

NAFTA's Chapter 11 and the Environment

**A Discussion Paper for the CEC's Public Workshop on NAFTA's
Chapter 11**

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1. Introduction

This paper briefly outlines the key environmental issues raised by NAFTA's Chapter 11. The Chapter, aimed at creating a regime to protect NAFTA-based foreign investors within the three countries, has in recent years weathered a great deal of criticism from the environmental and social justice communities.

The paper starts by outlining five key substantive provisions of Chapter 11 – obligations that host countries have accepted in their treatment of investors from the other NAFTA Parties. In each case it discusses the concerns voiced with respect to the environmental impact the provisions might entail, the discussion being informed by the (relatively few) cases to date.

The paper then turns to the concerns that have been raised with respect to the Chapter 11 process of dispute resolution, focusing on deficits of legitimacy, accountability and transparency.

In light of the preceding analysis, the paper explores several options that have been proposed to address Chapter 11's shortcomings: an exception for environment, health & safety; interpretive statements, and amendment of the NAFTA.

Finally, the paper makes a number of recommendations to the CEC on how it might become involved in the efforts to address the problems identified.

2. The Substantive Provisions

NAFTA's Chapter 11 contains a number of provisions that oblige the host country to accord certain types of treatment for investments from its NAFTA partners. These provisions include:

- Protection from direct or indirect expropriation (Article 1110)
- National treatment obligations (Article 1102)
- Most-favoured nation obligations (Article 1103)
- Prohibition of performance requirements (Article 1106)
- Obligations for minimum international standards of treatment (Article 1105)

Together, these provisions and others in the Chapter constitute an accord among the NAFTA governments on what constitutes fair treatment of investors from the other NAFTA countries. The specifics of each of these provisions is examined in more detail below, but as background it is worth first elaborating on the *scope and coverage* of the obligations. That is, these provisions restrict the types of measures that can be imposed on investments. So to fully understand the impacts of the provisions, we need to first understand how NAFTA defines both measures and investments.

As a number of analysts have noted, the definitions are unusually broad. The measures covered by Chapter 11 include “any law, regulation, procedure, requirement or practice.” This covers most conceivable acts of government (at all levels from federal to municipal), from lawmaking to zoning codes, and even extending to cover the actions of the courts.

Investment is also broadly defined, including anything from an enterprise to a debt security or loan to an enterprise. A holder of a bond from a multinational enterprise is thus an investor, conferred with the extensive legal rights discussed below. This definition has been extended by several rulings that have held that a company’s *market share* is an investment asset that can be protected. So when Pope & Talbot’s US market share decreased as a result of Canadian government policy, it was entitled to compensation.¹ In effect this approach has the potential to bring the full gamut of *trade* measures under the purview of NAFTA’s *investment* law, as most trade measures will affect market share. This would greatly extend the reach of the provisions, and would grant more access to the direct investor-state process (discussed below) than was arguably ever intended.

2.1. Expropriation

Article 1110 stipulates that any expropriation must be:

- a) For a public purpose
- b) Non-discriminatory (that is, not targeted at a specific company or nationality)
- c) In accordance with the due process of law; and
- d) Compensated by the expropriating government.

¹ Or, more accurately, the panel ruled that Pope & Talbot *would* have been entitled to compensation had they been able to show a significant loss, but they could not.

It also notes that its strictures cover both direct and indirect expropriation but, importantly, fails to define these terms. This is not so problematic with the former; direct expropriation – the physical taking or nationalization of an enterprise – is easy to identify, and there is a significant body of international law to guide arbitrators in addressing it.

But indirect expropriation is much more difficult. Also commonly referred to as creeping expropriation, or disguised expropriation, indirect expropriation is the taking of an investment property by means of regulations or other measures that achieve more or less the same final effect as direct expropriation.² Rather than nationalizing an investment outright, for example, a country might replace all of its managers with government appointees, or prohibit it from importing and exporting, with the intent of putting it out of business. With this type of expropriation there is little agreement on definitions, and little in the way of case law to use as guidance.

The key question in the NAFTA context is this: if a NAFTA government measure is undertaken for a clear public welfare purpose (such as health and safety, environment, public morals or order, etc.), and is non-discriminatory, but has the effect of harming a NAFTA foreign investor, under what circumstances can that measure be held to be an indirect expropriation, for which the government must pay compensation? The concern is obvious: most people would agree that taxpayers should not be paying investors to alter behaviour that is contrary to the public interest. A secondary concern is that regulators who are held liable for their impacts on investors will not regulate to the extent that they should (the *regulatory chill* argument).

What might allay these concerns? First and most obvious: a clear statement that regulations cannot be held to constitute expropriation. Failing that, we might look for some delineation that would exempt *bona fide* public welfare regulations from Article 1110. This would necessarily involve defining the “untouchable” regulations, or at least giving guidance as to their characteristics. And failing that, we might hope to see at least some signs that the Tribunals were considering the purpose of regulations, as opposed to simply looking at the extent to which they affected investors. Such a consideration would in the end come close to being a case-by-case determination of what regulations should be exempt, presumably on the basis of their *bona fides* and their public welfare objectives.

² Article 1110 also refers to measures “tantamount to” expropriation. The consensus to date is that this is equivalent to indirect expropriation.

To date we have none of these elements of hope. All panels that have considered the question have held that regulations can indeed constitute expropriation. Neither in the rulings to date nor in the NAFTA text do we find any attempt to “carve out” *bona fide* public welfare regulations. And while it is too soon to say how the case law will develop, the rulings to date have focused solely on the extent of impact (asking whether it was substantial enough to constitute expropriation) as opposed to the purpose of the contentious measures.³ The *Metalclad* tribunal, for example, ruled that “The Tribunal need not decide or consider the motivation or intent of the adoption of the Ecological Decree.”

2.2. National Treatment

Article 1102 obliges Parties to “accord to investments of investors of another Party treatment that is no less favourable than that it accords, in like circumstances, to those of its own investors.” The main cause for concern here is the difficulty in determining whether circumstances are “like.” Clearly the text does not mean “identical,” but neither does it give any guidance on how to determine whether circumstances are sufficiently similar as to trigger this obligation.

For example, if several existing firms are already polluting to the maximum allowed in a certain ecosystem, would a refusal to permit a foreign investor to open another plant at the same site amount to a breach of national treatment? Certainly the foreign investor is not being treated as well as the existing domestic firms.

There is little comfort in some of the rulings to date. In a particularly convoluted piece of reasoning, the *S.D. Meyers* panel ruled that a Canadian processor of hazardous waste was in like circumstances with a Canadian office established by the US investor for the purpose of brokering the export of hazardous waste. That being established, it was a simple matter to show that an export ban on hazardous waste accorded very different treatment to the two, though both were equally bound by it.

The Tribunal in *Pope & Talbot*, on the other hand, used reasoning that gives more hope for rational application of national treatment obligations. *Pope & Talbot*, a US-owned forest products company operating in the Canadian province of

³ Such case law may take some time to develop (if it ever does). Rulings of Chapter 11 tribunals have no force as precedent on the rulings of future panels, though they may be influential.

British Columbia, had argued that it was in like circumstances with producers in those provinces that were not restricted by the quotas of the Canada-US softwood lumber agreement. The tribunal rejected these arguments, noting that the differential treatment bore a “reasonable relationship to rational policies not motivated by preference of domestic over foreign owned investments.” This is a welcome sign of deference to governmental authority in balancing the many competing priorities of public policy.

2.3. Most-Favoured-Nation Treatment

Article 1103 states that Parties shall accord to investors and investments of other Parties: “treatment no less favourable than it accords, in like circumstances, to investors of any other Party or of a non-Party ...” In other words, all NAFTA Parties shall be “most-favoured.”

There is, of course, the same problem here as in Article 1102: what constitutes like circumstances? But another concern may turn out to be far more significant.

Article 1102 may provide a way to import into NAFTA the most favourable treatment found in any of the bilateral treaties signed by the defendant in a dispute. That is, if a Party is obliged under NAFTA to provide a certain standard of protection, but a higher standard exists in a treaty signed by that Party with a non-NAFTA country, does the most-favoured nation obligation mean that the higher standard prevails? An example illustrates the power of this possibility. The US and Zaire have a bilateral investment treaty that sets a very low threshold for finding regulatory expropriation, protecting against any measures that cause, “the impairment of [the investment’s] management, control or economic value.” Such a standard would arguably be unacceptable to the NAFTA Parties,⁴ and was arguably not part of the accord they thought they were signing. To imagine otherwise is to imagine that the Parties wasted their time in drafting any provisions other than Article 1103 (except, of course, in the case of

⁴ This assertion is based on the language of the recent US Trade Promotion Authority Act, which mandates that in future trade and investment agreements “foreign investors in the United States are not accorded greater rights than United States investors in the United States,” – a condition that would be violated if foreign investors were accorded the US-Zaire level of protection. And it is based on the public comments by Canada’s Minister of Trade questioning the value of a broad interpretation of Article 1110. The author has no evidence of a Mexican position on expropriation, but strongly suspects that the US-Zaire language would be unacceptable. Also see Vicki Been and Joel C. Beauvais, “The Global Fifth Amendment? NAFTA’s Investment Protections and the Misguided Quest for an International “Regulatory Takings” Doctrine.” *New York University Law Review*, 78 (forthcoming April 2003).

provisions offering better protection than found in any of the hundreds of existing BITs.)

This possibility is worryingly concrete. At least one bilateral investment treaty dispute (*Maffezini vs. the Kingdom of Spain*⁵) found in favour of such a use of the treaty's MFN provisions. Closer to home, at least two Chapter 11 claimants have argued that the NAFTA Free Trade Commission's 2001 interpretive statement (discussed below in section 3.1) – on minimum international standard of treatment – is worthless, since a stronger standard of treatment exists in various BITs, and since Article 1103 obliges the Parties to accord the higher standard. In *ADF*, the argument was dismissed because Articles 1102 and 1103 do not apply in cases of government procurement, of which this was one.

But the argument was favourably considered in *Pope & Talbot*, though the Tribunal did not find it necessary to rule on it: “The Tribunal's view is well known – the Commission's interpretation would, because of Article 1103, ... produce the absurd result of relief denied under 1105 but restored under 1103.”⁶ The Tribunal is arguing here that the Commission's interpretive statement produces an absurd result, *based on acceptance of the argument that, by reference to existing BITs, Article 1103 can “restore” the protections the FTC's interpretation has allegedly removed.*

In section 3.1 we shall return to this provision to assess what it means for the prospects for addressing the shortcomings this paper identifies in Chapter 11.

2.4. Performance Requirements

Article 1106 prohibits host countries imposing certain types of requirements on investors as a condition of entry and establishment. Among the requirements proscribed are demands to export a certain percentage of sales, demands to purchase locally for certain inputs and demands to transfer certain technologies to the host country.

The concern here is that in several cases now it has been argued (though no ruling has yet been issued) that an import ban constitutes a performance requirement. In *Crompton*, for example, Canada banned the import of lindane-based seed treatments for canola on environment and health grounds. But

⁵ ICSID Case No. ARB/97/7, 25 January 2000; 40 ILM 1129 (2001).

⁶ Letter to the investor and defendant from The Hon. Lord Dervaird, Chair, *Pope & Talbot* Tribunal, dated Sept. 17 2001.

Crompton US, the manufacturer, plans to argue that the ban forces its Canadian subsidiary to buy local substitutes, and thus is in effect a local purchasing requirement. Ethyl made similar arguments in its case, which Canada settled out of court. Import bans being a frequently used tool of environmental policy for dealing with toxic substances, this argument is worrying.

2.5. Minimum Standard of Treatment

Article 1105 requires that investors shall receive treatment “in accordance with international law, including fair and equitable treatment ...” The text leaves this requirement undefined, and before it was specifically ruled out by a Free Trade Commission (FTC) interpretive note dated July 2001, several cases interpreted it to mean that investors were due treatment spelled out in *any* international law, including the WTO, and even non-Chapter 11 parts of NAFTA. The interpretive statement narrows the scope considerably, asserting that the Parties meant to commit to treatment in accordance with *customary* international law.

This does not leave matters completely resolved. There is no clear-cut consensus on what constitutes customary international law, which is normally defined in a circular fashion: that body of international law that has become so widespread in its use that it has become customary. But it has at least narrowed the scope for bringing into Chapter 11 a wide variety of law that is not specified anywhere in its text, customary international law being a subset of international law.

The concern now is that the interpretive note may not have the intended effect when read by arbitral panels under Chapter 11. As noted above, the investor in *Pope & Talbot* argued that Chapter 11’s MFN obligations mean that investors are due a better standard of treatment than found in customary international law, by virtue of commitments to that effect in various BITs the Parties have signed with non-NAFTA nations. The Tribunal was inclined to agree, but did not rule on the question.

As well, several claimants have now asserted that the Parties did not actually interpret Article 1105 so much as they amended it, changing its meaning. The difference is important; Article 1131 (2) grants the Parties authority to issue interpretations that are binding on all panels. But amending the NAFTA is much more difficult process. We will return to this issue when considering options for reform, but note that *Pope and Talbot* basically agreed with this argument (though again there was no need to rule on it): “... were the Tribunal required to make a

determination whether the Commission's action is an interpretation or an amendment, it would choose the latter."⁷

Further, in retrospect the note may not have prevented certain troubling rulings issued before its release. In *Metalclad*, for example, the tribunal ruled *inter alia* that the government of Mexico was liable for the assertions of a single bureaucrat, and that the government had a duty to correct legal misunderstandings held by the investor. These are extremely broad readings of 1105, and if followed would impose dauntingly high hurdles on national regulatory and administrative processes.

2.6. Conclusions

This section argues that the provisions of Chapter 11 are being interpreted, or risk being interpreted, in ways that are overly broad. This problem, of course, is compounded by the expansive definitions of investments and measures, giving a wide scope to extremely effective investor protections.

It needs to be asked: what is wrong with giving effective protection to investors? Investment, after all, can be an engine of sustainable development. And the growth it brings can, if managed appropriately, bring real welfare benefits.

Whether the NAFTA Parties are currently equipped to manage growth appropriately is beyond the scope of this paper. The issue of more direct relevance to the present inquiry is one of balance. Expanding the rights of private investors typically comes at the expense of the rights of the public at large. This is perhaps most clearly demonstrated in the granting of patents, which allow a limited monopoly (monopolies always being against the public interest, other things being equal) as a reward to investment and innovation. To use an example from the context of investment law, *Metalclad Corp.*'s right to run a hazardous waste processing facility outside San Luis Potosi balances against the public's right to an ecological preserve on that same land. Neither right is absolute, and it is normally the task of governments to find the appropriate balance.

The concern expressed by some with NAFTA's Chapter 11 is that there seems to be real potential to shift the balance unduly in favour of investor protection and away from the public good. It is not at all clear that the Parties anticipated the broad readings of Chapter 11's provisions now being accepted or contemplated.

⁷ *Pope & Talbot Inc. vs. the Government of Canada*. Award on Damages, 31 May 2002, para. 47.

Or, if they did, it is not at all clear that the balance they strike, or threaten to strike, would be acceptable to the public at large.

Further, it would seem inappropriate for the balancing of public policy priorities such as the environment, economic growth and health & safety to be conducted outside of government with few of the process safeguards that help ensure acceptable outcomes in the public sphere. It is to this issue that then next section turns.

3. *Process Issues: Legitimacy, Accountability and Transparency of the Arbitration Process*

NAFTA Chapter 11's dispute settlement mechanism allows for private parties (investors) to directly initiate arbitration with host states, in what is known as an investor-state dispute mechanism. This procedure contrasts to the process of trade law disputes, for example in the WTO, which are strictly state-to-state. The ability to bring a private case directly against a host state is a powerful mechanism, and is also found in most bilateral investment treaties.

Chapter 11 allows parties to arbitrate cases under any of 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 has its own set of rules of procedure, all roughly similar, and all drawn from a traditional commercial arbitration model.

This last point is important. Until recently investment arbitration was a purely commercial matter between two disputants, and it is for this reality that the present institutions are still geared. However, the broad scope of the Chapter 11's coverage and the expanded interpretations of the substantive provisions virtually guarantee that many of the cases that will be heard will have wider impacts on public welfare, in which more than the two disputants will share a legitimate interest.⁸

⁸ See Howard Mann and Konrad von Moltke, "Protecting Investor Rights and the Public Good: Assessing NAFTA's Chapter 11." Background paper to the ILSD Tri-national policy workshops, Mexico City, March 13; Ottawa, March 18; Washington, April 11. Winnipeg: IISD, 2002. (http://www.iisd.org/trade/ilsdworkshop/pdf/background_en.pdf)

When the International Institute for Sustainable Development and Earth Justice argued (in separate submissions) their interest in the *Methanex* case, petitioning for “friends of the court” standing, the Tribunal strongly agreed:

“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.”⁹

It was argued above that rulings in such cases amount to a balancing of competing public policy objectives, with final results that impact on public welfare. This type of balancing is done on a regular basis by a number of institutions in all three NAFTA Parties, including the judiciary and various governmental bodies. There is, however, a striking contrast in the attributes of these well-developed institutions and the commercial-model arbitration conducted under Chapter 11. The former are carefully constructed so as to operate with legitimacy, accountability and transparency – qualities that the latter is utterly lacking.

As to legitimacy and accountability, the Chapter 11 dispute process is lacking in several respects. The panelists themselves are not drawn from a permanent roster of arbitrators, and the selection process has the litigant choosing one of the three arbitrators, and potentially collaborating on the choice of the third – a situation that invites biased choice. A permanent roster of panelists would address this issue of bias, wherein the disputants are tempted to choose panelists whose views are known to be sympathetic to their positions. It would also greatly facilitate the development of a consistent body of case law on the key questions of interpretation. And it would attenuate the conflicts of interest that are inherent when lawyers interpret the law by which they make their daily bread. That is, it is clear that expanding the scope of possible causes of action against governments results in a greater volume of arbitration.

The Chapter 11 dispute process allows only a very limited form of review – essentially a challenge of the arbitral award in the courts of the country where

⁹ *Methanex Corp. vs. the United States of America*. Decision of the Tribunal on Petitions from Third Persons to Intervene as “Amici Curiae,” 15 January 2001, Para. 49. As of March 2003 the Tribunal still has not ruled on the request, though it indicated in the cited document that it was “minded to” grant it.

the Tribunal was legally located. The review then proceeds under the applicable international arbitration laws of the country or state/province in question, but the standard for review in such cases is much higher than that set for domestic appeals. The Tribunal would have to be shown to have committed an error of law so great that it amounted to an exceeding of its jurisdiction, rendering its decision null and unenforceable. In the end this is not an appeal process; the review cannot rule on simple errors of fact or law, or substitute a decision for the one made by the tribunal. The widely-acknowledged value of the WTO's permanent Appellate Body in giving consistency and predictability to the process should be seen as instructive.

The *ad hoc* nature of the panel selection and the lack of opportunity for appeal stand in sharp contrast to what is found in the Parties' domestic systems of justice, where essential safeguards are part of a rich institutional web of mechanisms designed to ensure accountability and legitimacy of process.

Moreover, both legitimacy and accountability are impossible where there is no transparency. On this score, even Chapter 11's strongest supporters agree that change would be beneficial. As befits a purely commercial dispute mechanism, there is no provision for public access to the court documents. ICSID cases must at least be notified in a public record, but UNCITRAL lacks even this basic requirement. There is an obligation on the NAFTA Secretariat to keep a public registers of notices of intent to arbitrate. This obligation has recently begun to be fulfilled by the Canadian and US governments, which go further, posting to their web site all submissions and decisions from cases against them (the US also posts other cases).¹⁰ Finally, the Free Trade Commission's 2001 interpretive statement committed the Parties to making public all documents submitted to or issued by a Chapter 11 Tribunal but there is reason to believe that this pledge may have little effect, since the FTC has no jurisdiction over the rules of ICSID or UNCITRAL.¹¹ The interpretive statement and its transparency commitment are analyzed in greater detail in the following section.

While there is now better access to the legal documents in Chapter 11 cases, there is still no allowance for observers in the hearings, no access to the court minutes and no allowance for submissions by non-Parties.¹² Given the public interest in

¹⁰ Even so, the most complete collection of court documents comes from an unofficial source. See www.naftaclaims.com.

¹¹ See IISD (August 2001). "IISD's Note on the NAFTA Commission's Recent Initiative to Clarify Chapter 11 Investment Provisions." http://www.iisd.org/pdf/2001/trade_nafta_aug2001.pdf.

¹² In the *Methanex* and *UPS* cases the Tribunals have ruled that they have the authority to grant friends of the court standing, but in neither case has a final ruling on this issue been rendered.

the cases, there seems no reason not to systematically make the case documents public, and to allow the same kind of access to proceedings allowed in any domestic court. While some contend that this would place confidential business information in the public domain, such documents could still be restricted, even as they are in the domestic setting. Or, as some have suggested, transparency might be the price to be paid for the privilege of using the powerful and direct investor-state mechanism.

It should be emphasized that these are not criticisms of the investor-state process *per se*. The history of investment protection shows that it is probably best not left up to governments, who respond only to bigger players, and whose decisions whether to proceed with any given claim will always be tied up in the politics of the moment.¹³

4. Possible Solutions

The concerns summarized above have led to calls for reform of both the substance and the process of NAFTA's Chapter 11. (It is useful to keep in mind that the two types of reform are very different propositions. We will see below that some of the proposed solutions work better for one type than for the other.) The proposals fall into three main categories:

- Interpretive statements issued by the FTC;
- Exceptions in Chapter 11 for environment, health and safety;
- Amendment of the Chapter 11 text to narrow its scope, add precision to provisions, and to alter process.

The pros and cons of each of these approaches are discussed below.

4.1. Interpretive Statements

Article 1131 (2) of the NAFTA states: "An interpretation by the [Free Trade] Commission of a provision of this Agreement shall be binding on a Tribunal established under this Section." In other words the three Ministers of Trade may issue binding interpretations of the Chapter 11 provisions, presumably in

¹³ See Kenneth Vandeveld, United States Investment Treaties: Policy and Practice. Boston: Law and Taxation Publishers, 1992:23-25.

circumstances of uncertainty. Given the concerns that have been voiced about the overly-broad interpretation of Chapter 11's provisions, an obvious solution would seem to be interpretive statements issued by the FTC clarifying exactly what the drafters meant by, for example, indirect expropriation.

In fact the FTC did issue such a statement (hereinafter, the FTC statement) in July 2001.¹⁴ It had two parts: first, an interpretation of Article 1105 (minimum international standards of treatment); and second, a clarification and commitment on the issue of transparency. An analysis of this statement clearly illustrates the limited function such a mechanism can play in reforming some of the problems identified in this paper.¹⁵

The FTC statement had asserted that NAFTA's drafters, when promising treatment in accordance with international law, in fact meant *customary* international law – a much weaker standard of protection. As noted in section 2.5 above, the FTC interpretation of 1105 has been criticized as worthless on two grounds. First, it has been argued that Chapter 11's MFN provisions can end-run any attempts to limit the scope of 1105 by reference to bilateral investment agreements where the Parties have already committed to a stronger standard of protection. This is arguably not much of a stumbling block, since the FTC is obviously empowered to start their interpretations by limiting this sort of reading of the MFN provisions.

The more serious fault is that in two cases to date (and more will certainly follow) the investor has argued that the "interpretation" was in fact an amendment, since it actually changed the meaning intended by the drafters. While Article 1131 (2) gives the FTC authority to render binding interpretations, actual amendment is a much more difficult process, and is outside the FTC's jurisdiction. As indicated in section 2.5, the *Pope & Talbot* Tribunal was inclined to agree with this argument, but did not in the end rule on it.

This brings us back to the proposition that the interpretive statement is a solution to the problems identified in this paper. Clearly this is only true to the extent that the meaning intended by NAFTA's drafters is more limited in scope than the expansive readings we have found so troubling. For Article 1105 it is not clear that this is the case, but *any* interpretation worth its salt will undoubtedly repeatedly be the target of the same type of legal attack, it being a relatively straightforward line of argument with a potentially large payoff.

¹⁴ See <http://www.dfait-maeci.gc.ca/tna-nac/NAFTA-Interpr-en.asp>

¹⁵ For a careful analysis see IISD, *supra* at 11.

Is the potential any better that interpretive statements can address process problems than it is for substantive provisions? In fact it may be worse. Again, using the FTC statement as an example is instructive. The statement commits the Parties to “make available to the public in a timely manner all documents submitted to, or issued by, a Chapter Eleven tribunal.” This pledge is subject to three possible exceptions, one of which is vitally important: except for “information which the Party must withhold pursuant to the relevant arbitral rules, as applied.”

All Tribunals to date have established high levels of secrecy which would be fundamentally altered by the Parties’ commitments, were they fulfilled. But then again, in none of these cases *could* they have been fulfilled, since the information in question was being withheld pursuant to the relevant arbitral rules. The problem here is one of jurisdiction. By ICSID and UNCITRAL rules, each Tribunal at the outset agrees with the Parties on rules of procedure, including confidentiality orders. While the Parties may have authority to issue interpretations of the NAFTA provision, they have no authority to interpret or change the rules of ICSID or UNCITRAL. The only way this agreement will have any force is not as an interpretive statement, but rather as a compact to agree in all future disputes as to how the rules of confidentiality will be constructed at the outset.

On other process issues, such as changing the selection process for arbitrators, and opening up the process to public input and observation, the FTC has even less sway. These are not part of the rules of procedure on which Parties agree in each case, and are either the prerogative of the Tribunal, or are embedded in the rules of ICSID and UNCITRAL.

Thus, while in some cases interpretive statements may help curtail some expansive readings of the provisions, they may be subject to attack as *de facto* amendments. And because the process of arbitration is governed outside the NAFTA’s legal framework, there is not much that interpretive statements can do to address Chapter 11’s process faults.

4.2. An EH&S Exception in Chapter 11

An exception would be an addition to the text of NAFTA that exempted Parties from their Chapter 11 obligations when applying specified types of measures.

The most commonly called-for types are those aimed at protection of human health and safety, and protection of the environment, but it is not difficult to think of other important public policy goals that might also merit inclusion on the list.

The proposal for such a mechanism derives in large part from the existence of similar exceptions in trade law. Perhaps the best known example is Article XX of the General Agreement on Tariffs and Trade (GATT): General Exceptions. This Article lists ten types of measures that can be exempted from GATT law, including measures:

- Necessary to protect public morals;
- Necessary to protect human, animal or plant life or health;
- Relating to the products of prison labour;
- Imposed for the protection of national treasures of artistic, historic or archaeological value;
- Relating to the conservation of exhaustible natural resources;
- Essential to the acquisition or distribution of products in general or local short supply.

Before a measure can be considered as benefiting from these exceptions, it must qualify as per the opening paragraph to Article XX (the *chapeau*), which demands that the measures in question not be “applied in a manner which would constitute a means of arbitrary or unjustifiable discrimination between countries where the same conditions prevail, or a disguised restriction on international trade.” In other words, GATT will allow exceptions, but the drafters wanted to make sure that the exceptions were not abused to protect domestic producers under the guise of loftier principles.

Three considerations make this option questionable. First, to request an exception for a given behaviour is to concede that such behaviour is not acceptable in the first place. Some argue that in the investment arena there should be a presumption of the right to regulate in the public interest.¹⁶ This right may be circumscribed by international agreement, but to start by assuming that it already is seems a weak position. It has been suggested throughout the

¹⁶ See Howard Mann. “The Right of States to Regulate and International Investment Law: Comment.” Paper prepared for the UNCTAD conference: *Expert Meeting on the Development Dimension of FDI: Policies to Enhance the Role of FDI in Support of the Competitiveness of the Enterprise Sector and the Economic Performance of Host Economies, Taking into Account the Trade/Investment Interface, in the National and International Context*, Geneva, 6–8 November 2002.

above analysis that some of the expanded interpretations have gone beyond what was intended by the drafters of NAFTA – a position that would be severely compromised by seeking exceptions to cover the newly prohibited behaviour.

But if the effect is the same, should we care how the objective is achieved? The second cause for worry is that the effect may not be the same. The experience of the GATT shows that the Article XX exceptions are an extremely tough hurdle to clear. Any wording intended to prevent protectionism will undoubtedly cause a great deal of error on the side of caution. For example, the term “necessary” in the environmental exception above has been read by the panels to mean “least-trade restrictive” – a characteristic possessed by relatively few measures.

A third cause for concern is that such a mechanism would not by itself address the process problems identified above. This is not a serious fault, since addressing those problems and creating exceptions are not mutually exclusive endeavours. Since the NAFTA would have to be amended to accomplish the former, the latter could be revised at the same time.

A final cause for concern is precisely that adding exceptions would involve amending the NAFTA. This would be an extremely difficult proposition. The problem is that most trade agreements (or, more accurately, trade, investment and other related policy agreements) are something like an over-packed storage trunk that one has had to greatly compress to finally get it closed and locked. They are usually nailed down at the last minute, under great pressure, by way of compromises that none of the Parties is particularly happy with, but with which they all can live. It will not be a simple matter to go into the storage trunk to retrieve just one pair of socks – once it is sprung open all manner of things are coming out again. As of this writing, for example, the Mexican government is under extreme pressure to reopen NAFTA’s Chapter 7 to obtain more protection for its agricultural sector. Further, Mexico is being pressured by partners in other trade agreements to re-open those agreements in *their* favour, and the precedent set by renegotiating NAFTA would be impossible to downplay. It is no wonder the trade ministries are loathe to bring the trunk out of the closet.

Given the first two weaknesses cited above, if we are to embark on amendment, it would seem wiser to undertake a comprehensive repacking while we have the trunk open. The next section considers such a course of action.

4.3. Amending Chapter 11

The previous section made it clear that there is little political appetite for re-opening the NAFTA to fix Chapter 11. And yet if we go through the catalogue of concerns enumerated above, there seems to be little in the way of alternatives.

- On the question of scope – of NAFTA’s broad definition of investors and measures – neither interpretive statements nor exceptions will be of any use.
- On the troubling readings, or potential readings, of Chapter 11’s substantive provisions, both interpretive statements and exceptions offer some limited hope for improvement.
- On issues of process, both fail completely,

If we do admit that Chapter 11 needs fixing, in other words, it boils down to the need to reopen NAFTA to do it properly. This is unfortunate, given the difficulties involved, summarized above.

It might be possible for the Parties to draft an agreement in advance of re-opening the Agreement, specifying exactly which elements were touchable. The key question is whether such an agreement would be respected once the negotiations were underway.

5.0. Recommendations for the CEC

Before taking any action with respect to NAFTA’s Chapter 11 and the environment, the CEC needs to ensure that it clearly understands the issues in what is a complex area of study. This can only be done through a solid program of consultation and research that listens in greater depth to the many divergent viewpoints on the issues examined in this paper. In that context, the JPAC is to be commended for its persistent role in bringing the issues of investment and environment to the fore, and working to raise the level of understanding of all involved.

Having built capacity on the issues within the CEC, and assuming that the Commission finds cause for concern, the next appropriate step would be to engage the FTC on those same issues. Only the Trade Ministers have the power

to amend or interpret NAFTA, and their support would ultimately be critical to any progress.

The CEC's best conduit for this type of cooperation would be through Article 10(6) of the NAAEC under which there is a clear mandate to cooperate with the FTC to achieve the environmental goals and objectives of the NAFTA, *inter alia* by considering on an ongoing basis the environmental effects of the NAFTA. The 10(6) Working Group has a mandate ideally suited to collaboration on these sorts of issues. The possible modalities are varied: for example, jointly authored briefing papers on specific Chapter 11 issues, round table discussions, collaboration on CEC Chapter 11 research/events.

Should the FTC prove uninterested in the types of collaboration discussed above, or in alternate joint initiatives on Chapter 11 and the environment, the CEC might consider proactively offering its advice, as per its mandate under 10(6). Council already offered to do so in its June 1999 Final Communiqué, but the offer was never taken up. Since then the FTC has met and discussed the matter, with the resulting July 2001 notes of interpretation. But they appear to have done so without the Council's cooperation or input. Any such advice would have to be based on the results of careful analysis and consultation, as discussed above.

Finally, in accordance with its mandate for raising public awareness, the CEC might make efforts to increase wider understanding of the issues, through publications, symposia and through its well-developed channels for public outreach. Public understanding and sympathy for any issue is ultimately the bedrock of change.