The NAFTA Investment Chapter: Extreme Corporate Rights

Investment in Developing Countries: Meeting the Human Rights Challenge

A Think Tank sponsored by Rights and Democracy, Ottawa, June 11, 2003

Notes for an address by Michelle Swenarchuk

Publication #451

Prepared by:

Michelle Swenarchuk,
Director of International Programmes and Counsel

June 2003

CANADIAN ENVIRONMENTAL LAW ASSOCIATION
L'ASSOCIATION CANADIENNE DU DROIT DE L'ENVIRONNEMENT

130 SPADINA AVENUE • SUITE 301 • TORONTO, ONTARIO • M5V 2L4
TEL: 416/960-2284 • FAX 416/960-9392 • WEB SITE: **www.cela.ca**

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We are living in an age of extremes.

Like extreme sports, extreme and widening global gaps of rich and poor, and extreme claims of weapons of mass destruction in Iraq.

However, in international law, the proliferating investor rights agreements represent a codification of corporate rights to the detriment of local and governmental authority to manage investment to maximize public benefits. The NAFTA investment chapter 11 is a precedent-setting landmark in expansion of company rights. It continues to be controversial in the three NAFTA countries.

I will speak of four issues arising from it:

Prohibitions on performance requirements

Investor-state arbitral rights, including procedure, expropriation and regulatory impacts.

And finally, in contrast, I will discuss the Ontario Environmental Bill of Rights, a precedent for the integration of citizens' democratic rights, environmental protection, and investment oversight.

The neglected issue of prohibitions on performance requirements:

NAFTA (1106) contains these absolute prohibitions on performance requirements on foreign investments: governments may not require that foreign corporations:

- Export a given level of goods or services;
- Achieve given level of domestic content;
- Purchase or use goods or services locally;
- Relate volume or value of exports or imports to foreign exchange inflows from the investment;
- Restrict sales of the goods/services produced domestically by relating to volume, value or exports or foreign exchange;

- Transfer technology, production process of other proprietary knowledge (with exceptions including to meet health or environmental requirements);

- To be exclusive supplier of a good in a specific region or world wide.

Similarly, the WTO services agreement, GATS, which is also an investment agreement, applying to foreign service providers who establish a "commercial presence" contains prohibitions, expressed as "Market Access" terms, which apply to those services which countries have committed to liberalize. These terms ban limits on:

- numbers of service providers;
- values of transactions;
- total numbers of service operations;
- total numbers of natural persons employed in a sector; and
- limits of participation of foreign capital. (GATS XVI)

Conventional trade and investment theory maintains that maximum liberalization will best promote economic growth and development; but this theory is increasingly contested by, amongst others, the authors of the 2002 UNDP trade report, *Making Global Trade work for People*.

In a background paper to the report, Rodrik argued that a diversity of investment management policies have been essential to the development gains made by Southern countries[1].

> The reality of growth transformations is that they are instigated by an initially narrow set of policy and institutional initiatives, which might be called "investment strategies." Adequate human resources, public infrastructure, social peace and stability are key enabling elements of an investment strategy. But often the key is a set of targeted policy interventions that kindle the animal spirits of domestic investors…Typically, they entail a mix of orthodoxy with unconventional domestic innovations[2].
>
> No country has developed successfully by turning its back on international trade and long-term capital flows….But it is equally true that no country has developed simply by opening itself up to foreign trade and investment. The trick in the successful cases has been to combine the opportunities offered by world markets with a domestic investment and institution-building strategy to stimulate …(the animal spirits of) domestic entrepreneurs[3].

Factors which he credits for the economic growth of the East Asian "tigers" include

> A coherent strategy of raising the return to private investment, through a

> range of policies that included credit subsidies and tax incentives, educational policies, establishment of public enterprises, export inducements, duty-free access to inputs and capital goods, and actual government coordination of investment plans[4].

Further,

> they combined their reliance on trade with unorthodox policies – export subsidies, domestic-content requirements, import-export linkages, patent and copyright infringements, restrictions on capital flows (including DFI), directed credit, and so on – that are either precluded by today's rules or highly frowned upon. In fact, such policies were part of the arsenal of today's advanced industrial countries as well until quite recently. The environment for today's globalizers is quite different and significantly more restrictive[5].

A comparison of the prohibited performance and market access requirements with these approaches to managing investment for development shows that investment agreements have targeted these strategies for elimination. Developing countries who are now signatory to a web of multilateral and bilateral agreements are being required to commit not to use these investment strategies for development purposes, although Asian and Northern countries have used them.

In a letter to US Trade Representative Robert Zoellick regarding investment protection in the FTAA, leading US business trade associations and corporations support "elimination of performance requirements[6]". In contrast, during the Americas Business Forum, held in Ecuador in October 2002, there were dissenting views amongst the business people present, with some believing that states must be free to impose performance requirements on investments originating in other states, according to WTO principles[7].

In the recently concluded bilateral trade and investment agreements between the US and Singapore and Chile, the bans on performance requirements are repeated, qualified only by differing rights in each country to retain some controls on the timing of capital transfers[8].

In summary, OECD trade negotiators are deliberately limiting the autonomy of developing countries regarding investment management, preventing their use of strategies that were used by both Northern and Asian countries for economic development.

Investor-state arbitration and expropriation: the most contentious elements in Chapter 11 and the most extreme corporate rights.

Like many of the hundreds of bilateral investment agreements that currently exist, NAFTA gives corporations the right to sue foreign governments directly for alleged infringement of investment rights. Both the substance and the process of investor-state remedies are contentious in Canada.

With regard, to process, positive lessons have been learned. What began as an entirely private, confidential, arbitral process, indistinguishable from other private commercial dispute processes, has evolved, due to public pressure, to one in which:

- the existence of suits is published;
- most documents are public, except for protection of confidential business information;
- an observer has been permitted to attend one of the hearings;
- the right to file an amicus curiae brief has been accepted;
- decisions are published; and
- there has been some limited judicial review, though not of a full appellate nature.

Fundamentally, the three NAFTA governments have accepted the public interest arguments that lawsuits against our governments involving large sums of public money, which also concern public regulations and government decisions, may not be treated the same, procedurally, as truly private merely commercial disputes between corporate actors.

In discussions of these cases since 1997, I have not found one Canadian lawyer, corporate or non-corporate, who would defend the secrecy provisions. Many arbitral processes exist as alternative dispute resolution processes, parallel to the legal system, but there are no comparable secret hearings where public rights and policies are so affected. Openness of our legal processes, with few exceptions, limited and contested, is the rule, after centuries of development of the common law system.

Therefore the NAFTA Commission acted in July 2001 through an “interpretive statement” to increase transparency. Congress acted further in the United States, so that the recent Chile and Singapore agreements with the US have an essentially open process for investor state disputes.

That’s the good news.

But the problem of the **substance** of Investor-state cases remains, that is the right of foreign companies to use it to claim damages for an unfettered range of allegations that some government action has affected the profitability of their businesses. It is important to recall that these rights accrue only to foreign corporations, not to domestic ones, a striking departure from the foundational

premise of trade law – non-discrimination between domestic and foreign companies.

These claims, characterized as "expropriation" represent the most extreme assertion of investor rights. Upwards of thirty cases are now either completed or in process. Cases against Canada have affected numerous environmental concerns, particularly toxic chemicals (MMT, PCBs and a pending suit concerning the pesticide, lindane.) In addition, companies have issued numerous threats of lawsuits for other possible public regulations, from public auto insurance to brown paper packaging of cigarettes to controls on the pesticide 2-4 D. Numerous suits against the US and Mexico have also concerned environmental regulations and decisions.

Still, corporate apologists argue that there's no problem; not many cases have been decided; the possible harm is not proven; we should let the system work.

And we have no firm commitment from the Canadian government NOT to replicate these rules in future agreements.

Investor-state tribunal decisions include these extreme views of foreigners' property rights:

- Non-discriminatory regulations of general application may give rise to claims for compensation.

- Market share is a protected property right, a very surprising finding in a world that extols competitive capitalism.

- A mere sales office of a foreign company is a protected investment.

These decisions are consistent with the demand expressed by American business organizations to US Trade Representative Zoellick in their FTAA letter, when the writers called for investment agreements that include:

> protection of assets from direct or indirect expropriation, to include protection from regulations that diminish the value of investors' assets[9].

Government officials concerned about this aspect of NAFTA include the Federation of Canadian Municipalities, the US National League of Cities, the Ontario Ministry of Economic Development and Trade, the California legislature, and the US Congress.

Members of the California legislature commented on the investor-state suit filed by Methanex, a Canadian company, against the United States, due to the decision of the California government to phase out MTBE, a pollutant. The legislators stated:

> We find it disconcerting that our democratic decision-making regarding this important public health issue is being second-guessed in a distant forum by unelected officials. This shift in governance is made even more troubling by the fact that the California Legislature has not received formal notice of the MTBE case proceedings and is not entitled to participate in any way[10].

In Canada too, there has been considerable discussion in government about an approach to limit the apparent unfettered reach of tribunal decisions, by re-asserting that generally applicable regulation of business activities does not constitute expropriation. Despite years of consultation on this question, and some limited judicial review, the three NAFTA countries have not come to an agreement and the problem continues.

However, the US Congress, in its *Bipartisan Trade Promotion Authority Act of 2002,* required that new trade agreements not give foreign investors more substantive rights with respect to investment protections than US investors in the US. With regard to regulatory impacts of investor-state expropriation claims, this requirement has resulted in changed wording in the US bilateral agreements with Chile and Singapore, specifically:

> Except in rare circumstances, nondiscriminatory regulatory actions by a Party that are designed and applied to protect legitimate public welfare objectives, such as public health, safety, and the environment, do not constitute indirect expropriations[11].

Whether or not this wording will have the effect of limiting such claims in the future is unclear. Meanwhile, the problem remains unresolved in the NAFTA countries, despite thousands of hours of costly government consultations and millions of dollars paid in damages. No country is prepared to "open up" NAFTA for amendment, given the myriad legal and political disputes that would undoubtedly arise.

At a minimum, this stalemate reminds us of the effective immutability of trade agreements and the difficulty of reversing even extreme rights consecrated by international treaties.

The Ontario *Environmental Bill of Rights*: a strategy to integrate environmental protection, citizens' political rights, and investment.

In contrast to investment agreements, which protect foreign corporate rights regardless of local impacts, The Ontario *Environmental Bill of Rights* is founded on two hallmarks of the Canadian citizens' environmental movement:

- the right of citizens to know of government and business decisions that affect the environment and public health, and
- their right to participate and be heard in such decisions.

It's about giving people the rights and tools to protect their environment and health. The Bill became law in 1994.

It includes a statement of the rights of citizens to a safe environment:

- ➢ The people of Ontario recognize the inherent value of the natural environment;
- ➢ The people of Ontario have the right to a healthful environment;
- ➢ The people of Ontario have as a common goal the protection, conservation and restoration of the natural environment for the benefit of present and future generations;
- ➢ While the government has the primary responsibility for achieving this goal, the people should have means to ensure that it is achieved in an effective, timely, open and fair manner[12].

The core of the bill is public participation, as it

> establishes a regime that provides minimum rules for public participation in the development and finalization of proposals for new statutes, policies, regulations and approvals. It also provides a process for residents to request that existing laws, policies, regulations, or approvals be reviewed, or that new ones be developed[13].

The Bill includes an Environmental Registry, an electronic bulletin board which informs citizens of thousands of proposals for new laws, regulations, policies and approvals. Many apply to company actions, from forest management plans that govern logging over vast areas to many waste disposal decisions, to individual water-taking permits. At CELA, we frequently advise and represent citizens, individually or in groups, in using the rights accorded by the EBR to participate in decisions which affect the environment, from small local projects to large-scale province-wide policies.

It is a unique and outstanding example of a practical approach to creating new rights and enhancing long-standing democratic and judicial rights. A domestic statute can obviously not be transferred in identical terms to the international forum. However, the Bill is a useful model which Rights and Democracy may wish to contribute to the global debate on the promotion of human rights to health, a safe environment and development, and the integration of these rights with investment decisions and governmental authority.

[1] Dani Rodrik, The Global Governance of Trade as if Development Really Mattered, Harvard University, April 2001.
[2] Ibid. p.13
[3] Ibid. p.26
[4] Ibid. p.18
[5] Ibid. p.33
[6] Letter to Robert Zoellick from US Chamber of Commerce, US Council for International Business et al, April 19, 2001.
[7] VII Americas Business Forum, Quito-Ecuador, 29-31 October 2002, workshop on Investment, Report
[8] See the draft bilateral investment agreement between the US and Chile, Annexes 10-E and 10-F) and the US and Singapore (Letter of Understanding)
[9] Op.Cit, letter to Robert Zoellick
[10] Letter to Robert Zoellick, USTR elect, from California Assembly Speaker Pro Tem Fred Keeley and 13 other California legislators, January 31, 2001.
[11] Op Cit US-Chile draft investment agreement, Annex 10-D, and US-Singapore draft agreement, Letter of Understanding
[12] *Environmental Bill of Rights*, Statutes of Ontario 1993, chapter 29, Preamble.
[13] Paul Muldoon and Richard Lindgren in conjunction with Pollution Probe, *The Environmental Bill of Rights, A Practical Guide*, Emond Montgomery Publications Limited, 1995, p.3.