

NAFTA's Chapter 11 and the Environment

Addressing the Impacts of the Investor-State Process on the Environment

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1. Introduction

1.1 The Background: Foreign Direct Investment and Sustainable Development

Investment by private sector companies into foreign countries, often referred to as foreign direct investment or FDI, emerged in the 1980s and 1990s as a major source of international development capital for developing countries. From 1988-1997, annual flows of FDI increased more than five-fold from OECD to non-OECD countries. Total foreign investment, including FDI and other market-based instruments such as bank lending and bond issues, now provides three times more investment capital than all forms of grants, Official Development Assistance and other non-market-based forms of support. Between one third and one half of all private investment in developing countries now comes from FDI.¹ With vast amounts of capital needed to replace environmentally unsustainable industries and infrastructures with sustainable ones, it is clear that FDI is critical to achieving sustainability.

FDI provides much needed capital in many developing countries, though the distribution of FDI from developed to developing countries remains largely confined to ten or so leading recipients of these investments. FDI also provides needed infrastructure development, technology transfers, capacity building in the form of technological and management training to individuals in the host state (the state that receives the investment), and environmental leadership in many cases.² So critical are these potential benefits of FDI, that the World Business Council for Sustainable Development has called a proactive approach to the environmental aspects of FDI decision-making the "key to achieving globally sustainable development."³

But FDI can also pose significant risks to achieving sustainable development. FDI is a business process, not a foreign aid process. As such, it faces all the risks, temptations and profit requirements of any other form of business investment. This in turn creates the same challenges and opportunities for sustainability that have been demonstrated by all forms of business, both national and international. Achieving the full global benefits of FDI will, therefore, require policies that ensure it is both sustainable in its applications and sustained in its growth and global distribution. International investment agreements can play important roles toward both these ends, as shown in Table 1.

¹ E.V.K. Fitzgerald, et al., *The Development Implications of the Multilateral Agreement on Investment*, 1998, pp. 8-11. See also, Giorgio Sacerdoti, "Bilateral Treaties and Multilateral Instruments on Investment Protection," Vol. 269 Hague Recueil des Cours, pp. 261-282, 1997.

² Konrad von Moltke, *An International Investments Regime? Issues of Sustainability*, forthcoming, Section 1.

³ Erlam, Keith, and Plass, Ludolf, *Trade and Environment: A Business Perspective*, 1996, at p. 47.

Table 1: Policies Linking FDI and Sustainable Development⁴

Promoting Sustainable Investments	Promoting Sustained FDI
<ul style="list-style-type: none"> • establishing the obligations and responsibilities of the investor to ensure investments are sustainable, including environmental assessments and environmental management systems • maintaining and promoting the general ability of states to protect the environment • supporting environmental regulatory processes • ensuring that states effectively enforce their environmental laws • ensuring that the environmental liabilities of foreign investors can be fairly acted upon, including in the home state; • providing access to environment-related information on investments and investors; • preventing the lowering of environmental standards in order to attract or maintain investments • developing effective citizen instigated review processes 	<ul style="list-style-type: none"> • creating reasonable investor certainty and predictability • preventing arbitrary and discriminatory acts against an investor by establishing rules for <ul style="list-style-type: none"> • expropriation of any assets; • the application of national treatment rules; • the application of minimum international standards of treatment • letting investors manage the business, with mobility of assets and personnel • providing non-biased legally-binding dispute resolution processes

By promoting environmentally sustainable investments, investment agreements can help overcome unsustainable resource exploitation and industrial practices involving foreign investors. Such agreements can help ensure that unsustainable practices are replaced by environmentally sustainable ones, and new industries or activities are equally beneficial to the natural, social and economic environments in which they take place. Some of the leading issues concerning this aspect of international investment agreements are set out in Table 1.

While FDI has increased substantially in recent years, the growth has been concentrated in a relatively small number of countries.⁵ From a global sustainable development perspective, increasing the distribution of this investment will be critical to fostering increased development, especially for the least developing countries. As investments of

⁴ This list is a slightly expanded version of an unofficial note circulated within the OECD by the Environment Secretariat, "What would an MAI with high environmental content look like?," October, 1997. The note was subsequently made public by several NGOs. Copy on file with the authors.

⁵ For example, China receives about 1/3 of all non-OECD destination FDI; China, Singapore and Malaysia together receive about 1/2 of this non-OECD bound FDI; eight countries receive 2/3 of this investment capital. Stephen Thomsen, *Recent Trends in Foreign Direct Investment*, p. 4, OECD Report, 27 May, 1999. And see Fitzgerald et al., Chapter 2 for a discussion.

private capital cannot be compelled, an investment agreement provides an opportunity to help attract investments by increasing their security. In terms of attracting and promoting sustained and well distributed FDI, Table 1 shows how the issues turn from environmental management and protection issues to providing security and predictability to the investors. This aspect of investment agreements can help stimulate investments that might otherwise not take place, and take them into countries where risks of unfair treatment were previously perceived to be high.

1.2 Objective and Structure of the Report

The North American Free Trade Agreement (NAFTA), completed in 1992 by Canada, Mexico and the United States, was the first regional or multilateral investment agreement to try to grapple with these issues. The product of this effort, Chapter 11 of NAFTA, contains the first comprehensive investment regime between countries at different stages of development. The investment /environment issues that received the most attention during these negotiations were those related to promoting sustainable investments. As the three negotiating countries assumed that they had relatively comparable environmental laws on the books, they focused mainly on the enforcement of environmental laws and the assurance that NAFTA would not lead to the creation of so-called pollution havens, or a general "race to the bottom" for environmental standards.⁶ These few issues became central to the political requirement to develop the North American Agreement on Environmental Cooperation, NAFTA's so-called environmental side agreement.

What received little attention during the negotiations, and over NAFTA's first two years, was the scope and interpretation of the investment protection provisions and how they related to environmental protection by the host state.⁷ The past two to three years demonstrate, however, that this is a critical area for consideration. As Table 2 shows, the investor protections provided in Chapter 11 of NAFTA have been used repeatedly to challenge new environmental laws, or applications of existing laws, that have negative economic impacts for the foreign investors.

⁶ See, e.g., the comments of some of the negotiators of the agreements in the post negotiation period: Daniel Magraw, "NAFTA's Repercussions: Is Green Trade Possible?," Vol. 36, No. 2, *Environment*, p. 14 ff., 1994; Howard Mann, "Canada, International Developments," Vol. 4, *Yearbook of International Environmental Law*, pp. 303-307, 1993; Knox, John, "NAFTA's Environmental Provisions: What problems were they intended to address?" Vol. 23, *Canada-United States Law Journal*, p. 403, 1997. And see the overall evaluation in P.M. Johnson and André Beaulieu, *The Environment and NAFTA*, 1996. A full review of these issues and the related provisions of the two agreements are beyond the scope of this paper.

⁷ The early literature on Chapter 11 looked at the new arbitration system, or at the role of Chapter 11 in limiting the opportunities of the three parties to maintain or expand national investment policies promoting domestic ownership in key sectors, or other general approaches to investment policy. Some noted the extensive nature of the new regime, but few foresaw its full impact in the early years. See, e.g., Daniel M. Price, "An Overview of the NAFTA Investment Chapter: Substantive Rules and Investor State Dispute Settlement," Vol. 27, *International Lawyer*, pp. 727-736 (1993); Horlick, Gary and DeBusk, F. Amanda, "Dispute Resolution Under NAFTA: Building on the U.S.-Canada FTA, GATT and ICSID," Vol. 27, *Journal of World Trade*, pp. 21-41 (1993); Fred Lazar, "Investment in NAFTA: Just cause for walking away," Vol. 27 *Journal of World Trade*, pp. 19-35, 1993; Gloria Sandrino, "The NAFTA Investment Chapter and Foreign Direct Investment in Mexico: A Third World Perspective," Vol. 27, *Vanderbilt Journal of Transnational Law*, pp. 259-327, (1994).

The link between the investor protections and their use to challenge environmental laws and regulations is the investor-state dispute resolution process. This NAFTA process is the first one in any multilateral trade or investment agreement to give foreign private investors the capacity to directly challenge host governments on their compliance with the Agreement. It is the unexpectedly broad and aggressive use of this process to challenge public policy and public welfare measures that has caught governments and observers off guard, and led to the preparation of this paper. The objectives of this paper are to review the provisions and processes of NAFTA specifically relevant to investor protection and environmental regulation, identify the problems that they might raise, consider the opportunities to address these problems, and draw some lessons for future negotiations on investment agreements.

This introductory section includes a summary of our findings and recommendations. Section 2 of this paper then provides an overview of the scope and significance of the investor-state process, focusing on its precedent setting nature and its broad implications for government regulatory processes. Section 3 analyzes the substantive legal provisions in Chapter 11 relevant to these issues, and articulates potential responses to the environment-related concerns they raise. Section 4 reviews the specific procedural issues that arise from the investor-state process, with a particular focus on transparency and public access concerns.

Section 5 considers the process issues associated with developing the potential responses to these problems. Section 6 then draws some broader conclusions on the implications of Chapter 11 for the development of future international agreements on investment. Annex 1 of the report provides details of the causes of action and current status of the known cases under the Chapter 11 process. Annex 2 provides draft legal text which may assist the parties in developing focused and effective solutions to the most critical problems raised by Chapter 11.

Table 2: Known Cases Under Chapter 11 of NAFTA

Company	Party	Issue
Halchette Distribution Services	Mexico	Unknown
Signa S.A. de C.V.	Canada	Implementation of administrative drug approval process
Ethyl Corp.	Canada	Import ban on gasoline additive MMT for environmental purposes
Metalclad Corp.	Mexico	State and municipal decisions preventing the location of a hazardous waste facility
Desona de C.V.	Mexico	Alleged breach of contract to operate a landfill and seizure of property
Marvin Feldman, (CEMSA)	Mexico	Specific taxation measures on tobacco exports were discriminatory

USA Waste (“Acaverde”)	Mexico	Believed related to landfill contract decisions
S.D. Myers	Canada	Temporary ban on PCB waste exports
Loewen Group Inc.	United States	Conduct of a civil suit and the subsequent appeals process
Sun Belt Water Inc.	Canada	Allegedly biased treatment by provincial government of US partner in a joint venture
Pope & Talbot	Canada	Allegedly discriminatory export quotas to implement the US-Canada Softwood Lumber Agreement

(Cases in bold are environmentally-related.)

1.3 NAFTA's Chapter 11 on Investment and the Environment: Summary of Findings and Recommendations

Summary of findings

Section 2 of this report argues that the investor-state process in Chapter 11 contains the most extensive combination of rights and remedies ever provided to foreign investors in an international agreement. The investor-state dispute resolution process that is the central feature of this system has been described by leading trade lawyers as “unprecedented,” “remarkable” and “revolutionary.” It provides a virtually unfettered right of foreign investors to initiate direct actions against their host governments.

The original purpose of investor-state protections and the remedies to enforce them can be understood as defensive: to protect against arbitrary and unreasonable government actions against foreign companies. Today, however, the use of the rights and remedies has been drastically changed. Part of a new pattern of the “privatization” of trade and investment law, these rights and remedies have now increasingly been used by foreign investors in a strategic manner to shield themselves from the adoption of new laws or policies that would have an economic impact on them. This strategic development has changed, and arguably misappropriated, the investor-state provisions from their traditional role as a defensive investor protection mechanism to a potent offensive strategic tool.

It is the unexpectedly broad and aggressive use of this process to challenge public policy and public welfare measures, including environmental measures in about half the known cases today, that has caught governments and observers off guard. As a consequence, the provisions designed to ensure security and predictability for the investors have now created uncertainty and unpredictability for environmental (and other) regulators.

Closely related to this is a concern about the nature of the investor-state process itself. The presumption behind the process is that foreign investors do not generally receive fair and unbiased treatment in domestic courts in developing countries when complaining of a

government action. As a result, an alternative legal system is put in place. But this system does not have any of the procedural or public interest safeguards found in the judicial processes of developed, and many developing, countries. Hence it allows foreign investors to sidestep these processes and the safeguards they provide to all litigants, in favour of a non-transparent, secretive and non-appealable system of arbitration. While this is common in purely commercial areas where money is the only issue, the process in Chapter 11 is unprecedented because of its reach into critical areas of public policy making, as recent cases show.

Section 3 of this paper reveals the extent to which the substantive provisions of Chapter 11 might impact on environmental regulation. At least five separate obligations on governments, or “disciplines,” are applicable:

- national treatment;
- most-favoured nation treatment;
- minimum international standard of treatment;
- prohibitions against certain performance requirements on investors, and
- provisions governing expropriation.

Of these, the provisions on expropriation have garnered the most public attention to date. However, our study indicates that each of these disciplines is fraught with significant uncertainty as to how they will be applied in an investment context. Moreover, the only area where there are precedents available is from international trade law, but this raises fundamental questions of their applicability in the very different context of investments. The analysis concludes that the substantive uncertainties of interpretation in Chapter 11 are so great as to unacceptably impair the ability of governments to effectively regulate in the public interest. This uncertainty finds concrete expression as the risk that governments may be forced to pay foreign investors in order to be able to effectively regulate the environment, no matter how sound the science and non-discriminatory the measure. Such a risk makes it increasingly difficult to adopt new environmental regulations and enhance levels of environmental protection. This would be especially the case in Canada and Mexico, where foreign investment is at relatively high levels. With the exception of the minimum international standard of treatment, each of these disciplines needs further attention if this uncertainty is to be reduced, while at the same time maintaining the protections originally intended by the Agreement.

The substantive uncertainties are themselves increased by the exceptionally broad range of government actions that are included in the coverage of Chapter 11, under the word “measure.” This can cover both legally and non-legally binding acts, and it clearly covers all forms of environmental regulation and the administration of those regulations. This includes environmental assessment and permitting processes and decisions. Further, the risks of litigation being initiated are increased by the inclusion of the most expansive definition of “investor” ever used in an international agreement. Indeed, a minority shareholder in a foreign investment can initiate a challenge even without the consent of the actual company involved.

Section 4 considers the procedures that apply to the investor-state process, focusing on the secrecy and absence of transparency in the process. To date, information disclosed about the Chapter 11 arbitrations has been minimal, and this lack of disclosure can extend to the final decisions of arbitral panels. In more recent cases against Canada and the United States this is changing, but the process of change remains ad hoc. The legal analysis of the procedural rules in NAFTA and in the other arbitration forums that can be used under Chapter 11 reveal, however, that the current level of secrecy is not required by these provisions. Only in a few aspects of the procedure is secrecy the presumption, unless agreed otherwise by the parties. Thus, it is recommended below that the parties should use the discretion they have in applying the rules of procedure to promote, on every occasion available to them, a transparent and publicly accessible application of the investor-state procedure.

This is important not just on basic democratic principles of justice, but also because the absence of transparency leads to a significant loss of democratic legitimacy. Some of the most powerful ammunition in the campaign against the OECD's Multilateral Agreement on Investment, waged by public interest groups in 1997 and 1998, was provided by Chapter 11 where foreign companies were challenging environmental laws in secret proceedings. It will continue to provide such ammunition in any further negotiations on a multilateral investment agreement.

It is important for investment agreements to provide security and predictability to foreign investors. But security and predictability are equally important to public purpose regulators. The analysis summarized here leads to the conclusion that this can only be restored by reducing the uncertainties created by the substantive and procedural provisions in Chapter 11.

This paper recommends that this be done by means of an interpretive statement for specific provisions of Chapter 11. This is a mechanism specifically referred to in NAFTA, and it is legally binding on all future arbitration panels. This is the only way to establish a legally binding interpretation of any of the provisions in Chapter 11. Importantly, such an interpretive statement does not require an amendment to NAFTA, and does not raise any risks to any other chapters or sections of the agreement.

Finally, the process for achieving solutions in this area must be considered. NAFTA is under the jurisdiction of the trade ministers of Canada, Mexico and the United States acting as the Free Trade Commission. The responsibility to address this issue clearly lies, first and foremost, with them. But this does not mean that no other agencies or stakeholders should be involved. The underlying principles of sustainable development and its requirements of transparency and inclusiveness lead to the inevitable conclusion that the resolution of this issue can be most effectively achieved through a transparent and accessible process that meets the NAFTA's own positioning on transparency in the international trade process.

While the North American Commission for Environmental Cooperation (CEC) is not responsible for NAFTA, it does have a mandate to assist in developing a constructive relationship between trade and environment issues. In the present context, it can provide useful assistance and important public credibility to the Free Trade Commission. Cooperation between the two bodies would also signal openness to a more integrative approach to managing the trade and environment relationship on a continent wide basis.

List of Recommendations

1. The uncertainties surrounding the substantive obligations in Chapter 11 must be addressed. While additional longer term steps may still need to be considered, it is recommended that a risk management approach be adopted by the parties to immediately reduce the uncertainties and restore, to the degree possible, certainty and predictability for government regulatory activities.
2. Under Chapter 11, an interpretive statement formally adopted by the three NAFTA parties is the only way to establish a legally binding interpretation of any of the provisions in Chapter 11. It is strongly recommended that this approach be pursued by all three NAFTA parties in an aggressive and timely manner.
3. There should be two broad policy objectives for an interpretive statement. First, it should ensure that government regulators are given the certainty and predictability to carry out their business without the burden of the high degree of uncertainty now arising from the risks associated with the unknown possibilities of Chapter 11. Second, it should maintain the basic security of the investor to challenge government measures that are discriminatory or lack *bona fides*, or are expropriative in a classic sense of dispossession.
4. These policy goals should be achieved by a statement that:
 - clarifies the meaning of the national treatment discipline (and other non-discrimination disciplines) in an environmental context, by providing a sample list of environmental factors that recognize the temporal and spatial context of environmental regulation, and that should be considered in any comparison of whether investors are “in like circumstances”;
 - clarifies the relationship between environmental trade measures and the performance requirements prohibitions of Chapter 11; and
 - clarifies the scope of the expropriation provisions to exclude non-discriminatory environmental measures, thereby deflecting the potential investor-state challenges from expropriation issues to national treatment and minimum international standards disciplines.
5. The risk of a market-based approach dominating the interpretation of the national treatment discipline should be addressed. The goal should be to provide specific points of reference for establishing when conduct is or is not discriminatory, or does or does not constitute treatment “no less favourable.” This is very different from establishing a legal

exception for when discriminatory conduct is acceptable. The legal policy objective is also to establish when a type of regulation does not constitute a performance requirement or a measure falling under Article 1110 on expropriation.

6. Greater emphasis should be placed on due process issues as a comparative basis as between foreign and domestic investors.

7. A longer-term view should be adopted, with an eye to restricting the potential reach of the investor-state process into environmental and public welfare regulation, and to ensure full transparency and public access to the proceedings.

8. It is urgently recommended that a short term aggressive course of action be adopted by all three NAFTA parties to apply the existing rules of procedure in favour of transparency and public access on every occasion when there is a discretion in how they can be applied. Where secrecy is not expressly required by NAFTA or the associated arbitration rules, the parties should ensure public access and availability of the maximum number of documents and information. The absence of an agreed approach should not hold back each party from unilaterally pursuing these approaches.

9. Where the agreement of the disputing parties or an arbitral panel is required to provide public access to materials, to oral hearings or as friends of the court to submit their own briefs, such agreement should be actively sought by all three NAFTA parties. Individual investors using the system should be forced into a position of defending the secrecy if they so wish. This can be done by agreement of the parties or unilaterally.

10. Each party should establish national working groups involving appropriate stakeholders, and leading to the development of specific proposals by the governments for detailed but timely negotiation.

11. Such negotiations should proceed in a transparent manner, and in cooperation with the CEC. In the absence of an independent and centralized NAFTA Secretariat, the CEC Secretariat can provide an organized secretariat function and appropriate facilities for conducting both public and private meetings aimed at addressing this issue.

1.4 The Recognition of the Issues by the NAFTA Parties

The issues raised in this report are not special interest issues, nor are they anti-NAFTA or anti-globalization issues. The NAFTA parties themselves have recognized the importance of these substantive and procedural issues. Trade officials attended meetings in the fall of 1998, with follow-up meetings in December, 1998, and January and March, 1999.⁸ While

⁸ *Inside US Trade*, February 12, 1999, p. 1. The actual scope of these discussions has, however, been called into question in a recent paper stating that it is the transparency provisions of Chapter 11 that have been the subject of these meetings in the context of the five-year operational review of NAFTA undertaken by the three parties. See Valerie Hughes, *Canada and the New International Investment Regime*, Canadian Bar Association, Continuing Legal Education Program, Toronto, March 29, 1999, p. 3.

these discussions did not produce results, trade ministers recognized the need to continue them in the text of the Joint Statement of Ministers following their meeting in Ottawa in April, 1999.⁹ Still, news reports and other sources indicate some reluctance on the part of Mexico to address the issues in a concrete way, given the apparent success of Chapter 11 as a spur to investment in Mexico and the fact that 1999 is an election year in Mexico.¹⁰ There are also splits in the US Administration, with Justice and the Environmental Protection Agency evidently having a greater interest in addressing the issues than other departments.¹¹

Of the three trade ministers, Sergio Marchi of Canada appears to be the most committed to this issue, using the occasion of NAFTA's fifth anniversary meeting to cite the need to address transparency and openness in NAFTA institutions and to develop a

*common understanding on the investor-state provisions to ensure that government's ability to legislate and regulate in the public interest is protected.*¹²

Canada's advocacy of these issues has included a pair of discussion papers on both the process issues and a more limited range of the substantive issues.¹³ Canada has also established an informal consultation group, including private trade law practitioners, environmental group representatives and academics, to help craft responses to the issues at hand.

Environment Ministers have indirectly recognized the need to address the problems. In a letter responding to the demands of environmental groups for them to intervene in environment-related Chapter 11 disputes, the three environment Ministers acting collectively as the Council of the Commission for Environmental Cooperation acknowledged that the Chapter 11 challenges "may raise important environmental issues." They continued to indicate that officials were working to develop the role of the CEC Council under Article 10(6) of the NAAEC, which deals with the relationship of the

⁹ "NAFTA Commission: Joint Statement of Ministers: Five years of achievement," April 23, 1999.

¹⁰ Heather Scoffield, "NAFTA trade meeting fails to yield results," *The Globe and Mail*, April 24, 1999, p. B-1; "NAFTA Ministers clash over Canadian proposals to modify NAFTA," *Inside U.S. Trade*, April 30, 1999, p. 1. Mexico now ranks second to China in FDI inflows from OECD countries.

¹¹ *Ibid.*, and see the collection of comments and reports in Julie Soloway, "NAFTA's Chapter 11: The Challenge of Private Party Participation," 1999, *Journal of International Arbitration*, forthcoming, notes 68-72 and accompanying text.

¹² "Notes For An Address by the Honourable Sergio Marchi, Minister for International Trade, To the NAFTA Fifth Anniversary Luncheon," Ottawa, Ontario, April 23, 1999. Available by Internet at <www.dfait-maeci.gc.ca/english/news/statements/99_state/99_032-e.htm>.

¹³ The Canadian discussion paper on the substantive issue addressed only the issue of expropriation, and not the related issues of national treatment, minimum standards of treatment or performance requirements. "Canadian Memo on Investor-State Provisions," as reprinted in *Inside US Trade*, February 12, 1999, p. 19. It will be discussed in detail in sections 3 and 4, below. Hereinafter cited as the "Canadian Memo."

Council to the Free Trade Commission on environment-related issues.¹⁴ While there is not yet consensus on a role for the CEC, there is at least recognition of the importance of the issues and the need to consider how it might contribute.

It may also be noted that the strength of these issues was clearly expressed in the concluding stages of the Organization for Economic Cooperation and Development (OECD) negotiations on the Multilateral Agreement on Investment, (MAI) in which all three NAFTA parties were participants. In that context, the Chair of the negotiations clearly and unequivocally stated the need to address what were referred to as the unintended consequences of the NAFTA language.¹⁵ It is also clear from the MAI record that the United States was a leading promoter of the need to address these environmental issues. The failure to address these issues was one of the main factors leading to the collapse of the MAI negotiations.

¹⁴ Letter from the Council Members of the CEC, 1 December, 1998, to the Sierra Club of Canada, Council of Canadians, Greenpeace Canada and the Canadian Labour Congress. This letter was a response to one received by the Council from these same organization on September 17, 1998.

¹⁵ Annex 2, to the Organization for Economic Cooperation and Development (OECD), *The Multilateral Agreement on Investment, The MAI Negotiating Text (as of 24 April 1998)*.

2. The Nature and Significance of the Investor-State Dispute Settlement Process

Chapter 11 NAFTA has two components. Section A sets out the obligations, or disciplines, on the three NAFTA parties in relation to foreign investors from the other two parties. Section B provides, for the first time in a multilateral trade or investment agreement, a formal dispute resolution system that private sector foreign investors from one of the parties can initiate against the host government if they believe that one of these disciplines has been breached to their detriment. Known as the investor-state process, this is set out in detail in Section B of Chapter 11. Both of these components are important from the point of view of investor protection, and for their potential impacts on sustainable development.

The scope of Chapter 11 resulted from a confluence of interests between the two main protagonists in the investment negotiations, the United States and Mexico. The American objectives, generally supported by Canada, were primarily to liberalize the investment regime in Mexico, where constraints on foreign investment were widespread and accompanied by a view of the national ability to expropriate foreign investments that reflected a very bifurcated North-South view of the relationship between a state and a foreign investor.¹⁶ Although it may seem difficult to appreciate today, given the market-based approach to managing the Mexican economy that has emerged since NAFTA, market access restrictions and fears of expropriation and other interference with investments were significant issues in 1989-92 during the NAFTA negotiations. Indeed, the Government of the United States labeled the investor-state process of NAFTA “an historic investor-state mechanism, so that individual US companies no longer face an unbalanced environment in an investment dispute with the Mexican government but can seek arbitration outside Mexico by an independent body.”¹⁷ This sentiment was echoed by Canada, though in less apocalyptic terms.¹⁸

At the same time, the Mexican government recognized the need to attract and maintain foreign investors if its economy was to be transformed into one that could compete with the United States and others under a broadening trade liberalization regime. This required Mexico to provide effective remedies that investors could rely upon to protect their interests and security. The Mexican government saw the attractiveness of Mexico as a place to invest under a NAFTA regime as directly proportional to its willingness to provide investors with real security and predictability.¹⁹ This continues today to be the case.²⁰

¹⁶ For a review of Mexican positions pre and post NAFTA, see Sandrino, 1994.

¹⁷ Government of the United States, *Statement as to How the NAFTA Serves the Interest of United States Commerce*.

¹⁸ Government of Canada, *Statement on Implementation of the North American Free Trade Agreement*, Canada Gazette Part 1C(1), January, 1994, p.147.

¹⁹ See, e.g. Sandrino, 1994.

²⁰ Mexico, “Private Sector Shows Confidence in Mexico’s Economy,” *NAFTA Works* Vol. 4, No. 3, March 1999.

The result of this confluence of interests is the most extensive combination of rights and remedies ever provided to foreign investors in an international agreement.²¹ The central feature of this system is the unfettered right of foreign investors to initiate direct actions against their host governments to enforce their rights and the obligations of the governments.²² This is consistent with a larger trend described by Sylvia Ostry as the privatization of international trade law.²³ This trend is seen in the growing number of trade tribunals at the national level, and growing claims for direct access to trade litigation by business and public interest groups, replacing the previous state-only access to all international dispute resolution processes that was a hallmark of international law. Yet, even within this broader context, Chapter 11 and its investor-state process has been described by trade experts as “unprecedented,” “remarkable,” and “an as yet untapped source of extensive private investor rights.”²⁴ There are a series of factors that support these conclusions and collectively indicate why Chapter 11 has become an important issue for government concern.

The ability to bypass domestic legal mechanisms, and the safeguards they provide for all litigants, is one of these factors. As part of this new investor protection regime, Chapter 11 established a broad and essentially unfettered ability of foreign private sector investors to access a legally binding, international dispute resolution process. The process allows foreign investors to avoid the use of domestic courts to address whatever legal issues are at the heart of the dispute, and go directly to the international arbitration process.²⁵ In so

²¹ See Price, 1993, at 736; Gary Horlick and Alicia Marti, “NAFTA Chapter 11B: A Private Right of Action to Enforce Market Access through Investments” Vol. 14, *Journal of International Arbitration*, pp. 43-54 (1997); Lawrence Herman, “Settlement of International Trade Disputes - Challenges to Sovereignty - A Canadian Perspective,” Vol. 24 *Canada-United States Law Journal* pp. 121-137, 1998, at pp. 132 et. seq.; and Hope Camp and Andrus Kontrimas, “Direct Investment Issues (Including Competition and U.S./Mexico Taxation Treaty),” pp. 87ff in Norton, Joseph J. et. al., eds., *NAFTA and Beyond: A New Framework for Doing Business in the Americas*, 1996, p. 90, comparing NAFTA to the previous Canada-US Free Trade Agreement.

²² This unfettered right to initiate a proceeding comes from Articles 1116 and 1117. The only limitation on this is the need to show damages resulting from the alleged breach. There are also some procedural steps such as consultations being required, and formal “conditions precedent” (Article 1121) such as minimum time periods before an arbitration can be initiated and waivers of domestic court rights, to be met by the investors, but none of these negate the right to initiate the action. See Price, 1993, p. 732-733. Previous Bilateral Investment Treaties (BITs) have provided for dispute resolution between an investor and a state, but these have been with a more limited range of disciplines and signed in the course of specific bilateral investment negotiations. In addition, most early BITs included a requirement for a specific agreement, or *compromis*, between the state and investor prior to the arbitration being permitted. This second requirement has been included in fewer agreements in more recent years. See Sacerdoti, 1997, pp. 443-444; Herman, 1998, at 132-133; Gary Horlick and Amanda F. DeBusk, 1993.

²³ Sylvia Ostry, “Future of the WTO,” Brookings Institute Trade Policy Forum, April 15, 1999, p. 4.

²⁴ Horlick, and Marti, 1997, at 53-54; It was referred to as a “revolutionary mechanism” by other trade law supporters of the mechanism. Camp and Kontriman, 1996, p. 104.

²⁵ In fact, Article 1121(1) requires an investor to renounce its rights of local action in order to access the international arbitration process. The basic theory behind the development of this approach is that domestic courts, especially in developing countries, are likely to be non-transparent and biased against a foreign investor when evaluating governmental acts impacting that investor. As international investment law was developed in the context of developed country to developing country flows, investor security demands generally included an alternative legal process. The problem is that in addressing this aspect of investor’s

doing, the foreign investor is given rights and remedies not available to domestic investors, in an international process that is largely devoid of the safeguards that exist in domestic courts to ensure a proper balance between private rights and the public interest. These domestic safeguards include an appeal mechanism which is absent here,²⁶ and a standing roster of neutral judges. In the investor-state process, each side chooses one arbitrator, and the third member of the panel is then negotiated or chosen by a neutral person from a standing list of arbitrators with international trade and investment law experience.²⁷ Thus, at a minimum, the investor initiating the challenge chooses one of the judges, doing so on the basis of known views or orientations that would tend to support its position.²⁸ While this process is common in commercial arbitration practice, where money is usually the only issue, it is not common in areas where important public policy issues are at the heart of a dispute, including the WTO.²⁹ Such public policy issues will often be at the heart of Chapter 11 disputes.

Another critical factor is the singular focus behind initiating an investor-state arbitration. Foreign investors, unlike states, have no other interest to consider than their own operations and profits. There is no larger, public interest equation involved.³⁰ A recent trade-focused study from scholars at the University of Toronto considers over 100 examples of strategic uses of trade or investment law (including but not limited to Chapter 11) by corporations to “challenge or circumvent,” among other types of regulations, “the new generation of environmental laws.”³¹ When seen by some

concerns, little attention was paid to how this would impact on transparent and unbiased judicial process in developed countries such as Canada and the United States. See, e.g., Julie Soloway, 1999, forthcoming. However, comments of at least one Canadian negotiator indicate that all delegations were aware the provisions would be used against all parties, given the increasingly litigious environment of North America. Comments of C. Verdun, Vol. 24, *Canada-United States Law Journal*, 1998, at p. 292.

²⁶ The rules of procedure of the three arbitration bodies that can be used under Chapter 11 do allow for limited conditions of review of a decision, but these are of a very high threshold relating to a manifest excess of jurisdiction and similar tests. These are not equivalent to an appeal on the merits of an arbitration panel decision, as one now has in the WTO process. See Price, 1993, p. 735, Horlick and de Busk, 1993; Philip le B. Douglas, Takemi Ueno, “A Practitioner’s Guide to Chapter 11 of NAFTA,” pp. 143-168 in *L’ALÉNA et l’avocat d’affaires*, 1998, pp. 160 et. seq.. It should be noted that the arbitral awards are fully enforceable in the countries against which they are given, as if they are awards of the domestic court. NAFTA Article 1136, and see Herman, p. 123.

²⁷ The procedure for this is drawn from a combination Articles 1123-1125, and the rules of procedure of the three different arbitral bodies adopted by Chapter 11 to support an arbitration. These are the United Nations Centre for International Trade Law (UNCITRAL), the International Centre for the Settlement of Investment Disputes (ICSID) and the Additional Facility of ICSID. The investor has the option to choose which body and procedure it will apply to the arbitration it initiates. A comparison of the pros and cons from an investor perspective of each of these is found in le B. Douglas and Ueno, 1998, pp. 160 et. seq..

²⁸ This does not deny the professional qualities of the arbitrators to the assess the applicability of the law to the facts, but rather goes to their view of what the applicable law might be.

²⁹ The WTO now has a rosters of potential panelists to draw from, and a standing group of appeal judges. The Secretariat suggests a panel for any given case, which can only be objected to for good cause. In the case of an objection, the Director General of the WTO can appoint the panel.

³⁰ See, e.g., Jonathan Fried, “Globalization and International Law - Some Thoughts for Citizens and States,” Vol. 23, *Queen’s Law Journal*, 251, (1997), p. 274, on this motivation.

³¹ Alan Rugman et. al., *Environmental Regulation and Corporate Strategy: A NAFTA Perspective*, 1999, p. 1.

corporations and trade specialists through a market access or trade liberalization lens, many (if not almost all) of these laws are presumed to have been developed for protectionist purposes, often to replace the tariff required to be liberalized under expanded trade law regimes.³² This underpinning for the new strategic approach is described by the study:

*The study shows how innovative corporate strategies (of both a market-oriented and politically directed nature) have successfully opened international markets previously closed by national and local environmental regulations and by the “green and greedy” coalition of protectionists and environmentalists that can lie behind them.*³³

The reason for quoting this description is not nefarious. Chapter 11, argues the study, has now become “heavily used” in just this context.³⁴ It is clear from the history of the use of Chapter 11 to date that this strategic tool will be employed both before and after regulations have been adopted. Annex 1 provides details on eleven cases formally initiated, but there are also a number of instances where the use of Chapter 11 has been threatened as part of a campaign to prevent new regulatory measures being adopted.³⁵ In essence, the investor-state process of NAFTA has now become part of a dynamic institutional response by foreign business owners to government action in all public policy areas with an impact on their costs and competitiveness, with a large focus of this activity aimed at environmental measures. This strategic development has changed, and arguably misappropriated, the investor-state provisions from their traditional role as a defensive investor protection mechanism to a potent offensive strategic tool.

The settlement of one of the first Chapter 11 cases (the Ethyl v. Canada case, discussed below) reinforced the value of this strategic approach. In addition, initiating such suits is virtually cost free for major companies, costing literally just a few thousand dollars to prepare the notice of intent to arbitrate that starts the process and produces privileged access. This is a minimal cost to business, with a large potential cost to government.

The Ethyl case illustrates well the practical impact of the unfettered ability to pursue a singular private interest at the international level. In 1996, Ethyl Corp. initiated its case against Canada pursuant to its Chapter 11 rights.³⁶ At the same time, Ethyl sought to have

³² Rugman et al., p.1, See, e.g., Fried, 1997, p. 262, referring to the growth of technical barriers to trade, which in trade terms includes environmental laws; Luis de la Calle, *Linkages Between Trade and Environment Policies*, Speech to the High Level Symposium on Trade and Environment, March 1999, p. 1.

³³ Rugman et al, *ibid.*, p. 2.

³⁴ Rugman, et al, *ibid.*, p. 9

³⁵ Rugman et al, *ibid.*; See also , e.g., Horlick and Marti, 1997, at 52-54; David Schneiderman, “NAFTA’s Takings Rule: American Constitutionalism Comes to Canada,” Vol. 46, *University of Toronto law Journal*, pp. 499-537 (1996).

³⁶ The full history is set out in the documents referred to under the heading of “Ethyl Corp. v. Canada” in the references. See also Julie Soloway, “Environmental Trade Barriers Under NAFTA: The MMT Controversy,” Vol. 8 *Minnesota Journal of Global Trade*, pp. 55-95, 1999, for an extensive review of Ethyl’s litigation intensive approach. The effort to have the US government take up the cause is discussed at pp. 90-91.

its home state government, the United States, initiate a state-to-state proceeding against the Canadian import ban at the heart of the dispute. The US declined to do so, undoubtedly at least in part because of its own history of extended litigation with Ethyl over the legality of the same product (MMT) whose import was banned by Canada. Nonetheless, Ethyl was able to initiate and run its litigation, eventually achieving an out of court settlement whereby the legislation it opposed was withdrawn, and Canada paid damages of \$13 million US for the period the legislation was in place.

Chapter 11 contains a number of substantive elements that further extend the unprecedented reach of the investor-state process. Analyzed in Section 3, these include the expansive range of state actions that are covered under the notion of “measures,” the range of investors and investments that are covered, the extensive scope of the five major disciplines imposed on governments and their reach into all forms of public policy decision-making, and the general legal uncertainty that applies to the outer limits of these disciplines. To this list also must be added the lack of transparency in the investor-state procedure, discussed in Section 4.

All of these factors lead to the ability of investor-state disputes to impact on very significant areas of public policy. This was clearly recognized in the context of the debate on the MAI, which drew its inspiration and much of its draft text from Chapter 11: “By definition, MAI disputes would have been about matters of public policy and their legislative and administrative products.”³⁷ This, of course, can be no less the case for NAFTA's Chapter 11, especially given the context of an agreement including at least two countries that have not been involved in the expropriation of investments without proper compensation for many decades.³⁸

Why is the cumulative impact of these factors so important from a sustainable development perspective? If NAFTA establishes a potential right to compensation or damages for new environmental measures adopted by a NAFTA party, this may require hundreds of millions of dollars in compensation for foreign investors, and will rapidly raise the issue of equivalent rights for all domestic investors as well. The existing claims under Chapter 11 range in value from \$10 million to 750 million US.³⁹ At a basic level of principle, this amounts to taxpayers money being required to pay for the right of a government to protect the environment, an entirely perverse result in light of the ascendancy of the polluter pays principle in national and international environmental law since it was first elaborated by the OECD in 1972.⁴⁰

At a practical level, the economies of two of the three NAFTA parties have very high, and growing, levels of FDI. The growth in FDI is, in part, evidence of the positive role investment agreements can play. Mexico, for example, clearly links NAFTA to its now

³⁷ de Pencier, 1998, at p. 155.

³⁸ Charles Birchall, “NAFTA and the Environment: Canada Settles Ethyl Suit,” Vol. III, No. 2, *Environmental Law*, pp. 158-160 (1998), at 160.

³⁹ See Annex 1 for details.

⁴⁰ OECD, *The Polluter Pays Principle: OECD Analyses and Recommendations*, OECD Environment Directorate, 1992.

ranking second only to China as the developing country receiving the most FDI.⁴¹ But if the same agreement can be applied so as to require compensation to foreign investors for new environmental measures, this would significantly increase the costs of undertaking such measures, risking a freeze in existing laws regardless of how warranted new measures may be. This is directly contrary to the stated goals of NAFTA to operate in a context of the promotion of sustainable development, in a manner consistent with environmental protection, and to strengthen the development and enforcement of environmental laws.⁴² These goals were further developed through the NAAEC, tightly tied to NAFTA as “its environmental side agreement,” including its clear expression of the rights of the three parties to establish their own levels of environmental protection.⁴³ Importantly, these goals were also invoked by Canada in its Statement of Defence in one of the Chapter 11 proceedings initiated against Canada.⁴⁴

Just the ability of private investors to launch Chapter 11 challenges to environmental laws, or other public welfare measures, on the basis that they may breach the NAFTA investment disciplines, presents a serious obstacle to regulatory action. While it is important for investors to have security and predictability in their investment, it is equally important in public purpose regulation for the regulators to have security and predictability. The apparently unexpected and unintended uses of Chapter 11 to initiate challenges to public purpose lawmaking have reduced that security and predictability to the point where regulators now have to address significant levels of uncertainty and unpredictability due to Chapter 11. The full nature of this uncertainty is set out in section 3, below, in the legal analysis of the causes of action. Critically, this uncertainty and unpredictability has to be weighed against downside risks potentially in the hundreds of millions of dollars. To put the matter simply, if not crudely, few regulators have the career path certainty required to take on such risks.

The level of secrecy that surrounds the initiation and conduct of investor-state disputes raises additional issues concerning the overall nature and appropriateness of the current investor-state process. The lack of transparency was labeled by one of Canada's leading business-oriented newspapers as “NAFTA's Cone of Silence.”⁴⁵ The lack of transparency

⁴¹ Since NAFTA was signed, Mexico has received some \$57 billion US in foreign project investment, according to Mexican government figures. *NAFTA Works*, Vol. 4, No. 3, March 1999, p. 1. The link to NAFTA is made explicit here. See also Thomsen, 1999, p. 4, drawing the same link. And the Government of Canada notes a rise of 54% in FDI from 1993-1998. Department of Foreign Affairs and International Trade, *The NAFTA at Five years: A Partnership at Work*, 1999, p. 15-17. Available on the Departmental NAFTA web site, <www.dfait-maeci.gc.ca/nafta-alena/menu-e.asp>.

⁴² NAFTA, Preamble, paras. 11-14. The importance of these types of preambular paragraphs in international trade agreements was recently acknowledged by the World Trade Organization Appellate Body in their decision in the so-called Shrimp-Turtle case. “United States - Import Prohibition of Certain Shrimp and Shrimp products,” Appellate Body report, AB-1998-4, October, 1998, esp. para. 121.

⁴³ North American Agreement for Environmental Cooperation, Article 3.

⁴⁴ Statement of Defence, Ethyl Corporation v. Government of Canada, 27 November, 1997, para. 72.

⁴⁵ The Globe and Mail, Toronto, Canada, editorial, “NAFTA Cone of Silence,” August 26, 1998. The editorial appeared shortly after the S.D. Myers case against Canada was revealed to the public by journalists at The Globe and Mail, some five weeks after the notice of intent to arbitrate was actually filed. Access to the materials is specifically limited by governments. Access to the pleadings in the only concluded case is

also allows, or rather encourages, negotiations on issues of significant public interest to take place solely between the government and foreign investors in the privileged and secret context of an international legal process. Unlike multi-stakeholder consultations, what is seen in Chapter 11 is a single set of issues, potentially bearing on major public policy questions, being raised not with the government for balancing, but against it for damages. Often there is no access and little factual knowledge of the case available to the public, reducing or eliminating any democratic checks and balances. It is not plausible to argue that this preferred access is commensurate with the special interest the investor has in the issue. Given the very nature and purpose of environmental and public welfare legislation, it is clear that several stakeholders will have different but no less significant interests in the issues. Indeed, it is the recognition of this reality that has caused public interest group standing to be expanded over the past two decades, most notably in the environmental area and in cases involving a single actor and the government. However, in a normal court system there is a minimum level of accountability brought on by the public availability of the pleadings of the governments that are parties to a litigation. There is no such accountability here, and obstacles remain in ensuring this is achieved.

still barred by a procedural ruling of the arbitral panel in the Ethyl case, which itself was based on an agreement between Ethyl Corp. and the Government of Canada, even though the case has been completely settled. See *Ethyl Corp. v. Government of Canada*, Procedural Order, 2 July, 1998, and Procedural Order, 13 October, 1997, s. 9(c).

3. The Substantive Issues

3.1 Policy perspectives

The legal analysis of the critical substantive issues in Chapter 11 that relate to environmental law and regulation-making focuses on the scope of government actions covered by its disciplines and by the investor-state process. Five specific disciplines are examined:

- Art. 1102, the national treatment requirement;
- Art. 1103, the most favoured nation treatment requirement (MFN);
- Art. 1105, the minimum standard of treatment in accordance with international law;
- Art. 1106, which sets out prohibitions on certain types of performance requirements on all investors, including domestic investors;⁴⁶ and
- Art. 1110, which sets out prohibitions on direct or indirect expropriations, or measures tantamount to expropriation.

The detailed legal analysis below suggests that while the provisions on expropriation are the most publicly discussed threat, the disciplines on minimum standards of treatment, national treatment and performance requirements also play important roles in defining the relationship between the investor-state process and environmental regulation. The table in Annex 1 of this paper shows that the known Chapter 11 challenges just against Canadian environmental measures have already raised all five of these disciplines.⁴⁷ Therefore, a comprehensive review must consider the relationship of each of these disciplines to environmental regulation.

What is critical to appreciate from the legal analysis is that the threat to environmental and other public welfare regulation-making from these disciplines arises not from the certainty of how an arbitral panel will rule, but rather from the very uncertainty of how it might rule. This uncertainty is derived from the unprecedented breadth of the disciplines and coverage set out in Chapter 11, and the resulting unique ability for private parties to bring significant issues of public interest into the arbitration process. This includes the capacity to challenge both new environmental laws or regulations, and the implementation of those that exist. The legal analysis also shows that the existing law in this area can be used to support both expansive and narrower interpretations of the disciplines as they might relate to environmental regulation. This means that each case will be considered based on the absence of one defining approach or trend. This also means that regulators preparing a new law or regulation must consider each potential Chapter 11 claim with a very limited ability to predict whether they might or might not be

⁴⁶ Though only foreign investors of another NAFTA party are given any rights of recourse here.

⁴⁷ Materials on the known environment-related Chapter 11 challenges against Mexico have not been made publicly available, thereby constraining any commentary on these cases. The only Chapter 11 case against the United States is not environmental in nature, but does raise interpretational issues that are relevant.

successful. This has a significant impact on the predictability and certainty that regulators face in doing their jobs in the public interest.

Awaiting the development of a form of binding case law in this area faces a number of critical obstacles. First, the legal uncertainties in the Chapter 11 disciplines are inherent in the scope and language of the provisions adopted by the negotiators, and are unlikely to be significantly reduced by pending arbitrations. Second, any given panel is expressly not bound by the interpretation of NAFTA provisions adopted by another, but can set out a different and even wholly opposing view in its award.⁴⁸ Third, the risk of this occurring is heightened by the legal fact that some challenges may not even be known to the public under the procedural rules as they have been interpreted and applied to date. (See section 4, below) Further, there remains the possibility, as noted previously, of final arbitral decisions not being released to the public, and hence not being subject even to consideration by a subsequent panel. In essence, the investor-state arbitration process established by Chapter 11 has an anarchic aspect that reduces the predictability of any arbitration proceeding.⁴⁹

The uncertainties identified in the detailed legal analysis lead to the conclusion that some means to address them is warranted. The approach recommended below is fundamentally one of risk management by the parties: the use of an interpretive statement to reduce the uncertainties and unpredictability created by possible interpretations or applications of Chapter 11. NAFTA allows the parties to develop an interpretive statement on the key provisions of Chapter 11, and to have this interpretation bind all dispute resolution panels. Indeed, under Chapter 11, this is the only way to establish a legally binding interpretation of any of the provisions in Chapter 11.⁵⁰ This approach has already been discussed by the parties.⁵¹

Recommendation: The uncertainties surrounding the substantive obligations in Chapter 11 must be addressed. While additional longer term steps may still need to be considered, it is recommended that a risk management approach be adopted by the parties to immediately reduce the uncertainties and restore, to the degree possible, certainty and predictability for government regulatory activities.

Recommendation: Under Chapter 11, an interpretive statement formally adopted by the three NAFTA parties is the only way to establish a legally binding interpretation

⁴⁸ This is made clear in Article 1136(1) of NAFTA. While the normal practice of arbitral panels is to consider previous panel rulings on the same agreement, they are free to disagree with them. The practical risks of this are highest at a time when several cases are in progress at the same time dealing with similar issues, as is the case at present on the issues under discussion here. These risks are also higher earlier in the life of an agreement.

⁴⁹ Conversely, it will be noted below that all panels would be bound if the NAFTA parties adopted their own interpretation of any or several provisions of Chapter 11. This is made clear in Article 1131(2) of NAFTA.

⁵⁰ Article 1131(2).

⁵¹ See the reports in *Inside US Trade*, December 18, 1998, p. 1; January 15, 1999, p. 1; February 12, 1999, p. 1.

of any of the provisions in Chapter 11. It is strongly recommended that this approach be pursued by all three NAFTA parties in an aggressive and timely manner.

Recommendation: It is recommended that there should be two broad policy objectives for an interpretive statement. First, it should ensure that government regulators are given the certainty and predictability to carry out their business without the burden of the high degree of uncertainty now arising from the risks associated with the unknown possibilities of Chapter 11. Second, it should maintain the basic security of the investor to challenge government measures that are discriminatory or lack *bona fides*, or are expropriative in a classic sense of dispossession.

Specific draft legal text, as one example of how this fair balance might be achieved, is set out in Annex 2 of this paper.

3.2 Article 1101, The scope of coverage

The scope of coverage of the disciplines and the rights of investors to use the investor-state process are defined through NAFTA Article 1101(1).⁵² The opening words of this Article lead straight to the heart of the problem: “This Chapter applies to measures adopted or maintained by a Party relating to...” What has often gone unnoticed is the breadth of the scope of Chapter 11 that arises from the use of the word “measure,” a term also found in Article 1110 on expropriation. “Measure” is a defined term under NAFTA, and this definition has now been addressed in the Award on Jurisdiction in the Ethyl Corp. case.

Article 201 of NAFTA states that “**measure** includes any law, regulation, procedure, requirement or practice.” The use of the word “includes” in this definition indicates that other government acts could also constitute a measure under NAFTA. Thus, it is possible for policies, or possibly even government positions in some circumstances, presuming they produce an effect, to constitute a measure.

The Ethyl case raised the issue of what constitutes a measure. This case was brought after Canada adopted a law banning the import of MMT, or its inter-provincial sale.⁵³ Ethyl Corp. of the US is the sole manufacturer of MMT, a gasoline octane enhancer. Ethyl Canada was the sole importer of MMT prior to the ban. It mixed the imported, concentrated MMT for subsequent distribution to gasoline refineries.

⁵² Paragraphs 1101(2)-(4) contain certain exceptions to this scope, applying mainly to market access for foreign investors as opposed to treatment after an investment is in place. Some exceptions in this are also set out in NAFTA, but these are also not germane to the present discussion.

⁵³ For a variety of jurisdictional reasons under the Constitution of Canada, and definitional issues under the Canadian Environmental Protection Act, the product was not banned outright. This is not relevant to the present issue.

In a jurisdictional hearing on the case, two issues arose for determination as to what constitutes a measure for purposes of Chapter 11. The first issue was whether a trade ban constituted such a measure, and the second was whether a measure had to be in a legally binding form in order to create a cause of action. The panel, in its Award on Jurisdiction in the case, indicated that a trade measure could be made the subject of a Chapter 11 dispute, even if at the same time it could be dealt with in a state-to-state claim under Chapter 3 and 20 of NAFTA.⁵⁴ The tribunal noted that no authority was cited “as to why the two necessarily are incompatible” and that it “cannot presently exclude Ethyl’s claim on this basis.”⁵⁵ Thus, a duplication of remedies, one the investor’s and one the state’s, is foreseen by this decision.

In responding to Canada’s claim that a measure had to be in legally binding form, the tribunal referenced Canada’s own Statement on Implementation of the North American Free Trade Agreement. This Statement holds that the definition in Art. 201 was a non-exhaustive list of the ways in which governments impose disciplines in their jurisdictions.⁵⁶ The tribunal went on to note that something other than a law, including a practice that did not amount to a legal stricture, could qualify as a measure. This approach is consistent with the international law literature, which recognizes that government measures that interfere with an investment can take an increasing variety of forms.⁵⁷

The Ethyl case also raises a further question as to the scope of a measure. It argues, in part, that statements made by government officials and Ministers in the course of the very public debate on the proposed legislation damaged Ethyl’s good name and constituted an expropriation of its goodwill. Whether goodwill is properly the subject of expropriation under Chapter 11 is beyond the scope of this paper. The issue of whether government statements in the course of making regulatory decisions can be a measure and so found a claim is pertinent to the potential scope of Chapter 11. In response to this narrow point, Canada argued that neither such statements nor their effects could constitute a measure under Articles 210 or 1101.⁵⁸ This issue was not treated in the Award on Jurisdiction, and hence there is no determination on it. Thus, Ethyl’s claim continues to set a precedent for at least raising such statements as a basis for a claim.

One other case is also relevant here. Discussed in more detail below, the Loewen case relies on an award of a civil court, and a subsequent procedural decision of an appeals court, as the measures leading to the claim under Chapter 11.⁵⁹ In so far as these are legal acts emanating from an organ of the state, this would seem well founded, while at the same time illustrating the potential breadth of the term “measure” as used in Chapter 11.

⁵⁴ Award on Jurisdiction in the NAFTA/UNCITRAL Case between Ethyl Corporation and the Government of Canada, 24 June, 1998, para. 62.

⁵⁵ *Ibid.*, paras. 63-64.

⁵⁶ *Ibid.*, para. 66. See Government of Canada, *Statement on Implementation of the North American Free Trade Agreement*, Canada Gazette Part 1C(1), January, 1994.

⁵⁷ See the discussion in s. 3.7 for more on this point.

⁵⁸ Statement of Defence, *Ethyl Corporation v. Government of Canada*, 27 November, 1997, para 98.

⁵⁹ *The Loewen Group Inc. and Raymond L. Loewen v. The United States of America*, Notice of Claim, Submitted by Loewen Group on October 30, 1998.

3.3 Article 1139, Investments and investors

The definition of investors and investments is the next critical factor in identifying the scope of Chapter 11. Article 1139 defines the term investment to include virtually any enterprise; any form of equity participation in an enterprise; debt security; any loans to an enterprise; property, including intangible or intellectual property, acquired in the expectation of an economic benefit; interests arising from the commitment of capital or other resources in the territory of a party; and so on.

This definition includes direct foreign investment in the form of an industrial or resource extraction facility and property holdings—the traditional field of coverage of international law on foreign investment. But it goes on to include the new growth area of foreign portfolio investment, potentially including foreign investments held by mutual fund companies and other forms of pooled investment funds. Minority shareholders in a company, certain bond holders, and other foreign, and often fleeting, “passive” investors can all exercise the rights of an investor under Chapter 11, in some cases without even having the consent of the local company itself.⁶⁰ Showing “loss or damage” as a result of the alleged breach of the obligations of Chapter 11—in other words harm to their own economic interest—is all that is required of such investors in order to be able to launch an action under Chapter 11. This could be as low a threshold as the decline in market value of the shares of an investor.⁶¹

With the exception of holding property for the purpose of economic gain from that property,⁶² the balance of Article 1139 appears to revolve around the notion of an enterprise at the heart of an investment. As long as there is such an enterprise, virtually every connection to the ownership or profit of that enterprise can be considered as an investment. Enterprise is defined in Article 201 of NAFTA:

Enterprise means any entity constituted or organized under applicable law, whether or not for profit, and whether privately-owned or government-owned, including any corporation, trust, partnership, sole proprietorship, joint venture or other association.

Applied in the context of a foreign investment, this definition focuses on the attribute of having some form of legal personality in the host country, not simply having a business dealing.⁶³ There is little in the way of jurisprudence as to what might be necessary. However, the information publicly available in the S.D. Myers case indicates a somewhat minimal approach to the definition by the investor. S.D. Myers is an American waste disposal company with PCB disposal facilities in the United States. It sought redress for

⁶⁰ Article 1139, definitions, NAFTA. The company itself would have to consent only if the investor was actually suing on behalf of the company, rather than out of alleged damage to its own investment in the company. Horlick and Marti, 1997, p. 47.

⁶¹ See Articles 1116(1), 1117(1). Horlick and Marti, *ibid.*, p. 47.

⁶² This, for example, might be real estate purchased for development or speculation, or intellectual property rights obtained for licensing purposes.

⁶³ Price, 1993, p. 728.

damages suffered after Canada banned the export of PCB wastes to the United States for disposal. In its Notice of Intent to Arbitrate, the company did not note any actual legal enterprise it had established in Canada. Rather, the Notice of Intent notes simply that the company is incorporated in the United States, where it has its facilities, and it has operated in Canada since 1995, and sought to process, distribute and treat PCB contaminated waste from Canada at its US facility. It sites its conduct of lawful business-related activities in Canada to obtain contracts for this purpose.⁶⁴ In its Statement of Claim, however, S.D. Myers that it conducted business directly in Canada and through a joint venture with S.D. Myers (Canada) Inc., incorporated as a Canadian company. The Statement of Claim does not, however, indicate whether the conduct in question is specific to the activities of the joint venture or the Canadian or American companies.⁶⁵ Still, it appears that the major investment in relation to this claim is the conduct of operations by the American company, not the establishment of an enterprise in the host country, Canada. Absent further information on this point, one might anticipate this issue being raised as a preliminary objection to the hearing of the case.⁶⁶

Article 1139 excludes contracts for the import or export of goods or services as the sole foundation for being considered an investment. This may be applicable to the S.D. Myers claim. However, this does not mean that measures impacting on export or import contracts cannot be involved in a dispute under Chapter 11 when a viable enterprise within the definition of Article 201 is in place (see the discussion on performance requirements in Section 3.6 below).

These cases highlight the ability to found a Chapter 11 case on a fairly minimal investment. It is foreseeable under such a broad approach that minimal foreign investments may found full challenges to environmental measures. For example, a foreign component might be strategically added to an otherwise domestic investment simply to have access to the extraordinary rights and remedies found in Chapter 11. In the context of the strategic setting now emerging through and with Chapter 11, this would be a simple step to take.⁶⁷

⁶⁴ Notice of Intent to Submit a Claim to Arbitration Under Section B of Chapter 11 of the North American Free Trade Agreement, S.D. Myers Inc. v. Government of Canada, July 21, 1998, paras. 1.3.

⁶⁵ Statement of Claim, S.D. Myers v. Canada, October 30, 1998, paras. 13-15. This document was made available only after June 10, 1999, as this report was going to press. Not substantive discussion on the basis of this document could be made at that point, but this factual issue has been addressed for accuracy on this issue.

⁶⁶ In legal terms, this would be an objection to the jurisdiction of the arbitral tribunal on the basis that S.D. Myers is not an investor under the terms of Chapter 11 as regards the issues giving rise to this complaint, and hence does not have access to the procedure set out there.

⁶⁷ There is at least one example now of a US partner in an otherwise Canadian based consortium using its foreign status to threaten the use of Chapter 11 in a conflict between the consortium and the Government of Canada on the withdrawal of a contract over airport operations at Toronto's Pearson International Airport. See Horlick and Marti, 1997, p. 53.

3.4 Art. 1102, National Treatment and Article 1103, Most favoured nation treatment

The national treatment⁶⁸ and most favoured nation (MFN) standards are comparative standards that require a host country to treat a foreign investor in the same manner as a domestic investor or an investor from another country. These two standards establish the non-discrimination disciplines that form the backbone of much of Chapter 11. In an environmental context, these standards would require comparisons of how domestic and foreign investors are treated in the design, substance and implementation of an environmental protection law or regulation.

As comparative standards, national treatment and MFN prohibit a party from treating a foreign company differently from a domestic company. Article 1104 requires that, should there be a difference between the treatment of domestic and other foreign investors, the better of the treatments shall apply for comparative purposes. In environmental law-making terms, the key question here ought to be whether investors or investments are being regulated because the activity in question presents certain risks to the environment, or whether they are being regulated because they are foreign investors.⁶⁹

Two specific questions arise. First, while the spirit of the article is well understood as not treating a foreign investor differently simply because it is foreign, the language of the article is treatment “no less favourable.” The precise meaning of this phrase is not clear. Does it mean that a foreign investor must receive the best treatment of any other company? Does it require average treatment, if this can be measured? Can the comparison be against a domestic company receiving the least favourable treatment of all domestic companies?

This question was raised in the United States “Statement of Administrative Action” on the implementation of NAFTA, but only under the text of Article 1202 and 1203 on Services. Still, the language is the same as in Chapter 11. The US Statement argues that this language does not mean that a foreign investor must be given the same treatment, or even equal treatment as all other investors, but allows them to be treated differently where the circumstances warrant. NAFTA’s non-discrimination rules, it is argued,

⁶⁸ It is important to distinguish two aspects of the national treatment issues. The first is whether the principle should be applied at all to all sectors of industry or resource development, or some sectors should be excluded from their application completely. In sustainability terms, this is a question that largely goes to promoting sustainable investments, and identifying areas where this is best done by allowing preferential access or rights for national investors. In investment terms, it is an issue of market access for investors. In NAFTA, the national treatment obligation has been excluded from application to several sectors by all three parties (for example fisheries). The second issue only follows this first one: once the scope of application of national treatment or MFN has been agreed, how should it be interpreted or applied by the parties and by a dispute settlement body. It is only this second aspect that is addressed in this paper.

⁶⁹ See, e.g., Price, 1993, p. 729. The author uses the words “simply by virtue of foreign ownership” in this context.

*prohibit the imposition of laws and regulations designed to skew the terms of competition in favor of local firms: they do not bar legitimate regulatory distinctions between such firms and foreign service providers.*⁷⁰

The Pope & Talbot case against Canada concerns the allocation of export quotas for softwood lumber between provinces and producers by the Government of Canada under the Export Control Act. Four producing provinces (British Columbia, Alberta, Ontario and Quebec) have been allocated quotas, with levies for any excess exports. These quotas and levies are then passed on to the producers within the province. The other provinces, and their producers, have no quotas. Pope & Talbot, an American owner of a Canadian-based subsidiary, claims that the allocation of quotas and levies fails to meet the national treatment and MFN standard of providing “the best treatment that it accords to other softwood lumber producers in Canada.” It raised four comparisons for this purpose: between provinces subject to the quota and not subject to it; between producers covered and not covered by the quota system; the discriminatory allocation between provinces subject to the quota; and discrimination between producers in the province of British Columbia where it is located. Pope & Talbot claims that some producers in British Columbia were treated more favourably than it was.⁷¹ This provides an indication of the different comparisons that might be invoked under the no less favourable treatment test.

A more extensive development of national treatment issues is found in the Ethyl case. In its Statement of Claim, Ethyl argues that the national treatment obligation requires the best in-jurisdiction treatment, and that “The national treatment obligation is designed to ensure that all companies, whether domestic or foreign, are treated equally and without discrimination.”⁷² In its Notice of Arbitration, Ethyl goes on to rely on trade law jurisprudence to argue that even formally equal treatment could still result in less favourable treatment for a foreigner, and that the term “no less favourable” calls for “effective equality” in treatment.⁷³ Ethyl used the absence of a domestic ban on the production of MMT in Canada as evidence of non-compliance with the national treatment obligation.⁷⁴ Part of this argument was that the import ban created less favourable treatment for investors that imported MMT than for investors that manufactured MMT, or a competitive product, domestically. However, there were no producers of MMT in Canada — it was only imported.

Further, Ethyl itself notes that the second feature of the MMT legislation, a ban on inter-provincial trade in MMT, would have required them to build a manufacturing, blending

⁷⁰ Government of the United States, *North American Free Trade Agreement Implementation Act: Statement of Administrative Action*, at p. 152. The last words, “service providers” can simply be replaced with “investors” for present purposes.

⁷¹ Executive Summary, NAFTA Investor-State Dispute Claim by Pope & Talbot Inc., prepared by Appleton & Associates, p. 6.

⁷² Statement of Claim, *Ethyl Corporation v. Canada*, October 2, 1997, para.30.

⁷³ Notice of Arbitration Under the Arbitration Rules of the United Nations Commission on International Trade Law and the North American Free Trade Agreement, *Ethyl Corporation v. Canada*, April 14, 1997, para. 15-17.

⁷⁴ Statement of Claim, *Ethyl Corporation v. Canada*, October 2, 1997, para. 33-36.

and storage facility in each province in Canada. While the costs of this are not set out, they would certainly have impacted the economies of scale for the product, and in any event would take from 18-24 months to construct.⁷⁵ Consequently, to the extent that this argument dealt with a comparison to domestic MMT producers, Ethyl was founding part of its national treatment case on a hypothetical comparison. This was noted in the initial Canadian response to Ethyl's case.⁷⁶ Canada also noted that the fact only one company, a foreign investor, was involved with MMT could not itself found a claim of treatment no less favourable, as this reflected the underlying market structure that the Government faced.⁷⁷ The settlement of the case meant no ruling on these arguments was made.

Little material is available to date in the S.D. Myers case. Myers claimed for damages because of Canada's adoption of an interim regulation under the Canadian Environmental Protection Act that temporarily banned the export of PCB wastes to the United States for disposal in any form.⁷⁸ As part of the claim, S.D. Myers argues that the national treatment obligation was breached because the measure

*discriminates against American waste disposal operators who wish to operate in Canada by preventing them from processing PCB contaminated waste in the United States. Thus, American waste disposal companies were not permitted to operate in the same fashion as Canadian waste disposal companies.*⁷⁹

This appears to suggest that the alleged discrimination results from Canadian waste disposal operators being able to dispose of PCB contaminated waste in Canada, while US operators could not dispose of the waste at their US facilities. If this is correct, this would appear to constitute a very broad approach to the national treatment tests.

The national treatment obligation is also raised in the Sun Belt and Loewen cases. In the Sun Belt case, the foreign investor has argued that the alleged difference in treatment it received as compared to its Canadian joint venture partner. Following the withdrawal of a license to export water from British Columbia after legislation banning water exports was adopted, the Government of British Columbia settled all claims with the Canadian investor but failed to do so with Sun Belt, the US investor.⁸⁰ The Notice of intent to arbitrate includes a simple reference to a breach of the obligation not to provide "less

⁷⁵ Ibid., paras. 45-47.

⁷⁶ Statement of Defence, Ethyl Corporation v. Government of Canada, 27 November, 1997, para. 89-90.

⁷⁷ Ibid., para. 80.

⁷⁸ *PCB Waste Export Interim Order*, Canada Gazette II, Nov. 16, 1995)

⁷⁹ Notice of Intent to Submit a Claim to Arbitration Under Section B of Chapter 11 of the North American Free Trade Agreement, S.D. Myers Inc. v. Government of Canada, July 21, 1998, para. 11.

⁸⁰ This connection to the water export issue has made the case something of a "cause celebre" for reasons beyond the scope of this paper. In point of fact, the case as it stands in the notice of intent to arbitrate does not address the legality of the water export ban by British Columbia, and this is simply not in issue.

favourable treatment,” supported by comparisons of the treatment the two partners allegedly received in their settlement negotiations.⁸¹

In the Loewen case, the only one against the United States, national treatment and other provisions of NAFTA are also raised as a consequence of legal proceedings. Loewen, a Canadian investor, was the defendant in a civil suit against a local company in Mississippi. The Notice of Claim alleges the civil proceedings were deliberately biased because of Loewen's foreign investor status, and that the judiciary allowed this to take place. It further alleges bias and lack of due process by effectively being denied a right to appeal.⁸² The result, it claims, was a damage award that was over \$500 million, from an original civil claim of \$8 million, including the largest punitive damages award ever (by some 60 times) in the state of Mississippi. The Notice of Claim invoked, among other grounds, the national treatment obligation based on the no less favourable treatment standard. This was tied to deliberate efforts to inflame the jury specifically because of the company's foreign status.⁸³ Loewen also argues that the denial of the effective right to appeal was a denial of its right to equal protection under the law, and hence of the national treatment obligation.

The second key question that arises in the context of the national treatment and MFN requirements is whether there are circumstances where there may be some legitimate reasons for treating a foreign investor in a different manner? Clearly, the US position noted above suggests that there is a basis for differentiation, under the like circumstances test, as between domestic and foreign investors when circumstances warrant a distinction, and that being a foreign investor may be one aspect of these circumstances. The key element in answering this question, and an important element in considering the application of the concept of “treatment no less favourable,” lies in the interpretation and application of the phrase “in like circumstances” that is included in both Articles 1102 and 1103.

As there does not appear to be any existing jurisprudence on this phrase in international investment law, it is useful to begin a discussion of its possible meaning by drawing on its antecedents in trade law. This phrase is derived from the similar terminology of “like products” found in Art. III.2 and III.4 of the General Agreement of Tariffs and Trade (GATT). There, it performs the analogous function of requiring the treatment of “like” imported and domestic products to be compared in order to evaluate whether one is receiving discriminatory treatment. The general approach in trade law to determining

⁸¹ In the Matter of the North American Free Trade Agreement, Chapter 11, Notice of Intent to Submit a Claim to Arbitration, *Sun Belt Water Inc. v. Canada*, 27 November, 1998, p. 23 in particular.

⁸² The issue of an appeal is also critical, as it is common in US civil cases for excessive jury awards to be reduced on appeal. To initiate an appeal, Loewen would have had to post a bond into court of 125% of the award against it, a requirement beyond its financial capacity. The appeal court had the discretion to reduce this requirement, which it had exercised previously, but refused to do so, instead requiring the bond to be posted within seven days of its decisions for the appeal to be heard.

⁸³ *The Loewen Group Inc. and Raymond L. Loewen v. The United States of America*, Notice of Claim, Submitted by Loewen Group on October 30, 1998, pp. 50-51.

whether products are like products has come to rely on economic issues, in particular market substitutability, as the defining element.⁸⁴

This market substitution approach has been adopted by counsel in the Ethyl case, the only one to expressly address this issue so far in available documents. In Ethyl, the investor compared its manganese-based gasoline enhancer and competing enhancers made from other products, including grains. Part of its argument in this regard was that no ill environmental effects had been scientifically established for its product. All of these products, it argued, were commercially substitutable for the same purposes, as a result of which Ethyl should be seen as being in like circumstances with the producers of these other products.⁸⁵ The Government of Canada, in response, did highlight the different process and product characteristics, and different supply and demand characteristics, as between MMT and the alternative products, arguing this meant the different producers were not in like circumstances.⁸⁶

Both Ethyl and the Canadian government appear to have used the trade law approach of market substitutability, at least in large part, as a means of comparing products in trade without questioning whether this is fully applicable in assessing the much longer term and broader range of issues relevant to investments. The temptation to rely on precedents in the trade law area will be high in the implementation of these uncharted waters of Chapter 11, in particular as lawyers coming from the trade side are likely to be mainly responsible for advising both the companies and the defendant countries. This is already seen in the materials available in the existing claims. How arbitration panels will react to this cross-fertilization, given the very clear need to distinguish the trade in goods and the regulation of long-term investments having a potential wide range of environmental impacts, remains to be seen.⁸⁷

Several of the Chapter 11 cases also emphasize the fact that the government regulators knew of the heightened or unique impact on the foreign investors in question, as evidenced in regulatory impact analyses or other direct government materials.⁸⁸ Here, one runs into a serious problem when considering regulatory measures. On the one hand, all

⁸⁴ See, e.g., Japan - Taxes on Alcoholic Beverages, Report of the Appellate Body, AB-1996-2, pp. 26-27 (of Internet version); Canada - Certain Measures Concerning Periodicals, report of the Appellate Body, AB-1997-2, Section VI of the Decision. And see the important review of these issues in Robert Hudec, "GATT/WTO Constraints on National Regulation: Requiem for an "Aim and Effects" Test" Vol. 32, *The International Lawyer*, pp. 619-649, 1998, esp. pp. 629 et. seq..

⁸⁵ Statement of Claim, Ethyl Corporation v. Canada, October 2, 1997, paras. 31, 14-18.

⁸⁶ Statement of Defence, Ethyl Corporation v. Government of Canada, 27 November, 1997, para. 83.

⁸⁷ See von Moltke, forthcoming (1999) for a general review of this issue, in particular on the institutional issues it raises.

⁸⁸ Notice of Arbitration Under the Arbitration Rules of the United Nations Commission on International Trade Law and the North American Free Trade Agreement, Ethyl Corporation v. Canada, April 14, 1997, para. 34ff; Statement of Claim, Ethyl Corporation v. Canada, October 2, 1997, paras. 22-24; The Loewen Group Inc. and Raymond L. Loewen v. The United States of America, Notice of Claim, Submitted by Loewen Group on October 30, 1998, for most of the presentation; Notice of Intent to Submit a Claim to Arbitration Under Section B of Chapter 11 of the North American Free Trade Agreement, S.D. Myers Inc. v. Government of Canada, July 21, 1998, para. 8.

business and non-business actors would expect the government to be aware of the impacts of such proposed measures before enacting them. But if this information is then used to ascribe intent to achieve a discriminatory impact, or support the effect of being discriminatory, the entire regulatory process can be seriously disrupted. This same concern also arises in relation to all the disciplines imposed on governments by Chapter 11.

The issue of national treatment in an environmental context was raised during the MAI negotiations. The Chairman of the negotiations noted that the inclusion of the phrase “in like circumstances” was needed to address concerns about the practical implementation of the “de facto” discrimination principle, and thus to preserve the needed scope for non-discriminatory regulation.⁸⁹ An interpretive note to the Chairman’s proposals affirms that governments may have legitimate policy reasons for differentiated treatment between different investors or investments, including foreign and domestic investors. The “in like circumstances” test is to permit the consideration of all the relevant circumstances in deciding which investments or investors should be appropriately compared.⁹⁰

What is lacking in this recognition of a comparative approach, and certainly in a market substitution type approach, is an elaboration of what like circumstances means in the context of long-term and complex environmental impacts of investments. Two separate issues can be anticipated to arise here. One is the consideration of like circumstances when it is a product that is being regulated because of its product-related characteristics. Here, commercial substitutability may be a relevant factor when comparing the product to other products, providing they do have the same product characteristics. (One cannot, for example, compare leaded and unleaded paint from a product characteristic perspective just because both are usable as paint.) But other comparisons may still remain relevant, including the impacts associated with the life cycle of the products.

The second issue that can be anticipated is the treatment of the process and production methods and the siting of a production facility. Unlike trade law, where the inclusion of process and production methods is hotly debated, in investments it is often the principal source of impacts and hence the main reason for regulating the operation of the investment per se. In this context, commercial substitutability is a much less relevant test, if not wholly irrelevant. Rather, each investment, both foreign and domestic, is likely to exhibit different characteristics because of its specific process and production methods, its location, and the receiving environment of the facility and its effluents or emissions. It is important to recall here that environmental permitting and regulation is increasingly becoming site specific as well as time specific. Facilities undertaking similar activities even 50 kilometres apart are likely to have different environmental conditions attached to

⁸⁹ Chairman’s Proposals on Environment and Related Matters and on Labour, Para. 5. See Annex 2, Organization for Economic Cooperation and Development (OECD), *The Multilateral Agreement on Investment, The MAI Negotiating Text (as of 24 April 1998)*.

⁹⁰ Chairman’s Proposals on Environment and Related Matters and on Labour, Annex: Package of Proposals for Text on Environment and labour, para 2, note, Annex 2, Organization for Economic Cooperation and Development (OECD), *The Multilateral Agreement on Investment, The MAI Negotiating Text (as of 24 April 1998)*.

their operations. Facilities operating next to each other but having begun at different times are equally likely to have different regulatory conditions because of reductions in the capacity of the receiving environment to absorb additional pollutants or because of generally higher environmental standards. The long-term nature of investments, often extending several decades, also means that any comparisons must be sensitive to the temporal and spatial characteristics of sound environmental regulation.

Recommendation: It is recommended that the risk of a market-based approach to “in like circumstances” dominating the interpretation of the national treatment test be addressed. In legal policy terms, the goal is to provide specific environmental points of reference for establishing when conduct is or is not discriminatory, or does or does not constitute treatment “no less favourable.” This is different from establishing a legal exception for when discriminatory conduct is acceptable.

This goal can be achieved by expressly recognizing the site and time specific nature of environmental regulation. Relevant factors would be reasonably simple to identify: the location of the investment; its precise environmental impacts; the absorptive capacity of the receiving environment; sustainability of the required raw materials being used; environmental capacity changes over time; and others could be identified and simply included as part of the comparative process in the event of specific challenges.⁹¹

Recommendation: It is also recommended that a greater emphasis be placed on administrative due process issues as a comparative basis as between foreign and domestic investors.

The Pope & Talbot case raises alleged differences in administrative due process issues as part of the question of discriminatory treatment.⁹² It would seem equally appropriate for this to be an important positive factor to support compliance with the national treatment discipline. In other words, where environmental laws provide for discretionary decision-making on the part of the government, as many important laws do, non-discrimination in the application of procedural rules and processes should be a positive indication of meeting the national treatment test. The investor-state process should not become a review of the exercise of such discretion, nor should it become a barrier to such discretionary laws.

This type of positive recognition of different environmental factors and administrative due process for comparative purposes would be particularly useful in case of challenges to environmental assessment or similar permitting decisions. It is important to note that the national treatment and MFN disciplines apply to “the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of

⁹¹ This would likely raise the importance of having proper environmental law and science expertise available on or to an arbitral panel.

⁹² Executive Summary, NAFTA Investor-State Dispute Claim by Pope & Talbot Inc., prepared by Appleton & Associates, p. 6.

investments.”⁹³ Consequently, they apply to the entire period of interaction between the parties and a potential investor. This would include administrative processes such as permit and environmental assessment decision-making. Potential foreign investors might argue strategically that more constraining conditions on the construction or operation of a facility as compared to a domestic facility, arising from an environmental assessment or permitting process, are discriminatory and therefore provide a basis for compensation. Clarification of the nature of “in like circumstances” from an environmental regulation perspective would minimize this risk as well.

3.5 Art. 1105, Minimum standard of treatment in accordance with international law

Whereas the national treatment and MFN disciplines are comparative in nature, the minimum international standard test in Article 1105 is not comparative. It requires minimum standards of “international law, including fair and equitable treatment and full protection and security,” to be met, whether domestic investors receive a similar minimum level of guarantees or not. Hence, this is an absolute minimum standard. The purpose of setting such a minimum standard is to ensure that the national treatment test is not applied so as to produce “an anomalous situation where nationals and foreign investors were treated equally badly.”⁹⁴ At least four Chapter 11 cases have claimed breaches of this minimum standard of treatment.

The origins of this minimum standard provision lie in due process and *bona fides* considerations that ensure fair and equitable treatment of an investor. This includes being free from unreasonable and discriminatory measures. The essence of the standard is fair and equitable treatment based, in part, on fair and equitable due process. There is also a general international standard against malicious or discriminatory action, which brings in the issue of the *bona fides* of government action.⁹⁵ Thus, this general standard has a relationship to the national treatment and MFN obligations, as well as an express relationship to the Chapter 11 provisions on expropriation.⁹⁶

The applicability of this provision to a claim arising from the adoption of an environmental measure would seem to be related to the specificity and particular impacts of the measure in question. The more specific the language or impact of a regulatory measure is to a foreign investment or investor, the greater the ability to argue for an application of this minimum treatment standard. The existing cases provide some illustration of the nature and role of the minimum international treatment provision under Chapter 11, with a fairly constant theme of lack of due process and/or a denial of justice.

⁹³ Article 1102(1), (2), 1103(1), (2).

⁹⁴ Shihata, 1993, p. 78-79.

⁹⁵ Sacerdoti, 1997, at pp. 345-47; Sornarajah, 1994, pp. 118-133

⁹⁶ The precise role of this standard in relation to assessing an expropriation is unclear. See Article 1110(1)(c) for the reference.

The S.D. Myers notice of intent to arbitrate states simply that the PCB export ban was promulgated in a discriminatory and unfair manner which constituted a denial of justice, thereby breaching the requirement of Article 1105.⁹⁷ The Sun Belt case recounts alleged lack of good faith and arbitrary decisions, and consistent judicial decisions preventing the production of its evidence, to support its claim that there was an absence of due process and fair and equitable treatment.⁹⁸

In Pope & Talbot, the claimant cites four due process failings in an Executive Summary of its case. These are a failure to permit the investor to have a fair hearing with respect to its quota; a failure to inform the investor of the decision-making process; failing to provide adequate reasons for the decisions on the quota; and failing to provide a review procedure.⁹⁹ All of these aspects of due process are drawn from the most recent WTO environment-related decision in the Shrimp-Turtle case, where they were a critical part of the Appellate Body finding that the environmental measure in question was discriminatory in its application and hence inconsistent with WTO obligations.¹⁰⁰

The Loewen case provides the most extensive review of the minimum standard of treatment case law and literature in the currently available Chapter 11 materials. It invokes the basic principle of a foreign investor's entitlement to a fair and impartial hearing before any court or tribunal, free of irrelevant and discriminatory remarks and considerations. Loewen's arguments go on to address in detail the concepts of a substantial denial of justice through an egregiously wrong or excessive judgment (or decision), or through a procedural denial of justice.¹⁰¹ As a general matter, and without considering their application to the facts of that case, these concepts would seem to be properly identified as part of the minimum standard requirement.

The critical part in an environmental claim under this discipline will be the ability of a complainant to establish the lack of *bona fides* of the government action or measure, or the absence of due process. Without venturing into the merits of the claims in any way, the arguments seen in the Loewen and Sun Belt cases are examples of the classic application of this principle by a plaintiff investor, in that they highlight the linkages between the alleged improper treatment by the host government or an agency of the government and the fact that they were foreign investors. While the test does not hinge solely on such a link, its absence in the context of otherwise transparent decision-making processes will be an important defence element. The arguments set out in the Pope &

⁹⁷ Notice of Intent to Submit a Claim to Arbitration Under Section B of Chapter 11 of the North American Free Trade Agreement, S.D. Myers Inc. v. Government of Canada, July 21, 1998, para. 12.

⁹⁸ In the Matter of the North American Free Trade Agreement, Chapter 11, Notice of Intent to Submit a Claim to Arbitration, Sun Belt Water Inc. v. Canada, 27 November, 1998, p. 23.

⁹⁹ Executive Summary, NAFTA Investor-State Dispute Claim by Pope & Talbot Inc., prepared by Appleton & Associates, at p. 6.

¹⁰⁰ United States - Import Prohibition of Certain Shrimp and Shrimp Products, Report of the Appellate Body, AB-1998-4, 12 October 1998, paras. 177-184.

¹⁰¹ The Loewen Group Inc. and Raymond L. Loewen v. The United States of America, Notice of Claim, Submitted by Loewen Group on October 30, 1998, at pp. 50-59.

Talbot case draw on the recent Shrimp-Turtle decision in the WTO, and hence also bring a pedigree with them for their application to environment-related measures.

The minimum international standard of treatment is well established as part of the historical development of international law in this area. While it may be difficult to define with precision, it is a standard that is less likely to impact on *bona fide*, non-discriminatory measures than other issues addressed here. As a result, it is recommended that this issue not be seen as a priority for intervention.

3.6 Art. 1106, Performance requirements

Article 1106 sets out a series of prohibitions on performance requirements for investors. Such prohibitions are intended to reduce distortions in the efficiencies gained by free-market investment decision-making. The theory is that governments that condition the ability to invest on requirements such as, for example, sourcing of domestic inputs reduce the investment's efficiency and competitiveness. Requirements linked to the import or export of the manufactured product or of materials needed in the process and production method of the investor distort not just investment efficiencies, but also reduce gains made in trade liberalization that are intended to improve resource utilization efficiencies.¹⁰² Unlike most provisions of NAFTA, these performance requirement prohibitions apply to all investments in the three countries, domestic and foreign.¹⁰³ However, domestic investors are not given any of the specific remedies and recourse foreign investors have under the investor-state process.

The main performance requirement prohibitions for present purposes are set out in Article 1106(1):

1. No Party may impose or enforce any of the following requirements, or enforce any commitment or undertaking, in connection with the establishment, acquisition, expansion, management, conduct or operation of an investment of an investor of a Party or of a non Party in its territory:

(a) to export a given level or percentage of goods or services;

(b) to achieve a given level or percentage of domestic content;

(c) to purchase, use or accord a preference to goods produced or services provided in its territory, or to purchase goods or services from persons in its territory;...

¹⁰² Price, 1993, p. 729; Jo Brooks, "Performance Requirements," pp. 26-27 in OECD, *Proceedings of the Special Session on the Multilateral Agreement on Investment Held in Paris on 17 September, 1997*, OECD, 1997.

¹⁰³ See Article 1101(1)(c), 1106(1) of NAFTA.

(f) to transfer technology, a production process or other proprietary knowledge to a person in its territory, except when the requirement is imposed or the commitment or undertaking is enforced by a court, administrative tribunal or competition authority to remedy an alleged violation of competition laws or to act in a manner not inconsistent with other provisions of this Agreement;

There are two separate environmental exceptions for these rules in Article 1106. Under Article 1106(2), a technology requirement that might be captured by paragraph (f) but that is imposed in order to meet generally applicable health, safety or environmental requirements is deemed to be non-inconsistent with the prohibition in that paragraph, as long as it is non-discriminatory. The second exception is in Article 1106(6). It allows, by way of exception, measures “(a) necessary to protect human, animal or plant life or health, or (b) necessary for the conservation of living or non-living exhaustible natural resources,” providing the measures are not applied in an arbitrary or unjustifiable manner, and do not constitute a disguised barrier to trade or investment. As a threshold issue, this exception adopts the necessity test under trade law in order for a measure to be justified by a government. In the trade law context, this test includes at least three elements: (1) is the measure needed to protect the environment in the jurisdiction adopting the measure; (2) is it necessary to include a trade measure at all in order to achieve the objective; and (3) if a trade measure is necessary, is the least trade restricting measure adopted. The necessity test is understood as one of the most demanding for using any exception in trade law.¹⁰⁴

The first three of the performance requirement prohibitions quoted above can be tied to any measures restricting the flow of goods across a border.¹⁰⁵ The critical question, and one now raised in the Chapter 11 cases, is whether export or import measures not tied to the actual making of an investment can trigger the application of Article 1106. This is important for two reasons. First, if any border measure, no matter how general, gives this right, then every border measure is potentially subject to challenge by a foreign investor, including export or import bans, tariffs, quotas, etc.¹⁰⁶ This would constitute the most “unprecedented”¹⁰⁷ expansion of the privatization of trade law in international trade law history, but through the indirect mechanism of an investment agreement. This would apply within NAFTA countries at first, and could potentially apply elsewhere if a broader

¹⁰⁴ See, e.g., Herman, pp. 128-129. This test is derived from Article XX of the GATT. The necessity test adopted here operates in comparison to the “related to” test that is also included in Art. XX(g) of the GATT, but not in Art. 1106(6). For a general discussion on the role of these tests, see also Howard Mann, “Of Revolution and Results: Trade and Environment Law in the Afterglow of the Shrimp-Turtle Case,” Vol. 9, *Yearbook of International Environmental Law*, 1998, forthcoming, and the related series of articles in that volume.

¹⁰⁵ These type of trade related performance prohibitions have also been adopted at the international level in the WTO. Essentially, they are seen as a reflection of the obligations already existing under trade law relating to the reduction and elimination of trade barriers. See, *Agreement on Trade Related Investment Measures*, reprinted in GATT Secretariat, *The Results of the Uruguay Round of Multilateral Trade Negotiations, The Legal Texts*, 1994. Unlike NAFTA, however, the TRIMS Agreement does not go beyond these specific trade disciplines.

¹⁰⁶ Statement of Defence, *Ethyl Corporation v. Government of Canada*, 27 November, 1997, para.91.

¹⁰⁷ This language comes from Horlick and Marti, 1997, p. 54.

investment agreement is negotiated. It would also mean that investment and trade rights have become seamless, with the foreign investors' rights now including extensive free trade rights and remedies through the performance requirement discipline despite the absence of any intention to have achieved such a major result being evident. Second, if this is the case, then each challenge relating to an environmental trade measure brought by an investor would have to be defended on the basis of being permissible only as an exception to the rule against performance requirement prohibitions. As noted above, this defence would have to rest on the most restrictive tests for this purpose imported from trade law agreements.

At least two Chapter 11 cases have argued that a trade measure constitutes a performance requirement. In the Ethyl case, the trade ban on the gasoline additive MMT was argued to be a performance requirement, in breach of the obligation not to require an investor to achieve a certain level of domestic content for inputs into its products or manufacturing processes. MMT had been the primary product line of Ethyl's operation in Canada, and Ethyl was the only MMT user in Canada. Ethyl claimed that (1) the ban forced it to use domestically produced substitutes in place of the additive it was importing, (2) it otherwise forced them to open and operate domestic production facilities to use only domestically produced MMT, and (3) it required Ethyl to build MMT facilities and operations in each Canadian province.¹⁰⁸

While the legislation actually banned the import and inter-provincial trade of the product, Ethyl interpreted the potential effects of the import ban as creating these types of performance requirements if its operation was to continue. There was no express link in the legislation to the investment or investor.

In the S.D. Myers case, a similar argument was repeated, with the export ban on PCB wastes being identified as a performance requirement for waste disposal operators to use Canadian services and facilities only, thereby creating a preference for Canadian service providers.¹⁰⁹

Canada, as the defendant in both these actions, only has its response publicly available in the Ethyl case. The Statement of Defence argues that Article 1106 was "intended to cover conditions or obligations placed on the presence or operation of a business in the territory of a Party," and the legislation placed no such requirements on any investor.¹¹⁰ The government here relied on the text and form of the legislation, whereas Ethyl looked to the effect of the measure on its operations, and how the same MMT based operation or an equivalent operation with an alternative product could be maintained. Of course, the intention of the measure was that the same operation should not be maintained. Canada continued by arguing that

¹⁰⁸ Statement of Claim, Ethyl Corporation v. Canada, October 2, 1997, paras. 41 ff.

¹⁰⁹ Notice of Intent to Submit a Claim to Arbitration Under Section B of Chapter 11 of the North American Free Trade Agreement, S.D. Myers Inc. v. Government of Canada, July 21, 1998, para 13.

¹¹⁰ Statement of Defence, Ethyl Corporation v. Government of Canada, 27 November, 1997, para. 86.

Acceptance of Ethyl's contention that an import ban is the equivalent of a performance requirement would lead to the absurd result that every border measure (whether an import ban, a quota, tariff rate quota or tariff) is a "performance requirement." Chapter 11 does not apply to these kinds of measures.¹¹¹

Applying an effects test here, as advocated by Ethyl, would indeed lead to this result.

As already noted in s. 3.2, Canada conceded at a jurisdictional hearing that the issue of a trade measure falling under Chapter 11 could be decided on the merits. And the Ethyl arbitration tribunal expressed the view that trade measures could in fact be raised under Chapter 11.¹¹² Because the case was settled, it was never decided whether such a measure could be the subject of a challenge under the performance requirement disciplines. But statements on this point in the Award on Jurisdiction and Canada's concession leave the door to environmental trade measures being challenged in the future as a performance requirement under Chapter 11. The hope by some that a panel might be "hesitant to open the flood gates" was not well founded in this case.¹¹³

It should be noted that this is the only circumstance in which the fact that an environmental measure is in the form of a trade measure is relevant to Chapter 11. In all other cases the measure can be challenged regardless of its form, be it standards-based or trade based.

Recommendation: Given this potential avenue for the performance requirement prohibitions to impact on environmental trade measures, it is recommended that the scope of Article 1106 be addressed as part of an interpretive statement. The legal policy objective would be to establish when a type of regulation does not constitute a performance requirement, as opposed to when it might qualify as an exception to these disciplines.

3.7 Art. 1110, Expropriations

The nub of the legal issue in Article 1110(1)

Several Chapter 11 cases have now raised the question of whether, or in what circumstances, governments may be required to pay compensation to foreign investors because environmental protection measures constitute an expropriation of their business. This was the most visible issue during the MAI debates, and arguably has remained the issue with the most public impact to date. Given the significance of this issue, it is important to identify carefully and clearly the legal issues linking the investor protections against expropriation and constraints on the ability of the government to protect the

¹¹¹ Ibid, para. 91.

¹¹² Award on Jurisdiction in the NAFTA/UNCITRAL Case between Ethyl Corporation and the Government of Canada before the Tribunal, paras. 62-64.

¹¹³ Horlick and Marti, p. 53-54.

environment. The provision on the protection from expropriation is found in Article 1110(1), on Expropriation and Compensation:

1. No Party may directly or indirectly nationalize or expropriate an investment of an investor of another Party in its territory or take a measure tantamount to nationalization or expropriation of such an investment ("expropriation"), except:

(a) for a public purpose;

(b) on a nondiscriminatory

(c) in accordance with due process of law and Article 1105(1);
and

(d) on payment of compensation in accordance with paragraphs 2 through 6.

It is important to note that there are three different threshold definitions, and four different conditions found in this article. The three threshold definitions are:

- directly nationalize or expropriate;
- indirectly nationalize or expropriate; and
- measures tantamount to nationalization or expropriation.

Each of these constitutes a threshold question: does the government action in question constitute one of these types of acts? If it does, then all four conditions set out in paragraphs (a)-(d) come into play. It is essential to understand that all of these conditions must be met, or a Chapter 11 action will be well founded. Thus, a measure can be for a valid public purpose, can be absolutely non-discriminatory, and can be enacted with full due process accorded all stakeholders, (i.e. not in breach of any other of the disciplines in Chapter 11) but it would still require compensation to be paid if it falls within one of the threshold definitions.

The nub of the legal issue can be reduced even more by identifying the type of regulatory measures that are at the crux of the regulation/expropriation issue. The measures in question would not be the actual divesting or expropriation of physical property by the state, but the regulation of certain harmful or potentially harmful uses of that property (or that investment under NAFTA).¹¹⁴ In most jurisdictions, the expropriation of private property to use, for example, as part of a national park, would lead to compensation for the property owner and we see no reason to exclude such a result for foreign investors.¹¹⁵ But the regulation of industrial or other economic activity to prevent harm to human health or the environment is not the same. Clearly, all environmental regulation has an economic impact on the activity involved and hence on the investor. Indeed, some

¹¹⁴ This is language drawn from Rudolph Dolzer, "Indirect Expropriation of Alien Property," Vol. 1 *ICSID Review - Foreign Investment Law Journal*, pp. 41-65, 1986) at p. 62.

¹¹⁵ A problem can arise here in that domestic law in some cases may allow even such an expropriation to be made without compensation if the legislation in question specifically states this. Such situations are rare, however, and the courts will generally aggressively work to prevent expropriations without compensation taking place.

regulation for environmental purposes may even cause facilities to close permanently or temporarily. This type of regulatory measure will be the primary government action to be challenged in countries adhering to a general policy of investment and trade liberalization.¹¹⁶ And it is this type of measure that will raise the question whether it constitutes a compensable measure under Chapter 11 or whether it is a non-compensable government action for which the investor bears the business risks and costs. In precise legal terms, if this type of measure is classified as either an indirect expropriation or a measure tantamount to expropriation under NAFTA, foreign investors will be entitled as a matter of right to compensation, no matter how critical the public purpose of the action taken. Thus, the legal issue turns completely on whether an environmental measure falls within one of these two threshold definitions.

In the United States, this question has been a heated issue under the title of “regulatory takings.” This issue arises from the constitutional protection of private property, and has particular significance for environmental laws because of their impact on land and property use. A review of US takings law is beyond the scope of this paper, given its focus on international law as the applicable field of law under NAFTA.¹¹⁷ In brief, though, the debate encompasses both philosophical and legal differences that pit private property rights against societal rights to environmental integrity. The debate also reveals that US law in this area continues to maintain divisions between interference with the physical possession of property, deprivations of the full use of the property for economic purposes, and regulation of impacts on the environment and the public from the use of the property. The line between the second and third of these concepts is where the uncertainty as between compensable and non-compensable regulatory takings arises. In this, the debate is similar to that now being developed at the international level. But concerns continue to be raised within the United States that the provisions of Chapter 11 allow foreign investors to effectively sidestep the domestic legal debate by providing them with an alternative legal recourse. The absence of the same range of procedural and legal safeguards as found in US domestic litigation, including at least two potential appeals, adds to this concern.

The uncertainty around the threshold definition of expropriation and measures tantamount to expropriation

It has already been argued that the scope of the expropriation provisions in Article 1110(1) is uncertain, and a matter of concern. This uncertainty derives from the general evolution of this type of provision in international investment law. These foreign investor

¹¹⁶ As Birchall notes, investment disputes among developed states are not going to arise as a result of outright expropriations. This is equally true today of states adopting broader market-based economic policies. Rather, the provisions will be used in the way in which Ethyl Corp. did. For this reason, Birchall concludes that expropriation provisions in investment liberalization agreements among developed states have to be approached with caution.” Birchall, 1998, at p. 160.

¹¹⁷ For some general reviews of the takings issue, see, e.g., Donald C. Guy and James Holloway, “The Direction of Regulatory Takings Analysis in the Post-Lochner Era,” Vol. 102, *Dickinson Law Review*, pp. 327-353, (1998); Blaine I. Green, “The Endangered Species Act and Fifth Amendment Takings: Constitutional Limits of Species Protection,” Vol. 15, *Yale Journal of Regulation*, p. 329 *et. seq.*

protections have their origin in the kind of expropriations and nationalizations that truly constituted a physical taking of property. As these direct measures received the consistent approbation of the international law process, less extreme or obvious mechanisms, such as the removal of directors or excessive taxation programs, were developed to effectively remove control of an investment from the investor. This trend was referred to as “creeping expropriation” or as indirect expropriation. The broad recognition that a range of measures could be “disguised expropriations” required international law to be expanded to adequately protect foreign property owners. Still, international law continued to maintain the traditional exception for normal regulatory activities, under the label of “police powers,” as long as these were non-discriminatory in nature.¹¹⁸ The issue raised by the text of Chapter 11 is whether this traditional exception has been undermined or eroded under more recent tests or by the NAFTA itself.

Police powers have been defined as “The power of the state to place restraints on the personal freedom and property rights of persons for the protection of the public safety, health, and morals, or the promotion of the public convenience and general prosperity. . . .The police power is the exercise of the sovereign right of a government to promote order, safety, security, health, morals and general welfare within the constitutional limits and is an essential attribute of government.”¹¹⁹ This definition would seem, with some degree of certainty, to include environmental regulation, and hence exclude such regulation from being compensable.

This view is generally supported by George Aldrich, a veteran international arbitrator, in his review of the most extensive set of international investor-state arbitrations ever undertaken: those established under the Iran-United States Claims Tribunal. This set of arbitrations followed the overthrow of the Shah of Iran by the Islamic Government in 1979, an event which resulted in claims for property losses from both American investors in Iran and Iranian investors in the United States. Aldrich reached the following set of conclusions on the state of the law coming from this tribunal:

1. *The Tribunal has been concerned to ensure that property rights are respected and that compensation is paid when the alien owner of those rights is deprived of them by acts attributable to a state.*
2. *Liability exists whenever acts attributable to a state have deprived an alien owner of property rights of value to him, regardless of whether the state has thereby obtained anything of value to it.*
3. *Liability is not affected by the intent or absence of intent attributable to the state.*
4. *Liability does not require the transfer of title to the property.*
5. *Liability does not arise from actions that are non-discriminatory and are within the commonly accepted taxation and police powers of states.*

¹¹⁸ For general reviews of this evolution, see, Dolzer, Rudolph, 1986, at p. 62; Sacerdoti, 1997, pp. 379-389; Comeaux and Kinsella, 1997, pp. 3-15.

¹¹⁹ Black's Law Dictionary, 6th edition, 1990. This definition draws on US law in this area, but is consistent with international law.

6. *Liability is not affected by the fact that the state has acted for legitimate economic or social reasons and in accordance with its laws.*¹²⁰

This general approach is echoed in the Canadian Memo on the expropriations issue noted previously. This Memo then highlights the critical problem:

*Notwithstanding the broad consensus respecting the existence of a regulatory exception, customary law and the writings of leading commentators have yet to articulate clear rules to distinguish between a compensable taking and non-compensable regulation.*¹²¹

In other words, while there may be a line, no one knows where the line is drawn. At least one negotiator has explicitly recognized that this is so in the case of Chapter 11.¹²² Analysts of the present state of international law continue to hedge their bets as to when regulatory measures could constitute a compensable taking, arguing that the issue is often one of degree even for measures of general application and absent any other discriminatory or abusive factors.¹²³ One reason for this is the emergence of the effects test for assessing a measure, as opposed to considering its intent or purpose. Indeed, both the Aldrich and Canadian government summaries argue that the intent and purpose are not definitive, and may be of little relevance in defining a compensable regulatory measure. In contrast, Aldrich's sixth point, that "Liability is not affected by the fact that the state has acted for legitimate economic or social reasons and in accordance with its laws," implicitly invokes the effects doctrine as the critical, if not determinative test.¹²⁴ Comeaux and Kinsella make the point forcefully:

*No decision of which we are aware has turned on whether an expropriation was for a "public purpose." This may be because it is very easy for an expropriating state to couch ant taking in terms of some "public purpose."*¹²⁵

In Chapter 11, this is highlighted by the fact that even if a measure is for a valid public purpose (its intention or purpose) compensation is still required if the measure can be defined as indirect or tantamount to expropriation.

¹²⁰ George Aldrich, "What Constitutes a Compensable Taking of Property? The Decisions of the Iran-United States Claims Tribunal," Vol. 88, *American Journal of International Law* pp. 585-610, 1994, at p. 609. Aldrich included several other conclusions going to the quantum of damages, an issue beyond the scope of this review.

¹²¹ *Ibid.*, p. 20-21.

¹²² Price, 1993, p. 730.

¹²³ E.g., Comeaux and Kinsella, 1997, pp. 3-15. These authors state at p. 9: "Examples of actions which contribute to de facto expropriations are incremental increases in taxes, increasingly harsh regulations, import and export restrictions, price controls, zoning laws, prolonged "temporary seizures" of assets, high minimum wages, and controls on expatriation of profits." See also, e.g., Soloway, 1999, forthcoming; Dolzer, 1986, in particular the considerations at p. 58ff.

¹²⁴ See also Rudolph Dolzer and Margrete Stevens, *Bilateral Investment Treaties*, 1995, at p. 100.

¹²⁵ Comeaux and Kinsella, 1997, p. 80. See also their discussion at pp. 85 et. seq..

The effects test looks at the effect of a measure in fact (its *de facto* impact in trade law terms), not at its goal or purpose. If the effect is to significantly interfere with the operation of an investment, it can then be found to be an indirect expropriation or a measure tantamount to expropriation.¹²⁶ This approach is again similar to international trade law, where the effects test has become a central element in looking behind the declared intent or purpose of government action to establish whether the measure results in a *de facto* discrimination. The measure's aim is often minimized or eliminated as part of this analysis.¹²⁷ We have already noted that environmental measures can require companies to suspend or terminate some process and production methods, or prevent certain products from being used or sold, any of which clearly impacts on a company's operation and management. Consequently, if the effects test is central to the interpretation of the threshold language of indirect expropriation or a measure tantamount to expropriation, this significantly weakens the applicability of the police power approach for carving out non-compensable regulatory actions from the definition of expropriation.

Closely related to the potential role of the effects test is the fact that environmental regulation today is increasingly based on more targeted and site specific activity. While a framework piece of environmental law setting broad parameters for government regulators may not be assailable, this is often because it will have no immediate impact in the absence of the more specific regulations that are required to implement the act. The potential application of the effects test to these types of more specific regulation, permits or administrative decisions, which inevitably result in heavier impacts on some actors, raises the magnitude of uncertainty surrounding the regulation/expropriation question.

Not surprisingly, the existing Chapter 11 cases highlight the use of the effects test, and the need to consider its application in the specific circumstances of each case. In the S.D. Myers case, the claimant simply asserts that the "effect" of the measure in question was to totally frustrate the operations of the investor, thereby highlighting this part of the test.¹²⁸

In the Ethyl case, several related arguments are to be found. In its Notice of Arbitration, Ethyl argues that an "expropriation exists whenever there is a substantial and unreasonable interference with the enjoyment of a property right."¹²⁹ In its Statement of Claim, Ethyl offers no legal treatment of the threshold definitions, but simply asserts an

¹²⁶ Ibid, pp. 13-15. This is often the US approach in the investment law area. See *Restatement of the Law: The Foreign Relations Law of the United States (3rd)*, s. 712(g), V. 2 at p. 200 et. seq..

¹²⁷ For a broad review of this issue in trade law see Hudec, 1998. The aim or purpose test still appears to be relevant for part of the justification of environmental measures, but this is what has now been referred to as a "provisional justification." The effects test regains its ascendancy when the analysis of the test of discrimination and arbitrariness are then applied to any measures. This is seen in the Appellate Body decision in the Shrimp-Turtle case of 1998. United States- Import Prohibitions of Certain Shrimp and Shrimp Products, Report of the Appellate Body, AB-1998-4, para. 149. See also Herman, 1998, pp. 128-129, Mann, 1999.

¹²⁸ Notice of Intent to Submit a Claim to Arbitration Under Section B of Chapter 11 of the North American Free Trade Agreement, S.D. Myers Inc. v. Government of Canada, July 21, 1998, para 14.

¹²⁹ Notice of Arbitration Under the Arbitration Rules of the United Nations Commission on International Trade Law and the North American Free Trade Agreement, Ethyl Corporation v. Canada, April 14, 1997, para. 32

expropriation based on the effects—known beforehand by the government—of the MMT ban on its business.¹³⁰

The Loewen case provides the most categorical assertions, stating somewhat boldly that “Under international law, an expropriation occurs where government action interferes with an alien’s use or enjoyment of property.” It then asserts that the United States itself (the defendant country in this case) “has long recognized that expropriation covers a “multitude of activities having the effect of infringing property rights.”¹³¹

In its response in the Ethyl case, Canada has asserted that Article 1110 deals with the taking of property, not regulation, and that regulatory measures within the scope of the police powers exception is recognized by international law as outside the scope of a taking of property.¹³² However, the legal weight of this argument is now weakened by its own internal memo noting the uncertainty of the line between taking and regulation, and the heightened role of the effects test in making this judgment.

There is also a growing trend in international economic law generally toward assessing the scope of key terms or definitions differently for each case, rather than by adopting a precise definition that might be applied to any challenged measure. This is different from the very legitimate need to assess the specific evidence in each individual case. The trend is toward interpreting key provisions in a wider or narrower manner in order to achieve an identified underlying objective. In the WTO context, we have now seen the “accordion-like” quality of the “like product” test emerge, with the test to be squeezed or opened as needed. Similarly, the Appellate Body has enunciated a “line of equilibrium” to be fixed by Panels in balancing the rights and obligations of parties as between environmental regulation and trade law disciplines. In each case, the underlying goal identified has been the liberalization of trade, and applying exceptions in a manner consistent with the obligations of the parties.¹³³ This is also seen in investment law, and is closely tied to the view expressed above that a wide range of mechanisms can be used, or more aptly abused, to create indirect or creeping expropriation, meaning some flexibility is required in the scope of the definition itself.

The Chairman of the MAI negotiations sought to address the expropriation issue in his final proposals on environmental concerns in those negotiations. He proposed the following interpretive text:

¹³⁰ Statement of Claim, *Ethyl Corporation v. Canada*, October 2, 1997, paras. 20-24.

¹³¹ *The Loewen Group Inc. and Raymond L. Loewen v. The United States of America*, Notice of Claim, Submitted by Loewen Group on October 30, 1998, para. 164, 166. The last passage quotes a US Presidential statement on this point. (footnote omitted)

¹³² Statement of Defence, *Ethyl Corporation v. Government of Canada*, 27 November, 1997, para. 93-95.

¹³³ *Japan - Taxes on Alcoholic Beverages*, Report of the Appellate Body, pp. 21-22 (Internet version) on the “accordion-like quality” of the like product test, and Sections F, G, and H of the Report more broadly on the purpose guiding its flexible interpretation. *United States - Import Prohibitions on Shrimp and Certain Shrimp Products*, Report of the Appellate Body, paras. 120, 159 of the flexibility of the “line of equilibrium” test, and para. 151 on the purpose guiding its interpretation. The result, it can be argued, is the paradoxical situation where the purpose of the test provides a basis for making the test itself rather fungible in order to achieve the purpose, while the purpose of the measure itself is made irrelevant.

The reference [in Article IV.2.1] to expropriation or nationalization and “measures tantamount to expropriation or nationalization” reflects the fact that international law requires compensation for an expropriatory taking without regard to the label applied to it, even if title to the property is not taken. It does not establish a new requirement that Parties pay compensation for losses which an investor or investment may incur through regulation, revenue raising and other normal activity in the public interest undertaken by governments.¹³⁴

Unfortunately, the choice of words here leaves as much in doubt as it clarifies. While the MAI draft text may not have established a “new” requirement for compensation, this statement does not impact on the interpretation of any already existing requirement under international law, or how to distinguish between compensable and non-compensable regulation.

These factors all contribute to a state of uncertainty under general international law over the current scope of the police powers carve-out from the notion of expropriation. This state of uncertainty has been compounded by at least four unique provisions in the NAFTA itself.

First, Article 1110(1) uses three different tests to establish when a measure is compensable: direct expropriation or nationalization; indirect expropriation or nationalization; and measures tantamount to an expropriation. NAFTA is the first occasion when these three terms have appeared in the same legal text as different tests, causing many observers to argue that each of these terms must be given specific and different meanings.¹³⁵ This suggests a heightened risk of the scope of compensable measures being expanded under Art. 1110(1) beyond what had generally been thought appropriate even five years ago. In particular, the connection between the effects test and the notion of a measure tantamount to expropriation becomes more plausible because of the very specific articulation of these three distinct thresholds. All the existing challenges focus on this fact, and cite in particular “measures tantamount to expropriation” as the critical issue on which to rule.¹³⁶

¹³⁴ Annex: Package of proposals for text on environment and labour, para. 5, note, in Chairman's Proposals on Environment and Related Matters and on Labour, Annex 2, Organization for Economic Cooperation and Development (OECD), *The Multilateral Agreement on Investment, The MAI Negotiating text (as of 24 April 1998)*.

¹³⁵ de Pencier, 1998, pp. 151-153.

¹³⁶ Notice of Arbitration Under the Arbitration Rules of the United Nations Commission on International Trade Law and the North American Free Trade Agreement, *Ethyl Corporation v. Canada*, April 14, 1997, para. 34ff; Statement of Claim, *Ethyl Corporation v. Canada*, October 2, 1997, para. 37; *The Loewen Group Inc. and Raymond L. Loewen v. The United States of America*, Notice of Claim, Submitted by Loewen Group on October 30, 1998, para. 162, 167; Notice of Intent to Submit a Claim to Arbitration Under Section B of Chapter 11 of the North American Free Trade Agreement, *S.D. Myers Inc. v. Government of Canada*, July 21, 1998, para. 14.

Second, there are two narrow exceptions in Article 1110 setting out specific types of regulatory or administrative actions that do not constitute compensable measures.¹³⁷ One of these, Article 1110(8), specifically refers to measures of general application, indicating that the potential for non-discriminatory measures of general application to be considered as compensable was at least raised during the NAFTA negotiations. For lawyers, this raises an interpretive question as to what these exceptions imply for defining the full range of all the other types of regulatory measures as compensable.¹³⁸

Third, Article 2103(6) of NAFTA specifically states that the provisions on expropriation shall apply to general measures of taxation, an area normally excluded by the police power, absent discriminatory or other abusive features. However, a special procedure is established here for the deputy minister level officials of each party to determine among themselves whether or not the taxation measure at issue is an expropriation.¹³⁹ No other types of measures are made subject to such bureaucratic review before they can be challenged under Chapter 11. (This “gatekeeper” approach is returned to later in this section.)

Finally, there is the previously discussed definition of the word “measure” for purposes of Chapter 11. Given its expansive definition, and the inclusion of the word “measure” in the text of Article 1110(1) as well (“measure tantamount to expropriation”), there can be little doubt as to the potential for regulations, legislation and administrative acts implementing them to fall within the possible scope of application of Article 1110(1). This, once again, leaves everything resting on the issue of how to define “indirect” expropriation or “tantamount to” expropriation.

Each of these provisions in NAFTA has the potential to strengthen legal arguments that environmental measures taken for a public purpose can form a basis of a claim for compensation. Given the uncertainty in the terminology, this could be either as an indirect expropriation or a measure tantamount to expropriation. The NAFTA parties consistently maintain this was not the intention. Unfortunately, there is no specific drafting record publicly available to elaborate on what the precise scope, or limitations on the scope of Article 1110 was intended to be, and hence little to provide to arbitral panels to support narrower views of the intended scope.¹⁴⁰

A broader legal policy perspective on the issues

Absent from the debate on the meaning of the words is a legal policy-oriented consideration of the time frame in which investments occur, and how this relates to the potential impact of a finding that a regulation for environmental protection can be

¹³⁷ See Article 1110(7) and (8) for these exceptions.

¹³⁸ The role of an exception for measures of general application is highlighted by de Pencier, 1998, p. 152. The fact that the exceptions in NAFTA are only a partial, and not the complete exception he discussed, highlights the potential impact, *a contrario*, of its very limitations. See also the Canadian Memo, p. 20.

¹³⁹ Article 2103(6) and Annex 2103.6 of NAFTA.

¹⁴⁰ Indeed, according to some government officials, there is no collated drafting record in relation to Chapter 11 at all.

compensable. It has already been noted that, unlike the fairly instant nature of trade in products under WTO or NAFTA law, foreign direct investments are generally long-term interests, often extending to many decades. The prospect of requiring compensation for adopting new environmental regulations over the life span of a foreign investment has the potential of freezing the applicable law as regards that investment. Given the changes in scientific knowledge, cumulative impacts of industrial processes and natural resource harvesting on the environment, and changing social views and environmental values, this is an obviously unacceptable conclusion from an environmental perspective.

Simply accepting that regulatory changes can be made if compensated for, is also highly inappropriate. In effect, this would amount to a complete reversal of the now fundamental and broadly accepted polluter pays principle first enunciated by the OECD in 1972:

*Under the polluter pays principle, the community effectively “owns” the environment, and forces users to pay for damage they impose. By contrast, if the community must pay the polluter, the implicit message is that the polluter owns the environment and can use and pollute it with impunity. This message is inconsistent with the principles of sustainable development...*¹⁴¹

Nor, as has been noted previously, would such a result be consistent with the objective of NAFTA to foster sustainable development. If new laws to ensure environmental protection and sustainable resource management are subject to investor claims for compensation under the expropriation provisions of NAFTA, how is it possible for the objective of promoting rising environmental standards to be achieved? How is upwards harmonization to be achieved? How is the right of the three NAFTA parties to set their own levels of environmental protection, set out in Article 3 of the North American Agreement on Environmental Cooperation, to be respected? It might be noted in this context that the Ethyl and S.D. Myers cases against Canada challenged the only legally binding environmental measures with significant new impacts on business operations adopted by the Government of Canada since the coming into force of NAFTA.¹⁴²

In addition to these factors, an interpretation requiring compensation for new environmental measures would actually read into the provisions of Chapter 11 what is referred to as a “stabilization clause.” These clauses have been used in bilateral investment agreements or contracts between a state and a foreign investor in order to fix the law applicable to that investor at the time of contracting.¹⁴³ The reason such clauses

¹⁴¹ John Moffet and Francois Bregha, “The Role of Law Reform in the Promotion of Sustainable Development,” Vol. 6, *Journal of Environmental Law and Practice*, pp. 1-22, at p. 8, 1996.

¹⁴² The only other federal environmental measures adopted since January, 1994, have been the implementation of the Canadian Environmental Assessment Act and regulations, which did not extend beyond the scope of previous legislation in this area, the adoption of regulations on sulfur content in gasoline products, but which do not create legal obligations and penalties as yet, and New product Notification regulations which have not, so far as the authors are aware, led to any bans on new products coming into Canada as yet.

¹⁴³ Comeaux and Kinsella, 1997, p. 11, and Chapter 5, section C.3; Sornarajah, 1994, pp. 328-332.

may be necessary is because the international law on expropriation does not require states to suspend all new regulatory activity that might impact the interests of the investment, or to provide compensation for such changes.¹⁴⁴

The exclusion of *bona fide* and non-discriminatory public welfare regulatory measures from the potential reach of the terms indirect expropriation and measures tantamount to expropriation is supported by the weight of international law and the appropriate policy to be applied to the interpretation process. Nonetheless, legal arguments to the contrary are available, and receive support from the uncertainties created by the provisions of NAFTA itself. The impact of this uncertainty is the risk of freezing the development of sound environmental regulations, as well as other public welfare protection measures.¹⁴⁵

3.8 Developing an interpretive statement

An interpretive statement is not an amendment to the Agreement, but a means to clarify and reinforce the intended interpretations of its rights and obligations. It is a device that has already been used in relation to some provisions of NAFTA.¹⁴⁶

The ability of the parties to an agreement to make such statements is not new in international law. It is a recognized part of treaty interpretation under the *Vienna Convention on the Law of Treaties*.¹⁴⁷ Moreover, the general role of such a statement in relation to Chapter 11 is specifically augmented by Article 1131(2):

An interpretation by the Commission of a provision of this Agreement shall be binding on a Tribunal established under this Section.

Thus, unlike arbitral panel decisions that are not binding on any subsequent panel, and some of which may never even be made public under the existing rules, an interpretive statement would fully bind all future panels. Indeed, this is the only way to do so.

It has already been noted that the government of Canada, having recognized the uncertainties created by Article 1110, has articulated the need to develop such a statement. The Canadian Memo to the other two NAFTA parties recognizes that there is no simple formula for distinguishing between compensable expropriation and non-compensable regulations. It also notes a risk of creating arbitrary definitions of regulatory actions that would undermine the objective of effective investor protection as well as put at risk other legitimate government activity that does not fall within the enumerated activities excluded by an interpretive statement.¹⁴⁸

¹⁴⁴ This view is expressed by Canada in its initial response in the Ethyl case. Statement of Defence, Ethyl Corporation v. Government of Canada, 27 November, 1997, para. 93.

¹⁴⁵ de Pencier, 1998, p. 153.

¹⁴⁶ See, e.g., Article 1102(4).

¹⁴⁷ *Vienna Convention on the Law of Treaties*, Art. 31(3), Vol. 25 *International Legal Materials* p. 543.

¹⁴⁸ Canadian Memo, at p. 20.

Having set out these concerns, and its understanding of the state of customary international law on the issues at hand (see s. 3.6 above), the Memo poses some questions whose answers can lead to an interpretive statement:

- Can an interpretation confirm that the regulatory actions of government are not covered when they are reasonable on their face?
- Can it be confirmed that it is up to a challenger to establish the absence of *bona fides* or an abuse of government powers, or that the effects of a measure is truly expropriative?¹⁴⁹
- Is it feasible to define a list of activities that are illustrative of actions not requiring compensation?

Unfortunately, the Memo does not seek to answer these questions. It therefore confirms the uncertainties, but provides limited guidance for actually formulating an interpretive statement. Another problem is that the Memo does not go beyond the expropriation issues to indicate how other relevant disciplines may be applied, and what steps might be taken to provide direction on, for example, the meaning or scope of national treatment and “in like circumstances.”

News reports indicate that the United States is considering a possible interpretive statement as well, which would focus on the scope of the third threshold test in Article 1110(1): measures tantamount to expropriation. The thinking behind this, apparently, is to limit the scope of attacks by defining “normal regulatory activity” so as to clearly remove public health, safety and welfare measures from the scope of Article 1110.¹⁵⁰

The only short-term avenue available to reduce the impact of the investor-state process and the uncertainties created by the language in Chapter 11 is an interpretive statement, as provided for in NAFTA's Art. 1131(2). This Article appears to be intended precisely for unintended uses and impacts of the Agreement. The Canadian cautions noted above for preparing such a statement are worth noting, but as cautions in terms of drafting, not as brakes to prevent the effort. Given the uncertainties and the absence of any alternative binding avenue, it is difficult to overstate the need for action of this type.

Recommendation: It is strongly recommended that an interpretive statement be pursued by all three NAFTA parties, in an aggressive and timely manner. The three underlying policy goals for such a statement should be to:

- **clarify the meaning of the national treatment discipline (and other non-discrimination disciplines) in an environmental context, by providing a sample list of environmental factors that recognize the temporal and spatial context of environmental regulation, and that should be**

¹⁴⁹ Given that the plaintiff always has the burden of proof of his or her claims, one must assume that the investor already bears these burdens to establish its case, either under the expropriation or other provisions.

¹⁵⁰ “Administration split on changes to NAFTA investor provisions,” *Inside U.S. Trade*, January 15, 1999, p. 1.

considered in any comparison of whether investors are “in like circumstances”;

- **clarify the relationship between environmental trade measures and the performance requirements prohibitions of Chapter 11; and**
- **clarifies the scope of the expropriation provisions to exclude non-discriminatory environmental measures, thereby deflecting the potential investor-state challenges from expropriation issues to national treatment and minimum international standards disciplines.**

The language of an interpretive statement often begins with the words “for greater certainty.” This is, indeed, the point. Again, draft language aimed at achieving these goals is set out in Annex 2.

4. The Procedural Issues

4.1 Policy Perspectives

The process and procedure for investor-state dispute settlement in Chapter 11 has spawned perhaps the most united front of concern among the public and other concerned sectors. Venerable business-oriented newspapers have editorialized against the process' secrecy and lack of accountability, while public interest groups have used it as evidence of a conspiracy against labour and the environment, or against civil society in general.

The broader policy issues relating to the secrecy of the investor-state process have been discussed in section 2. In this section, the specific procedures that have created this lack of transparency and public participation are considered. A related issue, the need for an appropriate process to develop a response to the issues identified in this paper, is then considered in section 5, below. In essence, this section looks at secrecy as a significant part of the problem. The issues in the following section reflect the critical need for transparent and accessible processes as part of the solution.

The investor-state process found in Part B of Chapter 11 was developed from a traditional commercial arbitration model. Generally held between private sector litigants, these types of international or domestic commercial arbitrations commonly deal with private matters of a commercial nature. As commercial issues began to arise between corporations and foreign governments, these procedures were adapted to accommodate this new development.¹⁵¹

In particular, three arbitration centres were established to accommodate disputes between an investor and a state. Each of these is referenced in Chapter 11 as one of the three facilities that an investor must choose from when initiating an arbitration. These centres are the International Centre for the Settlement of Investment Disputes (ICSID), to which both national parties must belong for an investor of one state to sue the host state; the ICSID Additional facility, which allows its use when only the home or host state is a party to its rules; and the United Nations Centre For International Trade Law (UNCITRAL), created within the United Nation system. Each has its own rules of procedure which are applied once the facility is chosen by the investor, unless they are modified in the text of NAFTA itself.

NAFTA's Chapter 11 added two very important aspects to the operation of these three processes. First, as already discussed, Chapter 11 provided an automatic right of recourse for foreign investors to these arbitration processes.¹⁵² Second, the potential scope of Chapter 11 has gone well past private commercial issues to include any type of public policy or public welfare measure that might impact on the establishment, operation, management, control or divestiture of a company. This is the first time private and legal

¹⁵¹ See, for an extended review of these issues, Horlick and DeBusk, 1993; Sacerdoti, 1997; and Ibrahim F.I. Shihata, *Legal Treatment of Foreign Investment: The World Bank Guidelines*, 1993.

¹⁵² Articles 1116 and 1117 of NAFTA.

binding rights of action have been granted in any international agreement to challenge such measures. These two factors are critical to understanding the issues that arise from the procedural side of the investor-state process.

The ability of investors to initiate an arbitration process as of right allows private sector foreign investors, in particular those with the financial ability to engage lawyers with experience in international litigation, to set the agenda for interpreting and applying the substantive disciplines, as well as to choose the fact situations in which the interpretations are to be developed. The absence of transparency and public participation opportunities in areas of significant public interest — indeed the public may not even know about a proceeding — raises fundamental questions. The central issue of democracy and private/public rights in relation to the investor-state process has been explored in section 2, and need not be repeated here. What should be recognized here, however, is that while transparency has become almost a mantra of trade law and a fundamental pursuit of its provisions on arbitrariness and discrimination, and is expressly cited as a principal goal of NAFTA,¹⁵³ it has been completely cast aside in Chapter 11.

The full legal analysis below considers the procedural rules applying to eight different stages of the arbitration process. It indicates that, even within the existing text of NAFTA and the rules of arbitration of the three potential arbitral bodies, there is significant scope to improve transparency and public access for Chapter 11 proceedings. Accomplishing this can be done by the three NAFTA parties collectively, or even individually if collective action is not possible. This being said, the analysis recognizes that there are clear limits to what can be accomplished even through the most aggressive approach.

4.2 Legal analysis

The general approach of the parties to Chapter 11 arbitrations has been to presume confidentiality and secrecy. Initial cases were not brought to public attention, at least not willingly, by governments. Investors would use or not use the media, depending on their particular interest in exerting public pressure as part of a lobbying campaign. Milestones in any given case were never made public, and still often are not.

Over the past year or so, however, a closer look at the issue of secrecy in this process has produced a wider range of views. This is seen quite clearly in the Canadian proposal for reviewing the transparency of the investor-state process circulated to the United States and Mexico as far back as November, 1998.¹⁵⁴ This part of the Canadian Memo previously discussed in relation to expropriation identifies a sequential series of transparency-related issues that are raised by Chapter 11:

- the notice of intent to arbitrate;
- the consultations phase prior to initiating an arbitration;
- the filing of the notice of arbitration;

¹⁵³ NAFTA Article 102, Objectives.

¹⁵⁴ Canadian Memo, p. 19.

- constitution of the arbitral panel;
- development of the specific rules of procedure for the panel;
- the treatment of written submissions and pleadings of the investor and the state and public access to the oral hearings;
- the potential for *amicus* briefs by non-governmental organizations and stakeholders;
- publication of interim and final awards.

For most of these situations, the Memo concludes there is no actual provision in NAFTA, or in the rules of three arbitration bodies, that will prevent public transparency and access to the process. There are, however, some situations that presume confidentiality and privacy of the proceedings unless this is changed by agreement of the parties and/or the arbitrators.

The notice of intent to arbitrate

The notice of intent to arbitrate must be sent by the investor to the host government at least 90 days before actually initiating an arbitration process. There is no legal obligation of any type relating to the secrecy or publication of this notice of intent to arbitrate.¹⁵⁵ Hence, there is no legal bar to a party or the investor making this information and the associated documentation public. It has been argued that public information in this case is constrained by the respective access to information laws of at least Canada and the United States. However, in the US, the office of the United States Trade Representative (USTR) has already acted on the first Freedom of Information Act request it received, and made public all documents concerning the only case filed against it, the Loewen case. These materials are now publicly available in the Reading Room at USTR, up to and including the full text of the notice of arbitration discussed more fully below. The argument appears to persist in Canada, though it is not known at this time if any formal request for access to information has been made.¹⁵⁶ Canada has, however, made the notices of intent to arbitrate available to the public in the four current cases, but with the agreement of the disputing investors.¹⁵⁷

The Canadian memo on the investor-state provisions includes a suggestion that the NAFTA parties agree to an interpretation that either encourages or requires them to make public the fact of the receipt of the notice of intent to arbitrate. It goes on to suggest that the parties agree to an interpretation to seek the consent of the investor to release the whole document, subject to domestic access to information or privacy law requirements. Additional options to promote a “public version” or a summary of the notice of intent for disclosure are also raised.¹⁵⁸ While a common practice for all of these options (without

¹⁵⁵ This flows from the combination of NAFTA Articles 1119, 1120, and 1137.

¹⁵⁶ The argument is seen in the Canadian Memo, p. 19. See also Valerie Hughes, *Canada and the New International Investment Regime*, Canadian Bar Association, Continuing Legal Education Program, Toronto, March 29, 1999, p. 5-6.

¹⁵⁷ Hughes, *ibid.* These can be obtained from the Department of Foreign Affairs and International Trade, Ottawa, Canada.

¹⁵⁸ Canadian Memo, p. 22.

suggesting here that any access to information laws prevent full and immediate disclosure of the full notice of intent to arbitrate) would be warranted, the absence of any provisions in NAFTA on how a party should deal with such a notice leaves them free to take any of these steps. An agreed interpretation is not a prerequisite for any individual party to act in this manner.

The consultations phase prior to initiating an arbitration

No secrecy provisions of any type are set out in NAFTA for information relating to the consultations required in the minimum 90 days between the investor submitting the notice of intent to arbitrate and the actual initiation of the arbitration. Nor are any provisions in any of the arbitration rules of procedure relevant to this pre-arbitration period. Thus, while there is certainly some legitimate concern for not negotiating in public, the fact and timetable of such consultations, and at least a general indication of the substance and positions can legally be made public by the state or investor, and could be done in a manner so as not to prejudice any discussions.

The Canadian Memo addresses this issue. It suggests an agreed interpretation to encourage the parties to unilaterally, or with the consent of the investor, confirm that the consultations are or are not taking place, but without providing any other details. It also suggests making such an approach systemic, given its neutral effect on the unfolding of a case.¹⁵⁹ As with the publication of the notice of intent, no agreed interpretation appears necessary for any party to act in the manner suggested. Perhaps more critical is the minimal reach of these suggestions, emphasizing the non-release of any information on the discussions or positions, or on the place and dates of consultations.

The filing of the notice of arbitration

The actual initiation of an arbitration comes with the filing of a notice of arbitration (or a "request for arbitration") pursuant to the rules of procedure of the arbitration body chosen by the investor. Publicity for the filing of a notice of arbitration is actually referenced in NAFTA. Article 1126(10) sets out a requirement for the party that receives a notice of arbitration to deliver a copy of it to the NAFTA Trade Commission Secretariat within 15 days of receipt. The Secretariat is then required by NAFTA to maintain a public register of the documents.¹⁶⁰

The content for these notices of arbitration is set out in the rules of procedure applicable to the three arbitral processes. In each case, the description is very basic, essentially requiring sufficient information for the party to understand and consider the claim.¹⁶¹

¹⁵⁹ Ibid, p. 22.

¹⁶⁰ NAFTA, Article 1126(13). No central Secretariat was created by NAFTA, although a subsequent understanding was developed that such a central body would be established in Mexico City. This has not happened to date, leaving the original design of the NAFTA Secretariat operating in offices established in the capitals of the three parties. See Article 2002 of NAFTA.

¹⁶¹ The UNCITRAL Arbitration Rules, Art. 3 provide that the notice of arbitration shall include such basic information as the name and addresses of the disputants, the legal basis for the agreement to arbitrate, the

This includes the basic facts and the legal provisions alleged to have been breached. While the text of the rules is basic, international experience, supported by the publicly available texts of the notices of arbitration in the Ethyl Corp. and Loewen cases, support the Canadian view that these documents “should contain a more detailed assertion of the investor’s case than the notice of intent” to arbitrate.¹⁶²

The existence of a specific rule in NAFTA on publicity for the notice of arbitration overrides any provisions in the rules of arbitration in the three facilities. Fulfillment of the obligation in NAFTA to establish a public register of these documents would obviously help greatly in reducing the current secrecy of the process. At present, the United States action of putting the Loewen notice of arbitration into its public Reading Room meets the spirit of this at least in part. What remains absent is a public register that can be checked by members of the public from time to time. The Canadian office of the NAFTA Secretariat does have a register, but at the time of writing this included only the name, date and a one line subject indication of the filing. This falls short of the express language of NAFTA that the “Secretariat shall maintain a public register of the *documents* referred to” (emphasis added) that initiate the arbitration.¹⁶³

Outside of the register context, Canada has provided full public access to the notice of arbitration and other documents in the Ethyl case. As already noted, Canada acted pursuant to an order drafted by Canada and Ethyl and endorsed by the arbitration panel as an order of the panel. Under this order, the notice of intent to submit an arbitration, the notice of arbitration, the statement of claim and the defence of the Government of Canada were all released. Pursuant to the same agreement the detailed pleadings and transcripts of the hearings were maintained as confidential.¹⁶⁴ A similar situation has now arisen in the S.D. Myers case, whereby the notice of arbitration, statement of claim and statement of defence have been made public under an order of the tribunal in the S.D. Myers case. But this has taken place over six months after the notice of arbitration and statement of claim were filed.¹⁶⁵

As of the time of writing, there was no evident practice in Mexico to maintain any form of public register.

general nature of the claim and indication of the amount involved, the relief or remedy sought, and a proposal for the number of arbitrators. The Notice may also include the statement of claim provided for as a further step. This statement of claim would contain significant detail of the case of the claimant, including the statement of facts in the case and detail as to the legal points in issues. (Art. 18 of the Rules) The ICSID Rules of Procedure for the Institution of Conciliation and Arbitration Proceedings, Article 2, are similarly limited as to its Request for Arbitration. The same holds for the ICSID Additional Facility Arbitration Rules, Art. 2, 3.

¹⁶² Canadian Memo, p. 22. See also the list of references for the titles and dates of the notices of arbitration in the Loewen and Ethyl cases.

¹⁶³ NAFTA, Article 1126(13). Emphasis added. This Canadian practice was confirmed in a personal telephone communication with the NAFTA Secretariat office in Ottawa.

¹⁶⁴ Ethyl Corp. v. Government of Canada, Procedural Order, July 2, 1998.

¹⁶⁵ In a NAFTA Arbitration under the UNCITRAL Arbitration Rules, S.D. Myers, Inc. v. Canada, Procedural Order 3, June 10, 1999.

The Canadian Memo refers to this stage of the procedure, seeking an agreed interpretation for making the receipt of the notice public.¹⁶⁶ It also suggests seeking an interpretation that would encourage seeking the consent of the investor to release the document. These suggestions fall short of the requirement in Article 1126 of NAFTA. Further, there is no need for any agreed interpretation here, as there is already an obligation on the parties in place.

Parenthetically, it may be noted that Article 1126(13) is not the only NAFTA-related provision where the notion of a public register is found. As part of the elaboration of the process for citizen submissions under Articles 14-15 of the North American Agreement on Environmental Cooperation, the parties and the Secretariat of the Commission on Environmental Cooperation have established a registry of documents relating to this submissions process. The documents found on this register include both summaries and full texts of the original documents submitted by private parties and government agencies. This public register includes both a hard copy location at the Secretariat offices in Montreal, and fully accessible Internet service where electronic copies are available.¹⁶⁷

Constitution of the arbitral panel; Development of the specific rules of procedure for the panel

Publication of the key milestones, such as the selection of the arbitrators and procedural steps are matters falling within the rules of procedure of the three arbitral bodies. In each case, once the procedure has begun, the discretion of the appointed arbitrators can be exercised to set out the conduct of the arbitration, including public notice of key events. The parties can have input into how this discretion is exercised.¹⁶⁸ Agreement of the parties to the arbitration is required, as is an order of the arbitration panel. These, however, are relatively minor points whose publication would be hard for private sector litigants to reasonably oppose if governments have already acted on their ability to make the preceding documents public.

The Canadian Memo promotes a position of encouraging public dissemination of this information, and of seeking a ruling of the arbitral panel if any disputing party objects.¹⁶⁹ This approach can already be legally acted on in an aggressive and purposeful way, with or without an agreed interpretation to this effect.

The treatment of written submissions and pleadings of the investor and the state, public access to oral hearings

¹⁶⁶ Canadian Memo, p. 23.

¹⁶⁷ The web site and register can be found at <www.cec.org>.

¹⁶⁸ UNCITRAL Arbitration Rules, Art. 15; The ICSID Arbitration Rules, Article 19, Article 20 requires the President of the Tribunal to seek the views of the disputing parties on procedural issues. An agreement between the parties on the procedure shall be applied by the President. This same procedure applies under the ICSID Additional Facility Arbitration Rules, Arts. 28, 29.

¹⁶⁹ Canadian Memo, p. 23.

Under existing rules of procedure it is more difficult to address the key issue of public access to the detailed statements of claim and defence, the pleadings, statements of fact and other documentation. There is no NAFTA rule, thus leaving the issue to the procedures of the three arbitral bodies. These rules leave it to the parties to agree on issues of confidentiality for the pleadings, or a ruling by the panel in the absence of agreement.¹⁷⁰ There is a presumption of closed oral hearings unless the parties agree otherwise.¹⁷¹ Thus, establishing any right of public access will require an amendment to either the NAFTA or the respective rules of procedure.

The Canadian Memo promotes an interpretation in favour of each party actively taking a position for public release of the detailed pleadings during the arbitration process.¹⁷² Once again, this would seem a proper position, although it is not necessary to await an agreed interpretation for each party to act aggressively in this manner. As already noted, Canada agreed to an order of the arbitral panel not to disclose the pleadings in the Ethyl case.

The potential for amicus briefs by non-governmental organizations

There are a number of traditional legal issues surrounding any *amicus* or intervenor type status. These include rules on standing (who can make a submission), access to confidential business materials, and other technical matters. These issues are not addressed here specifically, as they can be resolved if it is decided the process should be open to such options. As NAFTA is once again silent on this, the rules of the arbitral bodies would govern these issues.

Once again, these rules require the agreement of the parties for access to the litigation materials by anyone other than the disputing parties, as well as for access to the oral hearings. However, there is still some room under the existing rules for more creative practices. The Canadian Memo is particularly helpful in this regard. It includes several immediately functional options to allow flexible, yet effective participation by stakeholders as *amici* or as experts.¹⁷³

One suggestion is to use the rules of NAFTA and the arbitral bodies to allow designated groups to participate as experts, on the request of a party or at the initiation of a panel. NAFTA itself allows experts to be appointed by a tribunal at the request of a disputing party or on their own initiative unless both disputing parties disapprove. This provision is quite specific to environmental issues, and is also limited to experts giving factual or scientific information.¹⁷⁴ The arbitration bodies also provide for the use of expert witnesses if required by a tribunal, or as required by a party. Broadly speaking, the

¹⁷⁰ UNCITRAL Arbitration Rules, Art. 15; The ICSID Arbitration Rules, Article 19-20; ICSID Additional Facility Arbitration Rules, Arts. 28, 29.

¹⁷¹ UNCITRAL Arbitration Rules, Art. 25(4); The ICSID Arbitration Rules, Article 32(2); ICSID Additional Facility Arbitration Rules, Arts. 28, 29.

¹⁷² Canadian Memo, p. 23.

¹⁷³ Ibid.

¹⁷⁴ NAFTA, Article 1133.

tribunals have the discretion whether to develop expert evidence through written materials and/or oral hearings.¹⁷⁵

A second suggestion is to apply the decision of the WTO Appellate Body in the Shrimp-Turtle decision that now allows WTO panels and Appellate Body tribunals to receive *amicus briefs* on their own authority, or alternatively allows the parties to append NGO briefs or submissions to their own pleadings and submissions.¹⁷⁶ The United States has now done this in the World Trade Organization, and there does not appear to be any impediment to adopting the same process for any and all Chapter 11 disputes. The Rules of Arbitration of the UNCITRAL forum, for example, allow the tribunal to determine if a party may submit additional written materials beyond the statements of claim and defence set out in the Rules. They also allow the tribunal to seek any other expert reports in writing as they deem necessary.¹⁷⁷ The ICSID and ICSID Additional Facility rules include a reference to the pleadings and submissions of the disputing parties, without setting any limitations on what might be included. The tribunal, of course, remains the judge of the weight to be given to any materials provided. Where *amicus* material is provided to the tribunal, an opportunity for participation in the oral hearing arises under its ability to establish the procedure for the hearings, or the more general rules on procedure noted previously.¹⁷⁸ The main logistical impediment may be ensuring that the NGOs have access to sufficient accurate information on the case to make such submissions in an informed manner. This problem is addressed in the preceding comments on access to litigation materials.

It should also be noted that NAFTA specifically requires each NAFTA party to receive the notice of claim in any arbitration proceeding initiated by an investor, as well as copies of all the pleadings in the case. It also allows, as a right, each party to make submissions to the tribunal on the interpretation of the Agreement.¹⁷⁹ These rights of the NAFTA parties can be used in the same way as a litigant's rights under the rules of procedure to include *amicus* briefs in the submissions. Even if a NAFTA party is not intending to make its own legal arguments, it can use this provision to make a submission that would incorporate an *amicus* brief.

Publication of interim and final awards

¹⁷⁵ UNCITRAL Arbitration Rules, Art. 27, 22, 15(2); The ICSID Arbitration Rules, Arts. 34-36; ICSID Additional Facility Arbitration Rules, Arts. 41-43. Practice dictates, however, that these provisions on expert participation are generally restricted to issues of fact or science, or of a particular practice. The use of expert witnesses does not generally extend to the application of the legal provisions of the agreement in question to those facts or practices.

¹⁷⁶ "United States- Import Prohibition of Certain Shrimp and Shrimp Products," Appellate Body Report, AB-1998-4, October 1998, at paras. 79-91.

¹⁷⁷ UNCITRAL Arbitration Rules, Art. 22, 27.

¹⁷⁸ The ICSID Arbitration Rules, Article 31, 32, 34; ICSID Additional Facility Arbitration Rules, Arts. 38, 39, 41.

¹⁷⁹ NAFTA, Articles 1127, 1128.

The publication of final awards is already a matter that Canada and the United States have full discretion to do under NAFTA.¹⁸⁰ Mexico has not adopted a right to make the award public unilaterally, choosing instead to have the matter governed by the rules of procedure of the arbitration body selected by the investor. In each of these cases, the award is to be kept secret except where both disputing parties agree otherwise.¹⁸¹

4.3 Recommendations

The substantive and procedural difficulties and failures reviewed above raise important questions concerning the role and application of NAFTA's investor-state process. These are increased by the institutional limitations of the process, given the absence of a centralized NAFTA Secretariat for administering the agreement and the Chapter 11 procedures. As a result, at least one senior private sector trade lawyer has raised the possibility for discussion of reversing the decision to open the investor-state process to mandatory dispute settlement, especially where broad public sector issues are involved.¹⁸² It would still be necessary to ensure that the government-to-government dispute resolution process in Chapter 20 of NAFTA remains available. A somewhat less radical alternative could be to require government approval of Chapter 11 challenges that raise certain types of public policy issues. A third option in this vein would be to follow the "gatekeeper" model established in relation to taxation measures under NAFTA itself by allowing deputy ministers of designated departments to assess and agree if a measure in the public interest is not expropriatory. If the ministers of the three countries determined that a measure is not expropriatory, then an investor-state challenge could not be launched. Conversely, if they do not make a decision that it is not expropriatory, then the challenge can proceed.¹⁸³ Extending this to other areas, and possibly other causes of action, could provide a major safeguard against the strategic use and abuse of the investor-state process. A somewhat similar gatekeeper process applies when a party relies on an exception to Chapter 11 as its defence. Here, the Free Trade Commission can be asked by the investor or the disputing party to rule on whether the exception applies to their case or not.¹⁸⁴

Recommendation: Each of the latter two approaches noted above should be seriously considered as potential alternatives to the existing system.

¹⁸⁰ NAFTA, Article 1137(4) and Annex 1137.4.

¹⁸¹ UNCITRAL Arbitration Rules, Art. 32(5); The ICSID Arbitration Rules, Rule 48(4); ICSID Additional Facility Arbitration Rules, Art. 53. This rule requires registration of the award where the law of the disputing state so requires. Otherwise there is no automatic registration, and the general rules of procedure calling for agreement of the parties and/or a decision of the tribunal apply.

¹⁸² Herman, 1998, pp. 135-137.

¹⁸³ Article 2103(6). The failure of the deputy ministers to make a decision that a measure is not expropriation simply opens the door to an arbitration but does not amount to a ruling that the measure is an expropriation.

¹⁸⁴ NAFTA, Article 1132. See Horlick and Marti, p. 49. If no ruling is made, then the tribunal can rule on this issue.

As one basis for applying these approaches, the existing concept of “legitimate objectives” as the basis for certain exceptions from the substantive rules in Chapter 9, Standards-Related Measures, can be adapted to the use of the investor-state process. The notion of legitimate objective is defined to include safety, protection of human, animal or plant life, the environment, consumers, and sustainable development.¹⁸⁵ It is precisely these types of areas that raise the concerns seen in this paper, concerns that could be significantly reduced if *bona fide* actions in these areas were fully exempted from the investor-state process or otherwise made subject to a gatekeeper process.

However, it must be acknowledged that any of these approaches would require an amendment to NAFTA, which is not something that is politically achievable for the next few years at least. With the Mexican general election in the fall of 1999, and the United States Presidential election in the fall of 2000, no opportunity even for discussions of amendments will arise until at least some time in 2001.

In the meantime, the legal analysis has indicated a number of opportunities immediately available to the three NAFTA parties to reduce the secrecy and lack of public access. Based on this analysis, two general recommendations can be made in this regard.

Recommendation: It is urgently recommended that a short term aggressive course of action be adopted by all three NAFTA parties to apply the existing rules of procedure in favour of transparency and public access on every occasion when there is a discretion in how they can be applied. Where secrecy is not expressly required by NAFTA or the associated arbitration rules, the parties should ensure public access and availability of the maximum number of documents and information. The absence of an agreed approach should not hold back each party from unilaterally pursuing these approaches.

Recommendation: It is recommended that, where the agreement of the disputing parties or an arbitral panel is required to provide public access to materials, to oral hearings or as friends of the court to submit their own briefs, this agreement should be actively sought by all three NAFTA parties. Individual investors using the system should be forced into a position of defending the secrecy if they so wish. This can be done by agreement of the parties or unilaterally.

Ultimately, express modifications to the rules of procedure may be required through the text of NAFTA. Institutional developments surrounding the investor-state process will certainly be required. But in the meantime, the impacts of the existing problems can be lessened if the parties adopt, both unilaterally and collectively, practices in support of transparency wherever they are not expressly prevented from doing so.

¹⁸⁵ See Articles 904(2) and 915 of NAFTA.

5. Transparency, democracy and the process for resolving issues

The resolution of the substantive and procedural problems is obviously critical. But so, too, is the process for arriving at this result. Principles of sustainable development require that transparency and participation be the hallmarks of processes designed to promote sustainability. Their application in this context is central to the credibility of the result.

In this regard, the Free Trade Commission, composed of the three trade ministers of the NAFTA parties, clearly has the lead role. It forms the governing body for the NAFTA, and has responsibilities under the agreement to address concerns that arise. In addition, only the Commission has the legal ability to adopt an interpretive statement that can bind Chapter 11 panels.

To date, only Canada's Minister of International Trade has sought focused public input in the form of an informal working group on these issues (see s. 2.2).

Recommendation: Each party should establish national working groups involving appropriate stakeholders, and leading to the development of specific proposals by the governments for detailed but timely negotiation.

Recommendation: Such negotiations should proceed in a transparent manner, and in cooperation with the Council of the Commission for Environmental Cooperation. In the absence of an independent and centralized NAFTA Secretariat, the CEC Secretariat can provide an organized secretariat function and appropriate facilities for conducting both public and private meetings aimed at addressing this issue.

While the Free Trade Commission has the lead role, this does not mean it must or should have the exclusive role. The environmental dimension of this problem is beyond doubt. Article 10(6) of the North American Agreement on Environmental Cooperation provides direction to the Council of the Commission for Environmental Cooperation to cooperate with the Free Trade Commission to help achieve the environmental goals of NAFTA. It sets out specific approaches for doing this, such as contributing to dispute avoidance and identifying appropriate experts for working with NAFTA committees and working groups. In addition, Article 10(6) includes a general clause for "otherwise assisting the Free Trade Commission in environment-related matters."¹⁸⁶ There is now a process underway involving trade and environment officials from the three parties to assist the Council and the Commission to identify appropriate ways to implement this Article.

The present issue provides an excellent opportunity to initiate such a constructive process. At a minimum, the general clause for cooperation in environment-related areas provides an avenue for a cooperative process to be initiated and directed by the two Ministerial bodies, the Free Trade Commission and the Council of the CEC. Specifically, and in the absence of an independent and centralized NAFTA Secretariat, the CEC can provide an organized secretariat function and appropriate facilities for conducting both

¹⁸⁶ NAAEC, Article 10(6)(e).

public and private meetings aimed at addressing this issue. It has both the credibility and the infrastructure to do this.

The Free Trade Commission has already recognized the need to address the impact of Chapter 11 on regulatory functions. The trade and environment ministers should take the next step and signal the need for integrative and cooperative approaches by using the CEC in such a manner. This, of course, would not alter the fact that the NAFTA is under the jurisdiction of the Free Trade Commission, and final decision-making power on the issues rests with that body.

6. Conclusions: NAFTA's Chapter 11 and the Negotiation of Future International Investment Agreements

The introductory section of this paper noted that there are two categories of issues related to international investment law and sustainable development: issues relating to the promotion of sustainable investments and issues related to sustained and widely distributed FDI. This paper has not sought to address the former group of issues, but this does not diminish the need for any multilateral process to carefully and systemically do so.

Investment protections can be an important element in attracting increased and well distributed foreign direct investment. The growth in FDI since the coming into force of NAFTA, and particular for Mexico, shows the potential effectiveness of this as part of an overall economic strategy. But it is also clear that NAFTA's protections for foreign investors have had important unanticipated consequences for other aspects of public policy making. The uncertainty and unpredictability created by NAFTA around environmental and public welfare legislation is profound. The reality that Chapter 11 has already led to one settlement for a foreign investor and the withdrawal of the environmental law at the root of the dispute indicates that the threat is real.

The theoretical and practical conflict between this reality and the ability to protect the environment is too real to ignore. The current structures and substance of Chapter 11 are inconsistent with the broader NAFTA regime's guarantees that each party will be able to set its own environmental standards, and its goal to ensure that trade law is supportive of sustainable development. The prospect that the expropriation provisions might require compensation to be paid to foreign investors for environmental laws that are non-discriminatory is a reversal of the basic Polluter Pays Principle so central to modern environmental policy making.

NAFTA's secretive process is also fundamentally at odds with the principles of transparency being promoted as a goal of NAFTA trade policy, and with the very nature of democratic processes. The failure to address this will continue, like a cancer, to erode the democratic legitimacy of the entire international trade and investment regime.

Addressing the issues raised in this paper — the impacts of the investor protection provisions on the regulation-making process — is fundamental to gaining, restoring and maintaining public support for future international processes. Public credibility in developing new rules for trade and investment is utterly dependent on the transparent and accessible manner in which the agreements are negotiated and implemented.

It is certain that continued secrecy under Chapter 11 and a lack of progress in addressing the substantive issues will impact the FTAA and Millennium Round negotiations. Indeed, this is already happening. Since the end of the Uruguay Round negotiations, trade and investment negotiations have experienced two dramatic setbacks. There has been the inability of the United States Administration to obtain "fast-track" negotiating authority

from the Congress. Without this, trade negotiations involving the United States can not make any real progress, as there is no ability to prevent Congress from making subsequent changes in a negotiated agreement.

The second major event was the collapse of the negotiations on the Multilateral Agreement on Investment in October 1998. This collapse was closely linked to the concern that the original design of the MAI did not address the relationship between sustainable development and investment agreements.¹⁸⁷ The failure of the MAI negotiations was the first time since the Bretton Woods Conference of 1944 that governments, in the face of persistent and organized public resistance, abandoned a major economic negotiation. The full impact of this event on the decades-long process of liberalization of international economic relations remains to be seen. It is, however, hard to conceive of any future negotiation on trade or investment which does not seriously address the issues that were raised, but not resolved, in the MAI negotiations. Moreover, left unresolved, the experience with the NAFTA investor-state process will contribute to the growing public perception of a trade system incapable or unwilling to address these needs.

The recommendations made in this paper strive to blend the best of international investment law with the means to ensure that the negative impacts of its most recent developments are eliminated. In the growth of any area of law responding to dynamic global processes, there are going to be occasions when such adjustments are necessary. If an international agreement on investment is to be furthered in the World Trade Organization, another ad hoc forum, or in the Free Trade of the Americas Agreement negotiations, the issues raised here will need to be carefully considered in drafting the substance and process for investor protection.

The willingness of trade Ministries to address the impact of their Agreements on the environment and sustainable development may be the most important issue now facing the future development of trade liberalization. This reflects the central role of trade ministers as managers of the international trade regime and its important role in the international economy and the achievement of sustainable development. The approach of the NAFTA parties will shape national, regional and global perceptions on the willingness of the managers of the international trade regime to adjust to the new environmental and sustainability requirements that must discipline their efforts. Absent this willingness, it is unlikely that the public mistrust and antipathy toward the MAI can be reversed to develop the needed public support for continued trade liberalization in the WTO and FTAA, and the launching of new investment negotiations.

¹⁸⁷ See, e.g., de Pencier, 1998. Also, "OECD Nations Forego MAI Decisions, Agree To Examine Possible Changes," *Inside US Trade*, October 23, 1998, p. 1.

Annex 1: Known Chapter 11 Cases¹⁸⁸

Case name and sector	Defendant	Home country	Chapter 11 grounds	Status
Halchette Distribution Services - Notice of Intent to Arbitrate: -Airport concession shop	Mexico	US	Claim and grounds unknown	Notice of intent to arbitrate filed, but apparently not pursued further
Signa S.A. de C.V. Notice of Intent to Arbitrate: - pharmaceuticals	Canada	Mexico	Claim was for \$50 million (Cdn) Alleged Canadian regulations for the approval of generic pharmaceuticals made it difficult to get approval for the manufacture of an anti-biotic drug for sale in Canada, injuring the company's Canadian investment (Signa was a supplier to a Canadian company which was in dispute with the Canadian government over its approvals process)	Notice of Intent set claim for \$50 million, not pursued beyond initial notice

¹⁸⁸ These cases are known to have been commenced. Others may have been commenced or may be in progress without any information being public. These cases also do not include some of the threatened challenges that did not materialize because the corporations otherwise achieved their strategic objective or declined to initiate the action. Sources for this table include Julie Soloway, 1999; Horlick and Marti, 1997; le B. Douglas and Ueno, 1998; and the publicly available documents for each case noted in the references.

<p>Ethyl Corp</p> <p>Notice of Intent to Arbitrate: Sept. 10, 1996</p> <p>- manufacturer of MMT, a gasoline additive</p>	<p>Canada</p>	<p>US</p>	<p>Claimed \$250 million plus for damages and expropriation:</p> <p>-Article 1102, National Treatment: ban on MMT imports by Canada discriminated against MMT in favour of Canadian producers of alternative octane enhancers</p> <p>-Article 1106, performance requirements: ban on MMT imports created a de facto performance requirement to use Canadian sourced MMT (which did not then exist) or Canadian produced alternative</p> <p>-Article 1110, Measure tantamount to expropriation: the ban on importing MMT erased about 50% of Ethyl's Canadian business, constituting a de facto expropriation of its assets, goodwill, and future earnings</p>	<p>-Notice of Intent to Arbitrate filed Sept. 10, 1996</p> <p>-Claim for Arbitration filed April 14, 1997</p> <p>-Preliminary hearings and procedural hearing,</p> <p>-Case settled July 20, 1998 for \$13 million US, withdrawal of Canadian legislation and letter from Government of Canada saying MMT had no health or environmental impacts</p>
<p>Metalclad Corp.</p> <p>Notice of Intent to Arbitrate: Oct. 2, 1996</p> <p>- waste management and disposal business, especially in Mexico</p>	<p>Mexico</p>	<p>US</p>	<p>Claim for \$65 million US for actions by the local and state government preventing it from opening a hazardous waste landfill, and for breach of contract</p> <p>-Article 1110: Claim that failure to approve a landfill and subsequent rezoning to prevent it was a measure tantamount to expropriation or an indirect expropriation</p>	<p>-Notice of Intent to Arbitrate: Oct. 2, 1996</p> <p>-Arbitration initiated: Jan. 7, 1997</p> <p>-oral hearing scheduled: Sept. 2, 1999</p>

<p>Desona de C.V. (Robert Azinian and Others v. United Mexican States)</p> <p>Notice of Intent to Arbitrate: Dec. 16, 1996</p> <p>Waste management and disposal</p>	<p>Mexico</p>	<p>US</p>	<p>Claim for \$17 million US for breach of contract to operate a landfill and “seizure” of the property by armed agents - precise grounds unknown</p>	<p>-Notice of intent to arbitrate: Dec. 16, 1996 -Claim for Arbitration: March 10, 1997 -Oral hearings scheduled, June, 1999</p>
<p>Marvin Feldman v. Mexico</p> <p>Notice of Intent to Arbitrate: Feb. 18, 1998</p> <p>Exports</p>	<p>Mexico</p>	<p>US</p>	<p>Claim for \$50 million US for lost profits, for denial of excise tax rebates on cigarette exports and for loss of goodwill -Art. 1105, Minimum standards of treatment, claim denial of rebates and of export opportunities was against court decisions and was a denial of justice -Article 1110, Measure tantamount to expropriation, the refusal to rebate the excise taxes amounted to an expropriation of the funds CEMSA was entitled to; also actions were an attempt to drive CEMSA out of competitive business</p>	<p>Notice of Intent to Arbitrate: Feb. 18, 1998 Notice of Arbitration filed May 27, 1999</p>
<p>USA Waste v. Mexico (“Acaverde”)</p>	<p>Mexico</p>	<p>US</p>	<p>Claim for \$60 million US</p>	<p>-Notice of Intent to Arbitrate: Feb. 29, 1998/June 30, 1998</p>

<p>Notice of Intent to Arbitrate: Feb. 29, 1998 or June 30, 1998 (in dispute)</p> <p>Waste management and city maintenance</p>				<p>-Claim for Arbitration: ??</p> <p>-Panel being selected</p>
<p>S.D. Myers v. Canada</p> <p>Notice of Intent to Arbitrate: July 22, 1998</p> <p>-Waste management company shipping and disposing of hazardous waste</p>	<p>Canada</p>	<p>US</p>	<p>Claim for \$20 million US for losses while an interim regulation prohibited the export of PCB waste to the US</p> <p>-Article 1102: Claim measure taken because it was a US company, and prevented the US company operating the same way a Canadian company would</p> <p>-Article 1106: Performance requirement, claim measure created a requirement to use Canadian PCB disposal services and facilities rather than its own in US</p> <p>-Article 1105, Minimum Standard of Treatment, claim regulation adopted in a discriminatory and unfair manner</p> <p>-Article 1110: Claim export ban had effect of totally frustrating its operations, constituting a measure tantamount to expropriation</p>	<p>-Notice of Intent to Arbitrate: July 22, 1998</p> <p>-Claim to Arbitration: October 30, 1998</p> <p>-Hearings scheduled to begin in February, 2000</p>
<p>Loewen Group Inc.</p> <p>Notice of Intent to</p>	<p>Canada</p>	<p>US</p>	<p>Claim for \$725 million US because of excessively biased court proceedings and lack of due process in a civil case</p>	<p>-Notice of Intent to Arbitrate: July 29, 1998</p>

<p>Arbitrate: July 29, 1998</p> <p>Funeral homes and related businesses</p>			<p>where \$550 million in damages was awarded against it</p> <p>-Art. 1102 national treatment, for deliberate inflaming of the court process because of the foreign investor status</p> <p>Art. 1105, minimum standard, for discrimination due to foreign status, and denial of justice, and for excessive awards as a breach of minimum standards</p> <p>Art. 1110, expropriation, the effect of the award being a substantial denial of the use and enjoyment of property and an expropriation of moneys</p>	<p>-Claim for Arbitration: October 30, 1998</p> <p>-Panel now selected</p>
<p>Sun Belt Water Inc. v. Canada</p> <p>Notice of Intent to Arbitrate: November 27, 1998</p> <p>Water exports</p>	<p>US</p>	<p>Canada</p>	<p>Claim for \$220 million US for biased treatment of US partner by government of British Columbia in a joint venture, where Canadian partner achieved a settlement in short period and US could not negotiate with government</p> <p>-Article 1102, national treatment, for less favourable treatment than the domestic partner</p> <p>-Article 1103, MFN, for less favourable treatment than other investors</p> <p>-Article 1105, minimum international treatment, for lack of fair and equitable treatment, respect for due process</p>	<p>Notice of Intent to Arbitrate: November 27, 1998</p> <p>-consultations ongoing at time of writing</p>

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<p>Pope & Talbot Inc.</p> <p>Notice of Intent to Arbitrate: Dec. 24, 1998</p> <p>Forestry Company</p>	Canada	US	<p>Claim for \$130 million US for manner in which Canada-US Softwood Lumber Agreement was implemented by giving quotas and special levy's to producers in only some provinces</p> <p>-Art. 1102, national treatment: fails to provide best treatment in Canada to the investor</p> <p>-Art. 1103, MFN: "best in-jurisdiction treatment not provided</p> <p>-Art. 1105, Minimum international standard: quotas were inexplicably allocated as between the provinces, and producers, without a hearing, no information on the process, no reasons provided, no review procedure.</p> <p>-Art. 1106: performance requirements: export regime creates a preference for operations outside the listed provinces</p> <p>-Art. 1110, expropriation: discriminatorily deprived investor of ability to operate business; failed to provide due process or meet min. standards; failed to provide compensation</p>	<p>Notice of Intent: Dec. 24, 1998</p> <p>Notice of Arbitration: March 25, 1999</p>

Annex 2: Draft Text for an Interpretive Statement

The following draft text is proposed as an example of how the policy objectives for such a statement, as noted in the previous section, can be achieved.

North American Free Trade Agreement
Free Trade Commission
Decision XX, 1999

Interpretive Statement on Articles 1102, 1103, 1106 and 1110 of NAFTA

The Free Trade Commission, established under Article 2001 of the North American Free Trade Agreement,

Recognizing that certain provisions of Chapter 11 (Investments) of the North American Free Trade Agreement (NAFTA) have now experienced uses and interpretations not intended by the three parties to the Agreement, and

Further recognizing that these uses can have a significant impact on the normal activities of the Parties in regulating to protect the health, welfare and environment of the Parties and their citizens,

Wishing to clarify the intentions of the negotiators, and toward this end

Acting pursuant to Article 1131(2) of the NAFTA in order to establish an interpretation of the Agreement binding on all dispute settlement panels established under Chapter 11, Section B of the Agreement,

Hereby establish the following interpretations of the provisions of Chapter 11 noted below:

Article 1102, National Treatment:

For greater certainty, it is hereby recognized that in interpreting and applying Article 1102 of NAFTA to measures whose *prima facie* purpose is to protect the environment,¹⁸⁹ in particular the issue as to whether a foreign investor has received treatment no less favourable than is accorded, in like circumstances, to a domestic investor, a range of factors that reflect the circumstances of the investment and any products produced or used by the investment require consideration. These factors help determine when conduct is not discriminatory or does not constitute treatment less favourable to that received by other investors. The factors may include, as appropriate:

¹⁸⁹ If the measure is *prima facie* for an environmental purpose but is otherwise abusive or deceitful in this apparent purpose, a foreign investor would have other potential causes of action, for example under Article 1105 on minimum international standards, or other questions of discriminatory practices that might arise under this Article. (Note: this footnote would be included in the interpretive statement as a footnote.)

- the specific location of the investment;
- the capacity of the receiving environment to absorb effluents, emissions, and other environmental impacts from the operation or maintenance of the investment, including the environment outside the jurisdiction of the host state, and changes in this capacity;
- impacts generated by both later and earlier uses of the environment or environmental resources;
- other assets of the investor in the jurisdiction (in the event of liability issues arising);
- changing environmental standards over the life of an investment;
- the environmental implications of products over their life-cycle;
- the characteristics of a product;
- changes in scientific information;
- changes in regulatory policy or the use of alternative instruments, such as economic instruments, for environmental protection purposes; and
- the appropriate application of the precautionary principle in environmental decision-making.

The conduct of administrative decision-making processes may also be seen as a relevant factor for consideration.

Article 1103, Most-Favoured-Nation Treatment:

For greater certainty, the interpretation set out in relation to Article 1102, National treatment, shall apply *mutatis mutandis* to Article 1103, as well as to other similar tests of non-discrimination applied pursuant to Chapter 11.

Article 1106, Performance Requirements:

For greater certainty, Article 1106(1) does not include within its scope measures of general application taken to prevent, limit, regulate or otherwise affect trade in products or services, in particular in order to achieve or assist in achieving a legitimate objective as defined in Chapter 9 of NAFTA.¹⁹⁰

Article 1110(1), Expropriation and Compensation:

¹⁹⁰ Article 915, Definition: "Legitimate objective includes an objective such as:

- (a) safety;
 - (b) protection of human, animal or plant life or health, the environment or consumers, including matters relating to quality and identifiability of goods or services, and
 - (c) sustainable development,
- considering, among other things, where appropriate, fundamental climatic or other geographical factors, technological or infrastructural factors, or scientific justification but does not include the protection of domestic production. (Note: this footnote would be included in the interpretive statement as a footnote.)

For greater certainty, and without prejudice to any other interpretational issues, Article 1110(1), as a matter of definition, does not include within any of the terms set out in that Article, including “directly or indirectly nationalize or expropriate,” and “measure tantamount to nationalization or expropriation,” non-discriminatory measures taken for a public purpose consistent with a legitimate objective as defined in Chapter 9 of NAFTA, and in accordance with due process of law and Article 1105 of NAFTA. This interpretation does not create any other implications or applications to the interpretation of Article 1110 beyond its express words.

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