LIBERALIZED INVESTMENT & INVESTOR-STATE SUITS: THREATS TO GOVERNMENTAL POWERS

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1. Introduction

The Canadian Environmental Law Association (CELA) is a non-profit environmental law clinic in Toronto, Canada. Founded in 1970, CELA represents environmental groups and individuals affected by environmental problems, and also provides leadership in law reform campaigns and environmental public education. CELA has analyzed and written on international trade and investment issues and their impacts on environment, health, and development, since 1988.

We have articulated a broad range of concerns regarding de-regulation of investment, as achieved in NAFTA Chapter 11 and as proposed in the Multilateral Agreement on Investment, and have participated in discussions with the Canadian federal government and provinces, the OECD, and the WTO.[1] At this time, we wish to address concerns related to expropriation and investor-state suits, arising from the experience of NAFTA.

We are not only concerned regarding environmental policy. Rather, every area of governmental public policy is now endangered by this unlimited opening for corporate investors to claim extravagantly high damage awards for governmental actions or inactions which reduce their anticipated profit margins

2. Chapter 11 Investor-State cases to date

2.1 Suits against Canada

2.1.1 Ethyl Corporation

In this first and best-known investor-state case, Ethyl Corporation of the US sued the Canadian government for US $250 million and obtained, in 1998, a settlement of US $13 million for the government's effective ban on the gasoline additive, MMT, a known nerve toxin. The ban has been reversed.

The proceedings were conducted in secret, in accordance with the NAFTA Investment Chapter provisions, were widely criticized in Canada, and provided a rude awakening to other governments regarding the impacts of the NAFTA expropriation provision. They also resulted in a direct reduction of Canadian health and environmental protections.

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[1] Canadian Environmental Law Association, "The Multilateral Agreement on Investment and Environmental Regulatory Powers" A submission to the Special Committee on the Multilateral Agreement on Investment of the BC Legislature," by Michelle Swenarchuk, September 29, 1998.

2.1.2 S.D. Myers

In October 1998, US-based S. D. Myers Inc., which treats transformers containing toxic PCBs, filed a claim for US $30 million for losses it claims to have incurred during a one and one half year ban (1995 to 1997) on the export of PCB wastes from Canada.[2] The Canadian federal government states that Canada is bound by international conventions that stipulate that PCBs must be destroyed in an environmentally sound manner, and that US standards for PCB disposal are not as high as Canada's. The wastes were destroyed in a Canadian facility in Alberta. The US government also controls cross-border movement of PCBs. Nevertheless, the suit is proceeding at this time in a confidential process for which little information is available.

Although the Canadian PCB export ban was revoked in 1997, the company is using NAFTA Chapter 11 to claim damages.

2.1.3 Sun Belt Water Inc.

This California-based company is suing Canada[3] for the decision of the provincial government of British Columbia to enact the Water Protection Act which bans bulk water exports and inter-basin diversions by domestic and foreign investors alike. In a "colourful" claim which alleges a decade of "smelly" actions by successive BC governments, Sun Belt Water expounds on the growing world-wide demand for water, assumes that water export must be a positive benefit (ignoring environmental and conservation requirements) and makes extravagant claims of improprieties by the BC government and BC courts. In a BC court action, Sun Belt did not achieve its desired result. It is therefore using NAFTA Chapter 11 to seek damages which, though unspecified, would appear to be an amount over US $500 million.

Everyone with an interest in investment agreements and NAFTA should be encouraged to read this particular claim to obtain a clear indication of the possible uses of an investment agreement for dubious business purposes.

The case raises the fundamental issues of the uses of the investment chapter to evade the result of an action in a domestic court, and to challenge a non-discriminatory policy and legislation by a subnational government. The BC government is of course deeply concerned about this attack on its resource management and conservation laws.

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[2]Americas Trade, "Notice of Intent to Submit a Claim to Arbitration under Section B of Chapter 11 of the North American Free Trade Agreement" September 3, 1998; Toronto Globe and Mail, "US Firm hits Ottawa with NAFTA lawsuit" August 21, 1998; and Canadian Press, "US company files suit under NAFTA," by Nahlah Ayed, October 30, 1998.

[3]See "Notice of Intent to Submit a Claim to Arbitration between Sun Belt Water, Inc. and Her Majesty the Queen in Right of Canada" November 27, 1998.

2.1.4 Pope and Talbot

This US based lumber company is claiming approximately US $510 million for alleged breaches of the NAFTA investment chapter related to changes in the profitability of its timber export business in Canada. [4] Softwood lumber exports from Canada to the US have been a source of contention and repeated trade disputes for decades. Forest products are amongst the most important exports from Canada, representing billions of dollars in export earnings, and over 80% of these products are exported to the US. In 1996, in yet another attempt to resolve the ongoing timber wars, the Canadian and US federal governments signed the Canada-US *Softwood Lumber Agreement,* governing exports of softwood lumber from four Canadian provinces, British Columbia, Alberta, Ontario and Quebec. The agreement establishes quotas for exports for each province, and requires producers to provide certain information regarding exports and pay an export levy if their exports exceed their particular quota. In arriving at such export agreements, the Canadian government consults extensively with industry.

Pope and Talbot claims that Canada has breached the NAFTA investment requirements regarding national treatment, most-favoured nation treatment, minimum standard of treatment, and performance requirements. The company's lawyers are critical of the Canadian government for its public release of the Notice of Intent to Submit a Claim, calling the release "a serious breach of international procedure."[4]a Consultations concerning the case were scheduled to occur in Ottawa last week.

Pope and Talbot's operations are located in British Columbia. During the period of the softwood memorandum, BC's share of total softwood exports has declined relative to total Canadian softwood exports; Pope and Talbot argue that this decline is related to the agreement, and amounts to a breach of the NAFTA chapter. Others point to the loss of BC's traditional markets in Asia, related to the Asian economic crisis.

The importance of this case for Canadian forests and government regulation of them cannot be over-estimated. Given the economic value of forest products to Canada, and the volatility of the US market, due to US domestic forest producers' lobbies, this case touches on one of the cornerstones of the Canadian economy, and on a decision essentially made by six governments: two federal ones and four provincial ones. It is an important indication of how far-reaching the impacts of the NAFTA investment chapter are and of how broadly multiple governmental powers and decisions may be challenged by an individual corporation for a huge compensatory

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[4] Pope and Talbot Inc. Investor v. Government of Canada ("Canada") Party, "Notice of Intent to Submit a Claim to Arbitration Under Section B of Chapter 11 of the North American Free Trade Agreement", reprinted in Americas Trade, March 25, 1999, pp. 7 -9.

[4]a Barry Appleton, quoted in Americas Trade, " NAFTA Investor Claim Hits Canadian Implementation of Lumber Act," pp 4 - 6, April 8, 1999.

claim.

2.2 Suit Against the US

2.2.1 Loewen

In the one known case filed against the US government, B.C.based Loewen Group is suing for compensation arising from alleged discrimination, denial of minimum standard of treatment and expropriation, claiming that a $500 million Mississippi state court verdict against it amounts to a breach of NAFTA. [5] The case involved competition between Loewen and a Mississippi company, O'Keefe, including allegations of fraudulent practices made against Loewen, and was eventually settled for $175 million. Loewen had been denied an appeal of the court decision due to a state law which requires an appellant to post 125 percent of the damage award ($625 million in this case) which Loewen could not post. It seeks to recover the $175 million settlement cost through this investor-state claim.

This case demonstrates, as does Sun Belt, the use by a corporation of the NAFTA Investment chapter to essentially reverse the results of domestic court proceedings, and to circumvent the course of normal commercial civil litigation. Having lost to a competitor in the courts, it claims compensation from the US federal government.

2.3 Suits Against Mexico

Although there are "rumours" in the trade community of four investor-state lawsuits against Mexico, we have information on two cases only.

2.3.1 Metalclad

This case involves a claim by US-based Metalclad, a waste-disposal company, that the Mexican state of San Luis Potosi breached Chapter 11 of NAFTA in refusing permission for a waste disposal facility. According to Preamble Center for Public Policy:[6]

> On the basis of a geological audit performed by environmental impact analysts at the University of San Luis Potosi, the Governor deemed the plant an environmental hazard to surrounding communities, and ordered it closed down. The study had found that the facility is located on an alluvial stream and therefore would contaminate the local water supply. Eventually, the Governor declared the site part of a 600,000 acre ecological zone.

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[5] Americas Trade, "In NAFTA first, Canadian Firm Challenges US on Investment Loss," November 26, 1998, pp.1, 20-21.

[6] Michelle Sforza and Scott Nova, "The MAI and the Environment," October 1997, Washington, D.C.; Preamble Center for Public Policy.

Metalclad seeks compensation of some $90 million for expropriation and for violations of national treatment, most favored nation treatment and prohibitions on performance requirements. This figure is larger than the combined annual income of every family in the county where Metalclad's facility is located.

As counsel involved frequently in environmental assessment hearings regarding the siting of waste management facilities in Ontario, we are aware that the hydrogeology of a site is usually the most important single condition to be considered in environmental assessment of potential waste sites. The huge damage claim by Metalclad in San Luis Potosi demonstrates that Chapter 11 may be used to undermine this fundamental issue in environmental planning in all NAFTA jurisdictions, national and subnational.

2.3.2 Waste Management Inc.

This case involves a claim by Waste Management Inc.[7] regarding its exclusive 15-year concession to its subsidiary to provide solid waste management to Acapulco. It claims that it was guaranteed payment by the state of Guerrero and the Mexican federal development bank, Banobras, and that the obligations have not been met, constituting actions "tantamount to expropriation."

3. Governmental Statements and Actions Demonstrating Concerns regarding Potential Impacts of Investment Liberalization Agreements.

During the international MAI debate, when only the Ethyl investor-state case had been commenced, governments and investment specialists in various parts of the world realized that the NAFTA model of expropriation and investor-state disputes could have far-reaching and negative effects on the necessary exercise of governmental powers for protection of the public. As a consequence, many statements of concern emanated from governments, together with recommendations against replication of the model in new agreements.

3.1. Members of the European Parliament on the Multilateral Agreement on Investment

In March of 1998, the European Parliament considered the Multilateral Agreement on Investment, and members voted 437 to 8 for a resolution containing 37 recommendations, including that dispute settlement measures should balance rights of enterprises and States. One member considered that the Agreement would compromise the right of States to set new environmental standards, for example, to implement commitments under the Kyoto Protocol on climate change, and the Montreal Protocol on Ozone-Depleting Substances. A member of the

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[7] Americas Trade, "Trade Lawyers Clash on Changes to NAFTA Investor-State Clause," March 25, 1999, pp.5-6.

European Parliament Committee on Fisheries was concerned about effects of the Agreement on the ability of States to reduce catch rates to preserve fisheries reserves.[8]

3.2 The Government of France and Prime Minister Jospin

While supportive of the principle of overseas investment, the government of France effectively caused the termination of the negotiation of the MAI by withdrawing from the negotiations. In reaching that decision, the government was acting on the recommendations of Madame Catherine Lalumiere, Member of the European Parliament, and Monsieur Jean-Pierre Landau, Inspector General of Finances. [9] Following a multi-faceted critique of the MAI and similar NAFTA provisions, they recommended certain conditions which France should require before entering into an international investment agreement, including:

- A mechanism of dispute resolution open only to states and not to investors.

- The suppression of the notion of a "measure of equivalent effect[10]" to a nationalization of (sic) expropriation, of which the interpretation by the same international judge could lead to declare all regulation or public legislation that reduces the economic value of economic foreign investment as not in conformity with the agreement.

- In the matter of "performance requirements," reduction of the list of forbidden measures.

In speaking to the National Assembly on October 14, 1998 about the MAI, French Prime Minister Lionel Jospin commented that it raised "essential issues as regards the sovereignty of States," and that

> Now, it is one thing to delegate sovereignty in the framework of a community which is ours, the European Union, in a process controlled by the States, in a historic venture of considerable importance for us all, but quite another too agree to abandon in some areas sovereignty to private interests, under the pretext of discussing an international investment code....France wishes to remain a country open to foreign firms and investment, anxious to support the development of its firms. But I believe that when you

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[8]Agence Europe, Strasbourg, March 11, 1998, "Multilateral Agreement on Investments (MAI) Cannot be Signed as It Is - European Parliament Sets Conditions."

[9]Lalumiere, C. and Landau, J.P., "Report on the Multilateral Agreement on Investment," September 1998.

[10] This wording is similar to the wording of NAFTA Article 110 which speaks of expropriation and "measure(s) tantamount to nationalization or expropriation..."

> see the recent upheavals, the hasty and irrational behaviour of the markets, we don't think it would be wise to see private interests encroaching on the sovereignty of States. States must remain the major players in international life."

3.3 Jan Huner, Secretary to the Chairman of the OECD MAI Negotiating Group

Mr. Jan Huner, a Dutch public servant and assistant to Frans Engering, Chairman of the MAI Negotiating Group throughout the MAI negotiations, , provided an instructive governmental analysis of the issues which caused concern to governments and ultimately caused the collapse of the MAI negotiations,[11] issues which are similar and relevant to those in the FTAA negotiations.

Huner stated that the meeting of NGOs and negotiators in October 1997, when concerns were raised regarding potential impacts of the MAI for development and for the environment, was

> Decisive, because some of the points raised by environmental groups convinced many NG members that a few draft provisions, particularly those on expropriation and on performance requirements, could be interpreted in unexpected ways. The dispute between the Ethyl Corporation of the US and the Canadian Government illustrated that the MAI negotiators should think twice before copying the expropriation provisions of the NAFTA. Ethyl considered that the Canadian ban on a certain additive for petrol amounted to an expropriation, mainly because it was the only producer of this additive. Canada eventually went for a settlement which reportedly involved the sum of $13 million. This surprised not a few observers, because Canada was expected to win the dispute. This settlement was invoked by NGOs to demonstrate the need for clarity in the MAI as to what expropriation really means. Above all, they insisted that the MAI should clearly state that the expropriation clause can never be interpreted to prevent governments from adopting rules and regulations on environmental protection.

In reflecting on lessons learned from the MAI process, Mr. Huner noted the need for interdisciplinary policy consultations within governments regarding the possible effects of such an agreement; the investment negotiators' lack of preparedness and experience in responding to the political questions raised by the opposition; and

> A third lesson is that complex multilateral negotiations in the trade and investment field are likely to raise questions. If on top of that you create an impression of secrecy, you create a political time-bomb.

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[11]Huner, Jan, "Environmental Regulation and International Agreements: Lessons from the MAI," a speech to a conference entitled "Trade, Investment and the Environment," Royal Institute for International Affairs, London, October 29-30, 1998.

3.4 The Government of British Columbia, Canada

In 1998, the government of the Canadian province of British Columbia established a Special Committee on the Multilateral Agreement on Investment, which heard testimony from 89 experts and citizens regarding impacts of the proposed MAI, and similar clauses in the Investment Chapter of NAFTA. In its First Report, the Committee made the following recommendations:[12]

- that as long as such requirements are transparent and apply equitably to domestic and foreign investors, an international investment treaty should not prevent governments from negotiating or enforcing performance requirements intended to meet economic development, environmental, or other legitimate objectives. (Recommendation 5)

- that in the case of expropriation for a public purpose, foreign investors must be assured of identical treatment under domestic law, the same rights to prompt, adequate and effective compensation as domestic investors, and full access to the domestic court system to litigate disputes. Foreign investors do not require special rights beyond those accorded to Canadian investors and citizens. (Recommendation 6)

- that provisions concerning "measures tantamount to expropriation" should be eliminated from the MAI and similar agreements. Furthermore, the federal governments should engage immediately with its NAFTA partners to gain effective binding agreement that regulatory takings are not compensable under NAFTA's investment provisions. (Recommendation 7)

- that the investor-state mechanism - which enables a foreign affiliated investor to bypass the domestic court system and challenge government measures before international arbitral panels should be eliminated. The use of international commercial arbitration procedures should be limited to their original purpose, the adjudication of contract disputes, where the parties, whether governmental or private, expressly consent to submit the specific dispute to arbitration. (Recommendation 8)

- that the granting of concessions, licences, authorizations, and permits, including rights to develop publicly owned natural resources, should be excluded from the definition of investment in the MAI and multilateral investment agreements. (Recommendation 15)

The government of British Columbia is particularly concerned about the Sun Belt investor-state suit filed against Canada since the measure at issue in that case is the BC Water Protection Act, which prohibits bulk water exports and inter-basin diversions by both domestic and foreign enterprises. The Chair of the Special Committee, Ms. Joan Smallwood , Member of the BC

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[12]Legislative Assembly of British Columbia, Special Committee on the Multilateral Agreement on Investment, "First Report," December 29, 1998

Legislative Assembly, stated:

> It is clear that we need international rules for investment, but these rules are headed in the wrong direction....For example, British Columbians have a recent reminder of the danger of these kinds of rules. A California company is using similar provisions in NAFTA to sue Canada because of BC's environmental prohibition against bulk water removals...The Committee heard how no level of government is immune from the impact of these agreements, not even local and regional governments[13]."

5. Canadian federal government

Faced with the accelerating threat from NAFTA Investment Chapter investor-state claims, the Canadian government is now attempting to reach an agreement with the US and Mexico to limit the breadth of the chapter, and to make the investor-state arbitral procedures more transparent, consistent with the fundamental principles of the Canadian domestic judicial system.

Specifically, the government is proposing that the three countries, through the NAFTA Free Trade Commission, adopt an agreed interpretation of NAFTA Article 1110 (Expropriation) which would have the effect of clearly enunciating that the term "expropriation" in the chapter does not extend to actions within normal governmental regulatory purposes..

Further, Ottawa is proposing adoption of an interpretation which would entail more openneness of the arbitral process, including publication of relevant documents, consistent with normal procedures of Canadian domestic courts, with safeguards regarding confidential business information.

These discussions are ongoing at this time.[14]

Conclusion

The plethora of NAFTA investor-state suits demonstrates that the NAFTA model can create significant problems for governments exercising their normal regulatory powers to institute environmental and health protections. Further, they show the disturbing and unacceptable trend to an abusive use of this mechanism to evade the results of properly constituted domestic court systems, and to undermine subnational as well as national governmental actions.

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[13]Joan Smallwood, Chair, British Columbia's Special Committee on the MAI, in a Press Release, "Legislative Committee Rejects MAI Provisions," January 25, 1999.

[14]Inside US Trade, "Canadian Memo Identifies Options for Changing NAFTA Investment Rules" February 12, 1999 and Americas Trade, "Trade Lawyers Clash on Changes to NAFTA Investor-State Clause," March 25, 1999.

The seriousness of these impacts is underscored by the current attempts by the Canadian government to contain the breadth of claims through a limiting interpretation of the NAFTA wording, to be implemented through the NAFTA Free Trade Commission. The Canadian government, an ardent promoter of free trade and liberalized investment agreements, is clearly experiencing serious political and economic impacts from Chapter 11.

Other governments in the hemisphere now have the opportunity to learn from Canada's past mistakes by not entering into an FTAA investment chapter modeled on Chapter 11 of NAFTA. Rather, management of foreign investors and investments for legitimate l public policy goals should remain an unfettered element of every government's jurisdiction.