” in trade law. Trade law cases addressing “like products” have established a series of factors that focus primarily on the commercial substitutability of products. Only recently, in the *Asbestos* case, has WTO case law given an indication that the environmental or human health impacts of a product may be a relevant factor for direct or indirect consideration in this regard, either as a direct factor in assessing likeness or indirectly as a factor in assessing aspects of the commercial substitutability test.¹⁷ What is merely complex in trade law appears almost insoluble in investment law, because the issues are so different, as pointed out above. The notion of “likeness”, however expressed, is equally central to investment law. But because investments involve numerous independent factors, and in particular a large time factor that is essentially absent in trade law, the interpretative task is orders of magnitude more difficult. There is nothing in NAFTA Chapter Eleven that suggests that negotiators were particularly aware

¹⁷ *European Communities – Measures Affecting Asbestos and Asbestos Containing Products*, Report of the Appellate Body, WTO, AB-2000-11, March 2001. The extent to which environmental or human health factors can be brought to bear remains a somewhat open question, with a minority opinion being specifically addressed to this point in the Appellate Body judgment in the case. The differences between investment and trade, however, make it critical for such factors to be brought to bear in the investment analysis of like circumstances.

of these difficulties, and so there is nothing that is of much help to those who now struggle to implement it.

From a sustainable development perspective, relevant factors in establishing “likeness” would include suitability of an investment to a receiving community and physical environment, the availability of sufficient resources and infrastructure for its operation, applicable legal processes and structures, and other factors relating to its establishment and operation. To date, the cases suggest a context sensitive analysis can and should be applied. Ensuring this is critical, as Chapter 11 has no associated general exclusion such as that found in Article XX of the GATT, which creates a framework for exploring government acts even when they appear to contravene core principles of the agreement.¹⁸ If this is not done in the context of defining like circumstances, it is unlikely it can be done effectively at all¹⁹.

The second key interpretational issue under Article 1102 is the meaning of “no less favourable” as the standard for treatment for investors that are in like circumstances. It is well understood from its trade law origins that this does not mean identical treatment. But exactly what it does mean, or what differences in *de jure* or *de facto* treatment are acceptable is much less clear. Minor or inconsequential differences are unlikely to found a case,²⁰ but how significant the differences must be in law or in effect is not clear. And, as already noted, the proper standard for comparison is most uncertain: is it the highest standard, the lowest, some middle ground? And in some cases, for example the application of environmental assessment procedures, is the treatment looked at to be process related or results related, or necessarily both? There is little guidance at present on these issues in the cases.

While the cases send a positive signal on this issue, and are insufficiently developed on the basis for comparing treatments, they are very troubling on another “like circumstances” issue. One would have thought that comparing like circumstances would involve comparing similar operations located in the host country. In *S.D. Myers v. Canada*, however, this was not done. The investment in Canada by US based Myers²¹ (S.D. Myers Canada) operated as a waste broker service – a middleman that wanted to export waste generated in Canada to its parent company’s U.S.-based waste disposal

¹⁸ Tim Burke, “Importing the ‘Aims and Effects’ Test into NAFTA Article 1102: *S.D. Myers, Inc. v. Government of Canada*”, Student term paper, Fall, 2001, University of Ottawa, Faculty of Law, on file with authors.

¹⁹ In the final phases of the MAI negotiations the chair proposed a footnote that would identify some environmental considerations that could be taken into account. This footnote points in the right direction without fully responding to the need that has been identified here. “Engering Paper on Labor and Environment”, reprinted in *Inside US Trade*, March 27, 1998, p. 17-19.

²⁰ In *The Matter of an Arbitration Under Chapter Eleven of the North American Free Trade Agreement Between Pope & Talbot Inc. and the Government of Canada*, Interim Award by Arbitral Tribunal, June 26, 2000. And see the comments on this issue in Anthony van Duzer, *NAFTA Chapter 11 To Date: The Progress of a Work in Progress*, Centre for Trade Policy and Law, NAFTA Chapter 11 Conference, January 18, 2002, draft paper available at www.carleton.ca/ctpl, final paper to be published by CTPL.

²¹ Whether it was actually S.D. Myers that made the investment or the individual owners of the company remains an outstanding question being considered in a judicial review process. The language used here is shorthand for the description of the investment, not the investor. We believe the Tribunal erred in ruling this distinction is not relevant for founding its jurisdiction in this case.

operations. The Tribunal, however, went beyond comparing the investment located in Canada with the many other Canadian-based waste broker services, and asked whether the investor's waste disposal operations located in the US were receiving less favourable treatment than that accorded to similar Canadian waste-disposal operations. In this way, the national treatment obligation was applied to the integrated business line of the investor including those elements that were not located in Canada.²² This has some appeal from a pure business perspective, but represents a remarkable extension of the scope of the "national" treatment requirement. Moreover, it is an extension that would override a true context-sensitive analysis in the host state by superimposing a business-focused context over all other issues.

A final factor that should be noted here is how broadly an investment or investor is defined. It is clear that no actual productive process or facility is now required for protections and rights to be vested in a foreign investor. In *S.D. Myers v. Canada*, a sales office was held to be an investment under Chapter 11. This may have been a correct interpretation of the language of Chapter 11, but it must be asked whether this is an appropriate approach. It reflects one of the means by which the concept of national treatment has been greatly expanded from previous investment agreements, and from the origins of investment protection to create the beginnings of a new system of international economic rights. The consequences are real: if a sales office constitutes an investment that allows a suit to be initiated, and if market share is a protected property right, as the *S.D. Myers* and *Pope & Talbot* cases found, then any measure impacting that market share becomes subject to challenge by any foreign company with a sales office located in the host country. This could amount to nothing less than a wholesale privatization of international trade law, and without any of the environmental, human health or other legitimate regulatory dimensions of government being expressly protected under these provisions.²³ This might prove destabilizing for governments, particularly since regulatory requirements will often increase over the life of an investment. Whether this fear will be justified remains to be seen, but the broad legal outlines for it to materialize are now present in the existing case law.

3.2. Minimum international standards

Like most bilateral investment agreements, Chapter 11 contains provisions requiring host countries to treat foreign investors in a way that meets minimum international standards. This requirement is expressed in very general language as "treatment in accordance with international law, including fair and equitable treatment and full protection and security."²⁴ Exactly what this means is not spelled out in NAFTA, or in other investment agreements. Still, when investment provisions were used only as a shield against egregious acts this created little controversy; it was understood that the intention was to provide a floor of minimum standards of fair treatment, regardless of whether domestic firms were being treated equally badly. But with the change in the use of the provisions

²² These issues are discussed at pages 52-59 of the *S.D. Myers* decision, In A NAFTA Arbitration Under UNCITRAL Arbitration Rules, *S.D. Myers, Inc. v. Government of Canada*, Partial Award, November 13, 2000.

²³ There are such exceptions built in for other parts of NAFTA, Chapter 7 and 9 for example, as well as for the agreement as a whole by a reference to Article XX of the GATT. However, this cross-reference is made inapplicable to Chapter 11.

²⁴ Article 1105 of NAFTA.

from a defensive shield into a sword to attack government measures,²⁵ the lack of precision simply invites new scope for claims under this discipline, often coming from different areas of law.

Chapter 11's *Metalclad* case highlighted the increasing significance of this obligation to public welfare law making. In this case, Mexico was found to violate the minimum international standards based on breaches of transparency requirements not expressed in Chapter 11 but elsewhere in NAFTA, a breach of Mexican law established by the Tribunal but not by a Mexican court, and a failure to be notified of a meeting after years of intense negotiations with all levels of government in the region in question.²⁶ The Tribunal summed up its findings by saying that Mexico failed to provide a transparent, predictable framework for business planning and investment, and demonstrated a lack of orderly process and timely disposition in relation to an investor.

This extremely broad reading of minimum international standards requirements was groundbreaking in international investment law. However, this breadth was rejected in a judicial review of the case by a court in Vancouver, British Columbia.²⁷ A narrower scope, based on a traditional customary international law interpretation of minimum international standards, has now been put forward by the Free Trade Commission in an interpretive statement under Article 1131(2) of NAFTA, a process discussed in more detail below.²⁸ Arguments that this statement is in fact an amendment rather than an interpretation have been made, however, and this is a live issue now before a Chapter 11 Tribunal.

Initial assessments of the minimum standards obligation in Chapter 11 suggested it was not an area of major concern from a broader public welfare perspective.²⁹ But this chain of events, and the current uncertainty they have generated, indicate the need to carefully define the nature of all the obligations in an investment agreement, rather than leave them undefined and hence open to broad interpretation with unanticipated consequences. Again, some questions highlight the need for greater government certainty: Can it really be, for example, that governments have an obligation to correct poor legal advice received by an investor as found in the *Metalclad* case? Does one bureaucrat's representation that a certain event will or will not take place under the law of another level of government bind the country at all levels of government? Is every government act, official's conversation, and any written communication from any level of government official sufficient to found a breach of Article 1105, as the final award in the *Pope & Talbot* case would suggest? These possibilities suggest standards never before

²⁵ See the discussion on this in Mann, *Private Rights, Public Problems*, *supra*, n.13, p. 16, and Peterson, *supra*, n. 3.

²⁶ See paras. 75-100 of the *Metalclad* decision, *Metalclad Corporation v. United Mexican States*, Award, International Center for Settlement of Investment Disputes (Additional Facility), Case No. ARB (AF)/97/1, 30 August, 2000, reprinted in *ICSID Review- Foreign Investment Law Journal*, Spring 2001

²⁷ *United Mexican States v. Metalclad Corporation*, 2001 BCSC 664, S.C.B.C May 2, 2001.

²⁸ The August 1, 2001 statement can be found attached to a press release at <http://www.dfait-maeci.gc.ca/nafta-alena/menu-e.asp> Under Article 1131(2) of NAFTA, this statement will legally bind any arbitration body set up under Chapter 11 as it relates to Article 1105.

²⁹ E.g. Mann and von Moltke, 1999.

made applicable in domestic law or international law, which may or may not be ruled out by the July 31, 2001 interpretive statement.

3.3. *Performance requirements*

Article 1106 of NAFTA prohibits the NAFTA parties from imposing what are known as “performance requirements.” This means that states cannot impose certain rules on the operation of a foreign investment—irrespective of whether such rules are imposed on domestic investors. Article 1106 prohibits host governments from requiring an investor to:

- Export a given portion of production;
- Use a given level of local inputs or services in business operations, or otherwise show a preference for domestic goods or services;
- Generate foreign exchange flows based on the firm’s levels of imports or exports;
- Use or transfer certain technologies (with some exceptions); or
- Employ specified types or levels of personnel.

Prohibitions on performance requirements are a classic example of the shift from investor protections to the creation of international economic rights for private companies. They aim to prevent a host government from imposing conditions on an investor that may limit its ability to achieve economic efficiency and profits.

It was originally anticipated that this provision would apply only to measures specifically targeted at a foreign investor or its investment. Therefore, even though the provision covered all stages of the investment cycle – from initiating to operating to terminating the investment – it was thought that only a narrow range of measures would be captured. The early cases have shown otherwise. It is now clear that under Chapter 11 even non-discriminatory measures of general application (that is, measures not targeted at a specific investor or sector), both new and pre-existing, can be considered to be performance requirements.³⁰ Using this reasoning, it can and has been argued that an import ban on a product used by manufacturers is in effect a requirement to use local substitute products. The result is that foreign investors that might be affected by such a ban are able to bypass the traditional state-to-state process for challenging such trade measures – a process that has been the hallmark of the development of trade law in NAFTA and the WTO – and themselves directly challenge the measure. This issue was raised and accepted as a matter for proper ruling on the merits in the *Ethyl v. Canada* case.³¹ The case was never heard on the merits, as it was subsequently settled. Nonetheless, it is now being raised again in a new case at the initial stage of a Notice of Intent to arbitrate brought by Crompton Corp. against Canada.³²

³⁰ *S.D. Myers v. Canada*, paras. 289-300; *Pope & Talbot v. Canada*, paras. 74; and in the *Ethyl Corp. v. Canada*, Award on Jurisdiction in the NAFTA/UNCITRAL Case between Ethyl Corporation and the Government of Canada, 24 June, 1998., paras. 62-64. There is no jurisprudence to the contrary.

³¹ *Ethyl v. Canada, Award on Jurisdiction, ibid.*

³² Notice of Intent to Submit a Claim to Arbitration Under Section B of Chapter Eleven of the North American Free Trade Agreement, *Crompton Corp. v. Canada*, November, 2001, paras. 37-39.

While this reading of Article 1106 has not been seen yet in a final decision, the ingredients for it to emerge are in place, and this is disturbing. As in the possible combination of interpretations of investor, property right and expropriation (see below) that was discussed under the national treatment issue, this provision could now become a means for a foreign investor to challenge any measure impacting its operations as a prohibited performance requirement. Just the prospect that this can happen may seriously weaken the ability of governments to protect human health and the environment from the actions of foreign investors. Again, it is a case of the potential breadth of a provision not having been fully assessed during its drafting.

3.4. Expropriation

Chapter 11 sets out protections against expropriation that have now been expanded by the arbitration bodies to include an extreme reading of the American concept of “regulatory takings”³³: that a regulation impacting on the reasonable expectation of profit of a company constitutes an expropriation that requires compensation to be paid. The effect of this approach, if it is followed in other cases or other agreements, will be to require governments to pay foreign investors compensation if any regulation to protect the environment, human health, public welfare or community interests significantly interferes with their ability to make a profit from their investment. This interpretation of expropriation, which applies even if a regulation is completely non-discriminatory between any and all investors, was never seen before in international law, as recently acknowledged by a Canadian court that reviewed, but upheld, one such arbitral decision.³³

The Chapter 11 provisions on expropriation have been the most debated issue concerning the relation of investor protections to environmental and human welfare protection. Article 1110 of NAFTA requires that any expropriation of a foreign investor’s investment be for a public policy purpose *and* be accompanied by compensation. This is consistent with most OECD country approaches to government expropriation, where it is not sufficient for a government to expropriate property simply for a public purpose: it must still provide compensation. The critical question that triggers the provision is which government acts constitute an expropriation, or a “taking” in U.S. legal language, of property by a government in the first place, and therefore creates the need for compensation?³⁴ Different countries have evolved distinct approaches to this question. Lacking a principle of deference to national law, and lacking any criterion for its application in NAFTA disputes, these provisions are an invitation to companies to seek out arbitrators who espouse particularly pronounced views on the takings issue and who

³³ *The United Mexican States v. Metalclad*, Supreme Court of British Columbia, 2001 BCSC 664.

³⁴ The key issue of what constitutes a “taking” is widely debated in the United States in particular, where the full scope of a constitutional protection of private property rights remains unresolved. Most countries give public authorities wide latitude before recognizing a “taking.” In the United States, however, this issue has continued to be widely debated, and has a primary constitutional law dimension. One of the factors that has made Chapter 11 particularly disconcerting to U.S. environmentalists, and now increasingly environmentalists and other observers in all three NAFTA parties, is the growing prospect that a fundamental question of constitutional law in the U.S. and one of enormous practical implications for all environmental regulators—may now be decided not through the development of domestic case law but through the essentially unappealable rulings of *ad hoc* Chapter 11 tribunals meeting behind closed doors in a process modeled after private arbitration and based on non-domestic sources of law.

are willing to apply these in selecting a third member and in working within the dynamics of a three-person panel.

The public welfare issues raised here are profound, and difficult. To what extent would Article 1110 be applied to laws and regulations that protect the environment and/or human health from hazardous products, from pollution and from dangerous activities? Can setting high environmental standards amount to expropriation if it impacts on business activities?

The original fears of environmental groups and others centered around the inclusion of three “types” of expropriation – direct expropriation, indirect expropriation, and measures tantamount to expropriation in Article 1110 of NAFTA. The cases to date have held that these last two terms have the same meaning: measures that do not directly take investment property, but which amount to the same thing. A high enough business tax levied on a specific firm, for example, would eventually have the same effect as direct expropriation. This is also consistent with the more traditional development of the concept of “creeping” expropriation, whereby measures that incrementally create the effect of an expropriation are considered to be just that.

While this particular issue no longer appears germane to the debate, a second concern raised early on by at least one critical review of Chapter 11 has materialized. This concerns the way Article 1110 relates to what is called the exercise of “police powers” by a country enacting a measure.³⁵ Under the traditional international law concept of the exercise of police powers, when a state acted in a non-discriminatory manner to protect public goods such as its environment, the health of its people or other public welfare interests, such actions were understood to fall outside the scope of what was meant by expropriation. In trade law terms, this was “a carve out” from the applicable rules. Such acts were simply not covered by the concept of expropriation, were not a taking of property, and no compensation was payable as a matter of international law.

Stated simply, if the police powers rule is recognized under the expropriation provision in Chapter 11, then environmental and human health protection laws or regulations will not be considered expropriations.³⁶ If the rule is not recognized, on the other hand, then even normal exercises of a government’s regulatory authority may be considered expropriations requiring payment of compensation. It is on this issue that the interpretational “battle” over the scope of the expropriation provisions now centres.

There do not appear to be any cases of this type on the record prior to NAFTA. Certainly, issues of creeping expropriation have been addressed, but never in a context of

³⁵ This issue was first raised and explored in Mann and von Moltke, 1999.

³⁶ Measures within the normal scope of police powers rule would still be subject to review under the provisions of Chapter 11 on national treatment and minimum international standards, among others. The scope of a state’s legitimate police powers is, of course, not always simple to determine, and may depend on the type of law or regulation in question. For example, protective measures that limit polluting emissions, establish controls or bans on certain hazardous products, would generally be considered routine exercises of police power. Measures that take land to create a national park, on the other hand, are generally compensated for in most legal systems and may well not be excluded by the police powers rule. Still, the question of what constitutes a normal (or non-confiscatory) exercise of police powers varies in some measure in accordance with national custom and practice.

public welfare regulation. Thus, it is the Chapter 11 case law that is salient, and it is the *Metalclad* case that provides the clearest Chapter 11 decision on this issue. Rather than undertake an analysis of whether the Mexican government acted in a manner inconsistent with a normal (non-confiscatory) exercise of its police powers, the Tribunal stated simply and concisely that “The Tribunal need not decide or consider the motivation or intent of the adoption” of the environmental measure in question in that case.³⁷ Instead, the test that was used in *Metalclad* considered only the scale of impact of a challenged measure on an investment:

*Thus, expropriation under NAFTA includes not only open, deliberate and acknowledged takings of property ... but also covert or 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.*³⁸

This same approach is repeated in the *Pope & Talbot v. Canada* decision.³⁹ It is the identification of this singular test, combined with what appears to be a complete rejection of the police powers authority in *Metalclad*, that has raised so many concerns.

Some questions remain unanswered regarding this test: what constitutes a significant impact?⁴⁰ What is a reasonably-to-be-expected economic benefit if part of that benefit is based on creating environmental damage to others? And is that latter issue one for assessing quantum of damages or for assessing whether there is an expropriation in the first place requiring any compensation?⁴¹ Further, it is to be noted that the *S.D. Myers* tribunal did say that government regulatory action is not normally understood as being expropriation. Unfortunately, that decision creates a genuine ambiguity: it also states that the main reason the measure in that case does not amount to an expropriation is that it is a

³⁷ *Metalclad*, para. 111. The measure in question was the creation of an ecological reserve that included the land owned by Metalclad, thereby ending its possible use for siting a hazardous waste management facility, as Metalclad intended. Had the Tribunal held that such a change of land use, while in the public interest, still requires compensation to be paid to the landowners, as is the case in almost all OECD and many other countries, one would have at least found some analysis of the issues relevant to the application of the police powers rule, and a much lower degree of concern flowing from this case.

³⁸ *Metalclad*, para. 103.

³⁹ *Pope & Talbot*, paras. 96-105

⁴⁰ To constitute an expropriation, it is can be argued that traditional international legal analysis has required that an investor lose all or essentially all of the value of an investment through a government action that is so far beyond the normal exercise of police powers as to be confiscatory in nature. In the United States, the “loss of all value” doctrine and the question of normal police powers have been related, because the “value” of a property has been considered as subject to the routine exercise of local regulatory power. Thus, an investor has usually been held to enjoy a reasonable expectation to profit from his or her property only to the extent possible under legitimate applications of the police power. The full analysis of these types of issues under national and international law is complex and beyond the scope of this paper.

⁴¹ This proposal, which IISD believes is fundamentally flawed, is raised as an approach in T. Weiler, “A First Look at the Interim Award in *S.D. Myers Inc. v. Canada: Is it Possible to Balance Legitimate Environmental Concerns with Investment Protection*”, *Hastings International & Comparative Law Review*, Vol 24, pp. 173 et seq., at 187.

temporary one with a temporary impact, hence returning suspiciously close to the degree of impact test in *Metalclad*.⁴²

These “loose ends” give some cause for hope that the Metalclad test may not be as cut and dried as it appears to be. But the situation still remains that the only consistent test across the NAFTA cases is the scale of impact test enunciated most explicitly in *Metalclad*. At best this approach significantly limits the scope of the police powers rule. More realistically, however, it appears to effectively eliminate this traditional international law test from consideration in the review of an expropriation claim. Under this reasoning, regardless of the purpose, compensation must be paid if there is a significant impact. This is alarming since *any environmental law worth adopting* will affect business operations and may substantially modify or even end the use of, or trade in, certain processes or products, and therefore will have a significant impact on the business in question. The ultimate effect of this nascent NAFTA doctrine would be to reverse a central tenet of sound environmental policy: that the environmental costs of economic activities should be internalized in prices so that polluters bear the costs of their pollution, rather than enjoying a right to pollute which they must be paid to cede.

On the issue of expropriation, the concerns of many civil society groups appear to be well founded. No matter how needed or valuable a new piece of law or regulation, the odds against it will steadily stack up as regulators tally the costs of potential compensation claims from affected businesses under Chapter 11’s expropriation provisions. Indeed, if governments have to guess whether a measure to protect the environment or human health is covered by the concept of expropriation, it could have (and already appears to be having) a significant impact on the freedom of governments to enact strong regulations to protect the environment or other aspects of the public welfare.

4. DISPUTE SETTLEMENT AND SUSTAINABLE DEVELOPMENT

So far we have considered the rationale and basic structure of investment agreements, drawing upon Chapter 11 as the leading example of such an agreement. We have considered some of the sustainability issues relating to specific disciplines in these agreements, again using the jurisprudence surrounding Chapter 11 to give detail and texture to them. In this section, we consider the issues concerning dispute settlement under the investor-state mechanism of Chapter 11.

The principal issue considered here concerns the legitimacy of the investor-state process as a mechanism to resolve the type of public welfare disputes that are now a main feature of Chapter 11 litigation. The central focus of the legitimacy issue arises from the absence of full transparency in the proceedings on the one hand, and the absence of an institutional setting capable of managing the process in a publicly accessible way on the other.

⁴² *S.D. Myers v. Canada*, paras. 279-287.

4.1. Transparency

The investor-state process that is the main dispute resolution process for the protection of investor rights under Chapter 11 draws exclusively on three pre-existing arbitration mechanisms, the International Centre for the Settlement of Investment Disputes (ICSID), the ICSID Additional Facility, and the United Nations Centre for International Trade Law (UNCITRAL). Each of these bodies has a specified set of arbitration rules, drawn from a traditional commercial arbitration model. Each follows the basic steps:

- A private party submits the case;
- The state responds;
- Each side chooses its own arbitrator and a third is appointed in a neutral fashion (usually from a designated list of international commercial arbitrators);
- There is agreement on detailed rules of procedure;
- Proceedings are engaged through a series of briefs and oral arguments; and
- The arbitration panel reaches a decision.

With a few exceptions, it is these pre-existing rules of procedure that govern the arbitration process under Chapter 11. In addition to the procedural steps, these rules also share an antipathy towards public accessibility and transparency of the proceedings, drawing as they do on a traditional commercial arbitration model. As a result, the first Chapter 11 proceedings took place in almost complete secrecy. Indeed, the existence of many cases was not even discovered until well after they had begun. Further, none of the proceedings have been open to the public or the press, and written arguments of the investor and the state party have been made available in only one case to date.⁴³ The only area of guaranteed public access is for final awards, and then only in the case of Canada and the United States. Mexico reserves the right to maintain awards secret in cases where it is a party, though it has not done so to date.

In August 2000, the International Institute for Sustainable Development (IISD) initiated for the first time a petition to appear as an *amicus* in a Chapter 11 case, notably in *Methanex v. United States*. In arguments joined subsequently by three US NGOs IISD argued, in particular, that the public interest nature of the litigation in question, challenging the enactment of an environmental protection law, required a greater degree of public access and accessibility than in traditional commercial arbitration cases. Canada and the United States supported the *amicus* petition, Mexico and Methanex Corp. opposed it. The Tribunal responded positively, noting that:

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

⁴³ So far as we are aware, the full arguments have been made publicly available only in the Methanex v. United States case, still at the jurisdiction phase.

from being perceived as more open or transparent, or conversely be harmed if seen as unduly secretive. (Para. 49)

While an order allowing written *amicus* submissions is anticipated if the jurisdiction proceedings result in a determination to proceed to the merits stage, permission to attend the hearings and to have ensured access to the written pleadings of the parties prior to submitting a brief were both denied. On these points, the secrecy of the proceedings is to be maintained, unless the parties expressly agree otherwise.

The IISD recognizes the significant step taken by the tribunal in the Methanex case.⁴⁴ However, this step in itself does not overcome the remaining transparency failings of the investor-state process. As the Tribunal noted, the importance of public credibility and acceptance is real, and an important value. Both are seriously lacking. Indeed, nowhere is the democratic deficit of NAFTA more readily apparent than in its investor-state dispute settlement procedures.

By the summer of 2001, the transparency issue had risen to the top of NAFTA's political agenda. The July 31, 2001 interpretive statement of the Free Trade Commission focused most of its terms on this question. Even so, the statement in reality moved the legal basis for transparency only marginally. Recent analysis of the statement highlights both the absence of significant parts of the arbitration process from its scope and the lack of binding force of this part of the statement on tribunals. This is because its actual wording defers to the decisions of individual tribunals taken under the arbitral rules to establish their own final rules of procedure, including rules relating to confidentiality of documents. In addition, nothing in the statement overrides the requirements for secret proceedings, closed to press and the public.⁴⁵ In short while the statement recognizes the political dimension of transparency as a problem, it fails to address in a binding way the details of the problem.

4.2. The Institutional Void

Just as critical as the lack of transparency is the absence of an institutional capacity to manage the dispute settlement process and subsequent substantial issues that arise. The process is entirely ad-hoc, and problems begin with the very first steps of a dispute; there is not even an assured avenue to find out whether a dispute has been initiated. While this may be acceptable for commercial arbitration it contravenes the most basic principles of accountability when matters of public welfare are at issue. ICSID has recently begun to publish a list of current disputes but UNCITRAL has no comparable requirement. The negotiators recognized the significance of this issue and provided for a public register of arbitration notices filed, to be maintained by the NAFTA trade secretariat. This secretariat is, however, composed of three national sections with no central point of

⁴⁴ For a review of the full decision see Howard Mann, "Opening the Doors: At Least a Little Comment on the *Amicus* Decision in *Methanex v. United States*", Review of European Community and International Environmental Law, Vol. 10, 2001, pages 241-245; and Patrick Dumberry, "The Admissibility of *Amicus Curiae* Briefs in NAFTA Chapter 11 Proceedings: Some Remarks on the *Methanex* Case, A Precedent Likely to Be Followed by Other NAFTA Arbitral Tribunals", Bulletin 1, 2001, Association Suisse de l'arbitrage, pp. 74-85.

⁴⁵ Van Duzer, *supra*, n. 19, IISD, Note on NAFTA Commission's July 31, 2001, Initiative to Clarify Chapter 11 Investment Provisions, at http://www.iisd.org/pdf/2001/trade_nafta_aug2001.pdf

contact. The obligation to maintain a public register of cases has effectively fallen between the cracks since none of the national sections has overarching responsibilities that transcend its own interests.

The choice of arbitrators is left to the parties to a dispute. That may be acceptable for commercial disputes but when matters of public welfare are at stake it again contravenes one of the most fundamental principles of jurisprudence, namely that parties to a dispute may not pick their own judges. Moreover, with no standing roster of arbitrators the accountability of persons who serve as arbitrators is severely attenuated. The protections afforded judges in most societies are usually balanced by stringent requirements concerning public access to and transparency of proceedings. In addition, arbitrators are not expected to be conversant, let alone expert in, Chapter 11 in particular or international investment law in general, and even less so in terms of the types of national and international environmental law matters that have already arisen in the cases. For the most part, the arbitrators chosen for NAFTA cases have been persons of high standing, some of whom have extensive experience as judges but not necessarily in North America. Some choices suggest calculated self-interest from the party concerned. The essential point about institutional safeguards such as the ones discussed in this section is that they are designed to provide reassurance about the legitimacy of the process, no matter how honorable—or even dishonorable—the arbitrators.

Chapter 11 provides for no formal appeal process, leaving this to an ad hoc process of judicial review under various local statutes that vary in scope and quality of review. Given the importance of Chapter 11 in the scheme of NAFTA, and its now obvious linkage to critical public policy and public welfare issues, this lack of institutional framework is a critical gap.

Some observers have suggested that Chapter 11 “case law” would find pragmatic solutions to many of the problems that had arisen. The institutional and procedural gaps described above reduce the likelihood of this occurring. Most importantly, lack of transparency makes the notion of “case law” a hit or miss proposition: there is never any assurance that all relevant information is available. Declarations from parties to a dispute that the necessary information has been released cannot be verified and there is no objective standard against which to judge such declarations. Also highly significant is the lack of any institutions that might promote a sense of collective responsibility on the part of panel members. Moreover, their immediate obligations are to the specific aspects of the dispute before them and not to any overarching institutional purpose. Indeed, they are professionally enjoined from engaging in “strategic” behavior that may be required to remedy defects in the text of the agreement.

It is by now fairly obvious that the negotiators—themselves honorable men and women—created a quasi-judicial process without giving much thought to some of the most fundamental principles that underpin the administration of justice in the countries of North America. That is inexplicable unless one assumes they remained unaware of the public welfare implications of their actions. There is a certain irony in the fact that the United States has resisted the creation of an International Criminal Court with a full panoply of institutional safeguards for fear of harm for its citizens. Yet it has accepted the

jurisdiction of NAFTA arbitration panels that do not meet some of the most elementary standards of institutional probity when the public welfare is at stake.

In most democratic countries, major investment decisions involve a significant institutional commitment on the part of public authorities, to ensure that essential public goods are promoted, to provide necessary support to investors, and to ensure that disputes between investors and public authorities at all levels can be considered under circumstances that all parties recognize as legitimate and equitable. These include administrative hearings (often at several levels and with varying membership), transparency, environmental assessments, public participation and judicial review, all within a complex framework of substantive and procedural law. An international process that substitutes itself for these domestic procedures must meet the same fundamental standards of legitimacy, accountability and equity that have been implemented domestically. Otherwise it will inevitably result in the erosion of central values of many of the countries in question.

It needs to be emphasized that none of the above is an argument against investor-state dispute settlement per se. States do not invest in other states and it is not the function of governments to act as legal counsel to their citizens in private matters abroad. The logic of globalization with the resulting increase in private actions at the international level and the concomitant need for legal frameworks to promote fairness actually points strongly towards the creation of substantial international institutions. Indeed, this process is well under way. There are also a growing number of issues concerning international public welfare that can no longer be fully represented by individual states acting through their own institutions alone. These also create a dynamic towards the emergence of international jurisdiction. Yet none of this justifies abjuring the most fundamental principles of legitimacy, transparency and accountability that have been developed over long periods of time to ensure that private interests and the public welfare can be properly balanced. Moreover, none of this reduces the imperative—discussed below—to ensure that investment law incorporates the responsibilities of the investors themselves, as well as their rights.

5. OPTIONS FOR CHANGE

The inclusion of provisions promoting sustainable development can be seen as a positive new direction for international investment law. At the same time, addressing the interpretation of the specific investor protection provisions (of Chapter 11 or other agreements) can be understood to some extent as “damage control”: ensuring that legitimate elements of investor protection do not come at the expense of the governmental role in protecting public goods and the public welfare. Options relating to both of these categories are discussed below.

Options for change must also be considered with two other criteria in mind: options of specific relevance to Chapter 11, and options geared to the development of further investment agreements. Again, both are considered below.

5.1. Chapter 11 Options: Interpretive statement and amendment

In 1999, IISD proposed an interpretive statement under Article 1131(2) of Chapter 11 to remedy some defects of the Chapter 11 process that had become evident by then. This Article requires that Chapter 11 tribunals apply any interpretations of Chapter 11's provisions as may be set out by the Free Trade Commission. In international law, this is known as an interpretive statement. While an interpretive statement formally issued by the parties to a treaty is not necessarily binding on a dispute resolution body under Article 31 of the Vienna Convention on the Law of Treaties, Article 1131(2) of NAFTA does make it fully binding. In essence, this was a safety valve inserted into Chapter 11 to allow some control by the parties over the life of the Chapter. There were two main reasons for the approach advocated by IISD.

The first reason was that Mexico would not undertake any significant review of the provisions of Chapter 11 at that time, as it believed the cases would sort out any putative problems. An interpretive statement was thus seen as responding to this reluctance. In any event, further cases have not clarified the situation as was expected. Indeed some new issues of concern have emerged.

The second reason was the hope that an interpretive statement could be developed in a relatively short period of time, compared to an amendment process. It was thus thought worthwhile to test its value as a tool for the Parties to resolve problems that arose. To date, the one statement issued in July 2001 was limited in scope, and remains uncertain in terms of its substantive and procedural impact. Negotiations on a second statement are on the table, but there are no reports of any significant progress. To date, there is no indication of its possible scope, nor any public discussion of proposals for such a statement.

Finally, it was thought that suggesting a full amendment process might be premature. Given the apparent lack of additional issues that might be considered as part of an amendment process, it was seen as unlikely that an amendment process just for Chapter 11 was a realistic possibility.

As noted several times previously, the Free Trade Commission did issue an interpretive statement on 31 July 2001. It covered two issues, transparency and the interpretation of the minimum international standards provision. In both cases, as already noted, the scope of the statement is limited, and on transparency it is not legally binding on the tribunals.

While the IISD believes that the interpretive statement process should continue, its inherent limitations, combined with the passage of an additional three years, suggest that it may be necessary to move towards an amendment. The NAFTA text was written ten years ago and it has now been in force for over eight years. There are other issues of substance that have developed, and other areas of process that need addressing. (In particular, public access to the working groups and other bodies that implement and further develop NAFTA's obligations is becoming critical as these bodies move into areas of broader public interest.) Secondly, as regards Chapter 11 itself, it is apparent that an interpretive statement cannot provide the procedural legitimacy and institutional

robustness that is required of the dispute settlement system. Only an amendment can do so. Finally, while an interpretive statement can address the “damage control” required to mitigate the uncertainties and regulatory chill created by the existing provisions of Chapter 11, it cannot expand the content of Chapter 11 to include the promotion of sustainable investments.

Given these factors, the option of an amendment to Chapter 11, with or without other amendments to NAFTA, should now be considered. Promoting sustainable investments, and ensuring the practical ability of governments to maintain environmental management regimes that are dynamic, preventive and responsive to changing needs is central to the global capacity to achieve sustainable development. This recognition underscores the importance of getting Chapter 11, and all other investment agreements, right.

5.2. Future negotiations

Future negotiations on an amendment to Chapter 11 or on a new agreement should address two factors: the promotion of sustainable investments, and ensuring that provisions related to investor protections do not inhibit the ability of governments to take legitimate actions to protect the public welfare.

The first step in relation to any negotiations must come at a conceptual level: investment negotiators can no longer remain in ignorance of the environment and sustainable development implications of their actions, as has been the case in the broadened investment negotiations since 1990. Environment and sustainable development are part of what they do – indeed are at the core of what they do – and only the narrowest neo-classical view of economics could pretend otherwise. It is no longer acceptable to simply promote investment and market liberalization while deferring the sustainability dimensions to the domestic legal systems, particularly when those systems are expressly overridden by the creation of internationally prescribed private economic rights. Yes, this would make already complex negotiations much more so. But any fear of addressing the necessary complexities only reinforces the need to broaden the negotiating base beyond trade negotiators.

Second, the process of negotiation must be much more transparent. The days of closed-door negotiations on matters of high public importance should be over. Open doors and access to evolving draft texts will also ensure a much sounder review of the potential consequences of the negotiations before they are concluded, rather than several years afterwards.

Third, on substance, several elements can be contemplated for inclusion in an agreement that would work to promote sustainable investments. These include:

- Mandating environmental assessments of proposed projects, based on the higher of locally applicable or minimum international standards in this regard. The World Bank standards might be considered here.
- Requiring investors to establish certified environmental managements systems in their ongoing operations.

- Ending the private international law rules on forum non conveniens that allow foreign investors to shed legal liabilities in their home states for acts of their foreign investments. This measure – cost free to governments – would dramatically alter the corporate perception of responsibility for the activities of their subsidiaries, and create a significant legal incentive to improve performance levels.
- Capacity building from a legal, administrative and enforcement perspective are necessary adjuncts to this approach, and should be developed as an integral part of a broader investment agreement.

Avoiding unintended interference with the government duty to protect the public welfare is obviously critical. Here, again, several elements can be proposed:

- Much closer attention must be paid to the negotiation of international investment agreements than appears to have been the case in NAFTA's Chapter 11. It cannot be assumed that provisions on investor protection are benign in this regard.
- A possible carve out provision or exclusionary clause for areas of "legitimate regulation" under NAFTA or areas covered by the general exceptions in Article XX of the GATT should be considered.
- The NAFTA experience must provoke a rethinking of the desired scope of investor protections and private sector economic rights. Disciplines must be spelled out clearly, not by simply utilizing terms brought over from trade law. It cannot be assumed that trade law is wholly or even in part applicable to investment. While trade and investment decisions may reflect decision-making on a business continuum, their footprints in environmental and social terms can be vastly different, and these differences must be reflected at the core of an investment regime.
- Disciplines must be clear, not vague. They must have a finite range of interpretation, rather than be open ended. To some extent, of course, lawyers will always seek the unforeseen. It is incumbent on governments to now take the risks associated with this search seriously, and undertake the same effort before an agreement is concluded rather than afterwards.