UNTANGLING THE EXPROPRIATION AND REGULATION RELATIONSHIP:

IS THERE A WAY FORWARD?

Report to the Ad Hoc Expert Group on Investment Rules and the

Department of Foreign Affairs and International Trade

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Howard Mann and Julie Soloway

1. Introduction

In their capacity as members of the *Ad Hoc Expert Group on Investment Rules* (the "Ad Hoc Expert Group") established by the Department of Foreign Affairs and International Trade, the authors were asked to consider, in a joint paper, whether the current case law under Chapter 11 supports the allegation that the expropriation provisions of NAFTA (Article 1110) have had, or threatens to have, a negative effect on the ability of a country to regulate in the public interest.[1] Both authors have been active participants in the Chapter 11 debate, expressing strong (although different) views.

In viewing the Chapter 11 debate more generally, the authors have observed that little progress has resulted from the many discussions in a variety of fora. Participants express their views, but rarely engage on a specific point-by-point basis. Frustrated with the lack of progress, the authors wanted to move the debate forward. As a starting point, in the context of the expropriation provisions of NAFTA, they felt the best way to do this was to identify precisely the areas in which the authors differ in their understanding of the case law and the implications of that case law. In this way, it is hoped that progress can be made on what seems like an intractable dilemma.

The Ad Hoc Expert Group is currently discussing the desirability and efficacy of a possible interpretative statement on Article 1110 of NAFTA. This paper provides background for that discussion by examining and summarizing the jurisprudence on Article 1110.[2] Consistent with the mandate to prepare this work for discussion by the Ad Hoc Expert Group, this paper has been prepared for readers knowledgeable in the NAFTA jurisprudence.

2. The Expropriation and Regulation Relationship in Operational Terms

What do we mean by the expropriation and regulation relationship? In our view, the debate centres on the extent to which the expropriation provisions of NAFTA can be used by investors to obtain damages for bona fide regulatory and legislative measures taken for public

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[1] Although the environment has been a large focus of the public debate, Chapter 11 has also been related to other areas of public welfare regulation such as tobacco controls, pharmaceutical licensing, pesticide ingredients. See *infra*.

[2] Views expressed here are without prejudice to other surrounding issues, such as the nature of the dispute resolution process, the scope of other provisions of Chapter 11, etc.

welfare purposes: Do the decisions to date support the concern about these provisions, or have such concerns been overstated?

This issue is important because it speaks to the heart of what governments do, that is, regulate in the public interest. If Article 1110 can be used to require governments to pay compensation to investors for adopting bona fide measures, this could have a chilling impact on the ability of governments to regulate, thereby compromising the protection of the environment, human health, etc.

The authors agree that the ability of government's to undertake *bona fide* public welfare measures was not intended to be compromised by Article 1110. However, given the potential for environmental or other measures to be used for protectionist purposes or to transfer economic benefits for reasons not related to public welfare, it is important that we maintain the ability to protect against the abuse of regulatory power.

The issue of defining a *bona fides* measure is a critical issue to this process. The issue is therefore not simply one of form, but is rather one of substance. This means that there are no "blanket exceptions" from review for a measure just because of its form, i.e. an environmental regulation. This conclusion, however, does not dispose of the issue.

3. The Legal Issues Defined

With the above conceptual framework for the expropriation and regulation relationship established, this section identifies how this problem translates into the legal tests and issues raised by Article 1110 and the jurisprudence. This step, in turn, provides an introduction to our analysis of the current case law relating to these legal issues.

Article 1110: 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:

(i) for a public purpose;

(ii) on a non-discriminatory basis;

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

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

Article 1110 sets out four conditions for a legal expropriation, including the payment of compensation according to standards set out in paragraphs 2-6 (not reproduced above). However, it does not set out any tests for what actually constitutes an expropriation that falls within the terms of Article 1110. Consequently, the first issue to be addressed is the test used for determining whether a measure of any type constitutes an expropriation.

As will be seen, however, establishing a test for expropriation does not by itself provide an answer as to whether there is a safe heaven for *bona fide* regulatory measures. Rather, an additional element that distinguishes such *bona fide* public regulatory measures from other measures requiring compensation is still needed. Under customary international law, this second issue was covered through the " police powers". There is no single definition of what constitutes a police power, but its scope is generally understood to include measures taken by a government under normal or common functions of governments to protect the environment, human health, consumer protection, regulate hazardous products, and so on.[3] A common thread is that such measures are designed to protect the public or public assets in general from harm that may arise from the acts of the regulated party.[4] "Liability does not arise from actions that are non-discriminatory and are within the commonly accepted taxation and police powers of states."[5]

The authors accept that there remains some uncertainty as to what exactly falls within the police powers rule, much as there remains uncertainty as to what falls within the rule on expropriation itself. The recognition that the issue is a question of substance rather than form does, however, help ensure that individual cases will be potentially reviewable on this point, which would allow *bona fides* regulation to remain free from liability and ensure any abuses are checked. In addition, there may well be some differences as to what constitutes the scope of police powers within different states that might need to be taken into account in any given case.

Nonetheless, our second question in the analysis of the cases is whether Article 1110 does in fact leave sufficient room for the application of the police powers rule as set out in customary international law, and hence for the exclusion of *bona fide* public welfare measures from the liability for compensation.

The third issue we will look at, though more briefly, is the type of property rights that have been viewed by panels as capable of expropriation. Simply stated, the broader the scope of protected property rights, the broader the range of regulatory measures that can be covered by Article 1110. This raises the importance of addressing the previous two issues, and the relationship between them.

In summary, the three specific legal issues to be explored below are:

(i) What is the legal test for expropriation found in the jurisprudence?

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3 "Police powers": "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 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 constitutional limits and is an essential attribute of government." Black's Law Dictionary, 6th ed, 1990.

4 General reviews of the evolution of the police powers rule can be found in, e.g., Rudolph Dolzer, "Indirect Expropriation of Alien Property", 1 ICSID Review – F.I.L.J. 44-65 (1986); and Paul Comeaux & Stephen Kinsella, *Protecting Foreign Investment Under International Law*, 1997, pp. 3-15.

5 George Aldrich, "What Constitutes a Compensable Taking of Property? The Decisions of the Iran-United States Claims Tribunal", 88 AJIL 585-610 at 609 (1994).

(ii) What is the test for the application of the police powers in the jurisprudence?

(iii) What is the scope of protected property rights in the jurisprudence?

One legal issue we will not be considering here is the interpretation of measures "tantamount" to expropriation. Absent a large change in direction from the current cases, which we do not believe is warranted, we accept that the use of this term in Article 1110 has not led to an expansion in and of itself of what constitutes an expropriation. There is no indication in the cases that this term can or will be used by itself to include regulations that would not have otherwise been included under Article 1110.[6]

4. The Expropriation Jurisprudence

The case law will be considered under the three legal issues just set out. Inter-relationships between these three issues will be considered in the course of doing so. Each analysis is supported by a table of cases, citing each relevant paragraph of the decisions. These tables are annexed to this report.

(a) Preliminary Considerations

(i) The limits of analyzing the jurisprudence

It is important to keep in mind that there are limits to the value of analyzing the jurisprudence because, under international law, Chapter 11 decisions have no *stare decisis*. A NAFTA arbitral tribunal's ruling is not binding on subsequent NAFTA arbitral tribunals.[7] In one recent case, a NAFTA arbitral tribunal declined to follow a ruling made by a previous tribunal on Article 1105 noting that the previous case is not "… a persuasive precedent on this matter and [this Tribunal] will not be bound by it." That said, a NAFTA arbitral tribunal will consider, among other things, the decisions of past NAFTA arbitral tribunals, as well as the decisions of tribunals in other contexts.[8] Thus, while not binding, the case law is an important element guiding all concerned parties.

(b) What is the legal test for expropriation?

The *Azinian* case (Desona v. Mexico)[9] was the first case to address the issue of expropriation on the merits. While it did not actually make a decision on a test for expropriation,

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6 This is confirmed *in Pope & Talbot Inc. v. The Government of Canada Award on the Merits of Phase 1*, (June 26, 2000), para. 96; and *S.D. Myers, Inc. v. Government of Canada, In a NAFTA Arbitration under the UNCITRAL Arbitration Rules, Partial Award*, (November 13, 2000), para. 286.

7 See Articles 38 and 59 of the *Statute of the International Court of Justice*.

8 Daniel M. Price, "Chapter 11 – Private Party vs. Government, Investor-State Dispute Settlement: Frankenstein or Safety Valve? (2000) 26 *Can.-U.S. L.J.* 107 at 111.

9 Robert Azinian et al. v. United Mexican States, Award, International Centre for Settlement of Investment Disputes, Additional facility, case No. ARB(AF)/97/2.

it did make some introductory comments. First, the Tribunal notes that NAFTA was not intended to protect against disappointments in dealings with governments, or disagreements with the final results of different government dealings. Neither of these situations found a claim under NAFTA, which requires a breach of an express obligation on governments. This limits the context in which a claim for an expropriation can be made.

Both authors agree that the test for expropriation that has emerged from the cases is consistent with our understanding of international law more broadly in this area. This test can be summarized in the following statements from the Pope & Talbot decision:

> "An interference with the investment's business activities **substantial enough** to be characterized as an expropriation."(emphasis added) [10]

This statement in and of itself is obviously circular, an expropriation is made out when the impacts of an action are large enough to constitute an expropriation. Reliance must be placed on a subsequent paragraph to flesh out its intent more clearly:

> The test is whether that interference is sufficiently restrictive to support a conclusion that the property has been "taken" from the owner. … Action that is confiscatory, or that prevents, unreasonably interferes with or unduly delays, effective enjoyment of an alien's property.[11]

These statements place a clear focus on the degree or significance of interference with the use or effective enjoyment of property as the key test. Specific factors referred to in the Pope & Talbot analysis support this test: they highlight the absence of nationalization in that case, that there was no loss of control, and note that lots of exports continued to be made by Pope & Talbot with commensurate profits from those exports. Based on these factors and the above noted tests, Pope & Talbot found there was no substantial interference with the property in that case, and hence no expropriation.

This focus on degree of interference with property rights as the test for expropriation is repeated in the *Metalclad* case. The test adopted in this decision is quite clear. The Tribunal makes its view clear that expropriation includes not just an outright seizure or formal transfer of title,

> "But also any covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use or reasonably-to-be-expected

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[10] Pope & Talbot, *supra*, para. 96.

[11] *Ibid*, para. 102.

> economic benefit of property even if not necessarily to the obvious benefit of the host State."[12]

Thus, *Metalclad* adopts the same degree of interference test (based on a significant impact) that is seen in *Pope & Talbot*. Neither case, however, sets out a specific test for what exactly constitutes a "significant impact" and one may reasonably expect some difficulty in setting an exact test of what constitutes a significant impact. Context will be a factor, and some degree of judgment will rest with the arbitral tribunal. If arbitral tribunals do use a test of substantial interference, this will likely create a high hurdle for there to be a finding of expropriation.

On the other hand, some argue that there is no clear indication that the test will be interpreted in such a way to be substantial or significant. The *Pope & Talbot* decision does stand for the proposition that a de minimus impact will not constitute an expropriation, and does suggest a reasonable threshold is needed. But none is established. Other experience in, for example, Canadian environmental assessment law cases have defined significant simply as any impact that is not insignificant. Such a low threshold would not create a high hurdle to a finding of expropriation.

The *S.D. Myers* case is the only one of the four completed cases that appears to have gone beyond just a significant impact test. This decision expressly states that regulatory measures do not normally constitute an expropriation, but adds to that the view that one cannot rule out the possibility that in some cases it will.[13] This opening view of the Tribunal will be returned to below. Closely related to this statement is the clearly expressed view that when examining the question of expropriation, it is important to evaluate the purpose and effect of a measure.[14] On the one hand, this suggests a role for the police powers rule, which is very much a purpose-based construct. On the other hand, this statement also suggests something that we have already noted our agreement upon, that the analysis must be based on substance, not form.

Having set out the need for a purpose and effect analysis, the factors and tests that the tribunal then turns to are important. In particular, the question arises as to whether they are different from those of the Pope & Talbot tribunal, which did not enunciate the need for a purpose and effect analysis. The analysis suggests that the extent to which they differ appears to be small, at most.

The main S.D. Myers decision set out several specific factors for consideration in this case:

- A deprivation of ownership rights v. a lesser interference;
- Expropriation is usually a lasting interference (but may not always be);

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[12] *Metalclad Corporation v. Mexico, Award,* International Centre for Settlement of Investment Disputes, Additional facility, Case No. ARB(AF)/97/1, para. 103

[13] S.D. Myers, *supra,* para. 280-281

[14] *Ibid*, para. 281, 285.

- Whether any benefit is realized by the enacting party.[15]

Based on these factors, the Tribunal ruled this was not a case of an expropriation, as the measure was temporary, did not involve a deprivation of ownership rights and did not confer any benefit on another party.[16] These factors clearly go to issues of degree of impact, as in the previous cases. What is less clear is whether they also go to distinguishing *bona fide* regulatory measures from other types of measures with the aim of excluding the latter from the scope of expropriatory measures. This lack of clarity stems from the use, primarily of the same type of degree of interference criteria, rather than criteria that actually address a purpose and effect distinction.

The separate opinion in the S.D. Myers case by Bryan Schwartz states that regulatory conduct is not remotely the subject of legitimate complaint, but then adds the caveat, "in most cases."[17] Schwartz also invokes the need for a purpose and effect analytical approach. However, we again must consider whether tests or criteria are set out that distinguish how one might look at the purpose as opposed to the effect. Schwartz includes some criteria that appear to address this issue:

- Severe deprivations v. much lesser interference (the main judgement only talks of "lesser" interference)[18]
- Does it enrich the state or a third party to whom property is given?[19]
- Is there an unfair deprivation on one side and an unjust enrichment on the other[20]
- Regulation tends to prevent the use of a property in a way that unjustly enriches the owner, through e.g. pollution of public property, etc.[21]

Schwartz concludes his analysis by noting there was no clear transfer of wealth here, and that the measure was temporary. However, he actually concludes by stating that he would "refrain from characterizing the export ban as an expropriation" in this case due to the political concern that issues surrounding expropriations were the most inflammatory in the public debate, so no ruling should be made on this unless necessary.[22] Given this conclusion, the potential relevance of the criteria set out for distinguishing expropriation from regulation, if that

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15 *Ibid*. The Tribunal never addressed the question whether a transfer of economic activity among different actors could constitute a potential benefit for a third party. Rather, it has delayed this issue to the damages phase of the process.

16 *Ibid*, Paras. 287-288

17 *Ibid*, Schwartz separate opinion, para. 207

18 *Ibid*, Schwartz separate opinion, para. 211

19 *Ibid*, Schwartz separate opinion, para. 212

20 *Ibid*, Schwartz separate opinion, para. 212

21 *Ibid*, Schwartz separate opinion, para. 212

22 *Ibid*, Schwartz separate opinion, para. 222-223

is a correct characterization of the criteria, may lack some weight. More concerning, is that the decision not to make a finding after extensive reasoning does not allow us to fully clarify what criteria or tests would apply to the caveat to his introductory, that regulatory conduct is not the subject of legitimate complaints "in most cases".

Summarizing the above, one finds a consistent reference to a degree of interference test for finding an expropriation, based on a standard of significant interference. In principle, we take no exception to this approach. A concern remains in terms of defining what constitutes a significant impact, but again both authors are aware that a single definition of this without context will be impossible. That does not remain a totally satisfactory answer, but this is likely not the most critical question either in the context of this paper.

(c) The test for the application of the police powers

The establishment of the test for expropriation begins the debate on the expropriation and regulation relationship. The next step is to establish whether the test for expropriation itself, or a related test, addresses the regulation half of the equation more directly. Absent such a second test, it is clear that, almost by definition, a test based solely on the degree of interference of a measure should always capture effective public welfare measures, and especially environmental measures. This in turn would entitle a foreign investor to receive compensation for even *bona fides* measures.

The second test here relates to the applicability of the police powers rule. As noted earlier, there is no single definition of the police powers rule. Its scope is generally understood to include measures taken by a government under the normal or common functions of governments to protect the environment, human health, consumer protection, regulate hazardous products, and so on. Also as noted earlier, the police powers rule was generally understood in customary international law to be what would now be called a carve out in trade law terms. A measure adopted under a police power should therefore not be subject to compensation.[23]

Of the three cases that have reached a conclusion on the expropriation question, only S.D. Myers has developed arguments that suggest a role for the police powers rule. The development of the legal reasoning on this particular issue may have been preempted by the Tribunals interpretation of the facts.[24] In S.D. Myers, for example, the Tribunal ruled that the environmental protection measure in question was really a disguised protectionist measure. Hence no issue of weighing a bona fide measure would arise, although the legal issue was still treated here. In Pope & Talbot, the legitimacy of the measure was questioned by the claimant but supported by the Tribunal. Still, the legal ruling on the lack of any significant impact may have forestalled any further legal analysis. In Metalclad, it was ruled that the environmental

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[23] Aldrich, *supra,* n. 5. It is not the purpose of this paper to develop a precise argument on each aspect of the expropriation/regulation relationship, but we believe this approach, with its attendant consequences on burden of proof issues, is appropriate.

[24] Whether these rulings were correct or not is not the issue here. Whether they had an impact as factual rulings on the further legal reasoning of the Tribunal is a relevant issue. Unfortunately, it is not easy to determine this issue.

protection issues had been managed and approved by the federal level of government in Mexico, hence no real environmental issue was left for determination by the local government that blocked the construction of the hazardous waste site. Thus it found the denial of the permit in question to have been an unlawful measure under Mexican law and hence in its view an expropriation.[25] However, this aspect of the ruling does not extend to the Ecological Decree, upon which a finding of expropriation was also made independently of the denial of the operating permit. Despite these problematic factors, the existing cases still do show some treatment of the legal issue being addressed in this section.

Pope & Talbot states clearly that non-discriminatory measures within the scope of the police powers are covered by Article 1110. A reason for this is stated as being the concern that a blanket exception would allow creeping or indirect expropriations to be left unchallenged due to the form of the measure. But the reasoning appears to stop here in the sense of the absence of any test that might address a distinction between *bona fide* public welfare measures under the police powers rule and other government measures that are confiscatory in a more classic sense. As already described in the previous section, the only criteria used by the Tribunal went to the degree of interference, based on a test of significant impact. However, this may have resulted from the finding that the significance test was not met.

Moreover, it is important to keep in mind that the absence of an established test to distinguish bona fides public welfare measures from protectionist measures does not mean that tribunals will override the police powers rule. It is in fact extremely difficult to reduce a "smell" test into a series of discrete legal questions. This problem is not isolated to international investment, but is a problem of international trade law as well. However, panellists are given discretion in order to be able to have some flexibility in making this determination.

In Metalclad, the Tribunal appears to have gone farther. On one reading at least, it appears to have rejected the applicability of a purpose and effect analysis outright. Doing so, for all practical purposes, has the effect of ending a police powers role, as it is essentially a purpose-based analysis.

> Para. 111: "The Tribunal need not decide or consider the motivation or intent of the adoption of the Ecological Decree"

One reading of this position could suggest it may have been taken because a finding on the ecological decree, in relation to which this statement is specifically made, was not essential to the case due to the other findings. Some have argued the whole section of the decision on expropriation was obiter, though this was completely rejected by the BC Superior Court decision that reviewed the Tribunal's award.[26] More realistically, however, this paragraph must be read in conjunction with the original test for expropriation cited above. The rejection of any need to assess purpose is consistent with its choice of a singular test based on degree of

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[25] This aspect of the judgment was one of several vitiated by the British Columbia Supreme Court review of the arbitral decision. *United Mexican States v. Metalclad Corporation*, (2001) 89 B.C.L.R. 3(rd) 359.

[26] *Ibid,* paras. 86-105.

interference. It is also consistent with the absence of any reference to a consideration of purposes in the Pope & Talbot case.

Metalclad presented a simple opportunity to examine the Ecological Decree in the light of the expropriation/police powers dynamic. An analysis of this type might well have produced a conclusion that recognized the right of governments to enact measures pursuant to the police powers rule without paying compensation. The analysis could then have considered whether the measure fell within the scope of police powers. Such an analysis could have then distinguished measures whereby governments acquire title or prevent the continued occupation and any use of land in order to create a state asset – an ecological reserve here- from measures that prevent the use of property in certain ways as to injure others or the environment. It could have done so without much need for potentially more difficult lines to be drawn. It might have noted that in most countries, at least, when land is set aside for public use, as was the case here, that is seen as an expropriation and hence outside the normal scope of the police powers rule. Such an analysis could have reached the same result, without rejecting the basic element of the police powers analysis: looking at why a measure is adopted. Whether deliberately or not, the Tribunal chose simply to reject it. It is this legal choice that remains troubling.

All this being said, the Metalclad case remains controversial. There is widespread disagreement among analysts on the findings of fact, and on the impact those findings have on different parts of the arbitral decision, disagreement which exists between the present two authors. These disagreements lead to differing views on the extent to which the Tribunal could or should have undertaken a serious police powers analysis.

This leaves S.D. Myers as the only case where the consideration of purpose was called for. Unfortunately, all the criteria then used in the main decision went to a degree of interference analysis. Only in the separate opinion of Schwartz does one find a deeper analysis of this issue.

Schwartz notes that regulation is something that owners ought to expect.[27] Further, he argues that Article 1110 must be read in the context of NAFTA's overall environmental construction, including the preamble, Article 1114 and the adoption at the same time of the North American Agreement on Environmental Cooperation. All these factors, he argues favour the strong right of governments to protected the environment. Consequently, he concludes, Article 1110 "does not constitute a generous invitation to impose liability for regulatory activity in the ordinary course of government business."[28] Towards this end, as noted in the previous sub-section, Schwartz does provide some criteria to identify regulatory measures as distinct from non-regulatory confiscatory measures.

There is no statement that non-discriminatory, *bona fide* public welfare measures are not within the realm of expropriation. Recall here that his original statement on this issue was that regulatory conduct is not remotely the subject of legitimate complaints in most cases. Nothing is readily apparent in this judgement to determine when one may be in the presence of

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[27] S.D. Myers, *supra,* Schwartz separate opinion, para. 213

[28] *Ibid,* Schwartz separate opinion, para. 214.

such a case. This is made a more relevant point by his subsequent refusal to take a final position on the expropriation/regulation relationship in this case in order to preclude possible political impacts from his potential decision. However, as stated above, it would be dangerous to *prima facie* exclude any form of regulation from the scope of review.

Whether existing tests recognize the police powers rule implicitly is another question to explore, though this has not been done to date in the cases. At least one phrasing of the test for expropriation includes the substantial deprivation of an investor's reasonably-to-be-expected benefit from the property. Certain regulations designed to protect the public interest may arguably be "reasonably expected" and thus not compensable. For example, a manufacturer of chemicals in a highly regulated industry may not be able to argue that he reasonably expected to sell certain chemicals, especially in the light of the steps leading up to an environmental measure (i.e., research, consultations, etc.) In this way, the reasonable expectations portion of the expropriation test may provide a second line of defence after the requirement that a measure substantially deprive an investor. While we both agree this would be arguable, it has not been addressed as yet in any of the cases.

(d) The scope of the protected property rights set out in the cases.

The main issue to address in this section concerns the potential extension of protected property rights under Chapter 11. Easily recognizable as protected rights would be the right to remain in possession of a property in law, to be able to operate and manage it in fact, and not to be stripped directly or indirectly of beneficial interests, profits, etc. The question that arises is whether Chapter 11 has expanded these types of property rights. The issue is related to the expropriation/regulation debate because the broader the array of protected rights, the broader the array of measures that can be brought within the scope of Article 1110.

One issue in particular illustrates this point. Pope & Talbot found that access to market share, including though trade, was a protected right, noting in particular the key export component of its business.[29] This same issue is still under consideration on the damages phase of the S.D. Myers case.[30] This putative right would have a significant impact on the argument in S.D. Myers that an expropriation requires some form of transfer of benefit. If market share constitutes a protected asset, and market share is shifted directly or indirectly by a measure, a transfer of benefit would thereby be made out and this test in the S.D. Myers case satisfied. This would increase the risk of a regulatory measure being found to be an expropriation.

5. The Problem Isolated

Although the authors, beginning from very different perspectives, have come to agree on a great deal of the analysis presented above, important disagreements remain on the implication o the analysis.

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[29] *Pope & Talbot, supra,* paras. 96-98

[30] *S.D. Myers, supra*, Schwartz separate opinion, paras. 45-46

A key part of the problem is the way in which the authors view the implications of the current case law. One view is that there has only been one finding of expropriation since the advent of NAFTA. This, itself, shows that there is no real threat posed to *bona fide* regulation. All of the arguments against the expropriation provisions are based on hypotheticals, about what could happen if a Tribunal decided in such a way. This simply has not happened. The fact is that no tribunal will make a finding of an expropriation lightly- there will have to be a substantial deprivation for this to occur. Tribunals have stated that the diminishment of profits is not sufficient for there to be such a finding, it has to be a measure that, in effect, renders an operating business inoperable, what ever form that measure may take. This type of protection does not in any way threaten *bona fide* regulation enacted under the police power.

The second view is that while the cases to date are not conclusive, they do establish an early trend that supports the view clarification is needed. This view holds that the police powers rule is not sufficiently stated or implied in the existing case law. While further arguments can be made as a matter of international law (see final paragraph below), the existing trend does not give confidence that they the will carry the day. In particular, reliance on a substantial or significant interference test is not sufficient in a context when every environmental or human health regulation should have a substantial impact on a business to be worth adopting. More is therefore needed.

A large part of the context for this difference of view revolves around the concern for regulatory chill. We both accept that more work could be usefully done on researching the degree to which Chapter 11 may have created a regulatory chill at federal, provincial or state levels in Canada and across North America, and note that government officials have expressed this same point of view. The literature is, to date, largely anecdotally based. However, we differ on the extent to which regulatory chill has, in fact, impacted government operations to date. Thus, where one author believes that it has had a significant impact, the sense of need to provide greater certainty rises significantly as compared to when there is a view that there has been little chilling impact on governments in practice.

Finally, there is a question as to what extent the police powers rule will protect *bona fide* regulation. While we both believe that the police powers rule is incorporated into Article 1110 through the application of Article 1131(1) which provides that NAFTA Chapter 11 shall be governed by the rule of international law, we disagree on the applicable degree of certainty that Tribunals will find this to be so. Under the general principles of international law, *bona fide* regulatory measures should not constitute an expropriation or nationalization. It is also important to keep in mind that it is not possible to exclude wholesale any type of regulation from examination for expropriation. On these points we agree. We appear to disagree, however, on whether a measure taken under the guise of a police power can be an expropriation in circumstances where it can go "too" far in substantially depriving an investor. In short, is there a point where an otherwise valid use of the police power becomes expropriatory due to the degree of impact on an investor?

Table 1: Test of expropriation

Case	Para.	Test
Azinian	83	NAFTA not intended to protect against disappointments in business dealing with government entities
	87	Need a violation of Chapter 11 obligations, not just a contractual breach or a court decision against you
	90	Labels such as confiscatory may describe breaches, but they do not establish a sufficient analytical tool to determine what is a breach of contract and what is expropriation
	97-99	Where courts have been resorted to the claimant must also show that that the court decisions or process breached Chapter 11
S.D. Myers	280	Exprop. Includes more than just a transfer of ownership
	281	Regulatory measures do not normally amount to a expropriation, but one cannot rule out the possibility that in some cases they will
	281 285	When examining the issues, there is a need to examine both *the purpose and effect* of the measure in question.
	  282 285 286	Factors for assessing: Deprivation of ownership rights v. lesser interferences Expropriation is usually a lasting interference, but may not always be Look at substance, not just form "Tantamount to" is equivalent to creeping expropriation or indirect expropriation, but does not equate regulation to expropriation per
	287	Factors considered:

		-measures here only for a short time - Canada realized no benefit - no transfer of property or benefit directly to - an opportunity was delayed
Schwartz	207	Regulatory conduct not remotely the subject of legitimate complaints in most cases
	211	Factors for distinguishing expropriation and regulation: -Severe deprivations of ownership rights v. much lesser interference
	212	-does it enrich the state or a third party to whom property is given - an unfair deprivation v. an unjust enrichment -regulation tends to prevent the use of a property in a way that unjustly enriches the owner (pollution, eg.)
	219-222	Not expropriation here because: -temporary -no clear transfer of wealth
	222-223	Political reason not to find an expropriation violation here: not needed for final outcome of case this is the most inflammatory issue now, so should not do it unless needed "refrain from characterizing the export ban as an expropriation"
Pope and Talbot	96	"An interference with the investment's business activities **substantial enough** to be characterized as an expropriation" The test involves "the magnitude or severity of that effect"
	Fn 73	The distinction may rest on the degree of interference
	100-102	No nationalization or confiscation; no loss of ownership or control; lots of exports still being made and lots of profit from them

	102	exports still being made and lots of profit from them
	102	"The test is whether that interference is sufficiently restrictive to support a conclusion that the property has been "taken" from the owner." -substantial interference -factors; the owner will not be able to use, enjoy or dispose of the property -"Action that is confiscatory, or that prevent, unreasonably interferes with or unduly delays, effective enjoyment of an alien's property" (Quoting Harvard Draft on State responsibility?)
	102	Find: Degree of interference here does not rise to an expropriation
Metalclad	103	Includes not just outright seizure or formal transfer of title, …"But also covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, or the use or reasonably-to-be-expected economic benefit of property even if not necessarily to the obvious benefit of the host State."
	108	Must look at the effect of the totality of the circumstances, not just one act (creeping expropriation or indirect expropriation)
BC Court	31	Recognized this was the test that was applied by the Tribunal

Table 2: Police powers rule

Azinian	97-99	Some marginally relevant thoughts, but no ruling on police powers here Disagreement with an act is not enough Where courts have acted, need to show a denial of justice or a "pretence of form to achieve and internationally unjustified aim"
	120	no evidence or even a claim of any fundamental departure from Mexican law by the claimants
S.D. Myers	281	Regulatory measures do not normally amount to a expropriation, but one cannot rule out the possibility that in some cases they will
	162, 171, 194	Focus on protectionist intent of the measure
	195	Indirect environment objective of keeping strong Canadian industry could have been achieved by other, less restrictive means (subsidies, use of government procurement contracts)
Schwartz	207	Regulatory conduct not remotely the subject of legitimate complaints in most cases
	213	Regulation is something that owners ought to expect
	214	Must look at the context of Art. 1110 in whole of NAFTA as supportive of environmental protection and regulation Art. 1114 Preamble NAAEC as supporting agreement adopted at same time
	214	Article 1110 is not a generous invitation to impose liability for regulatory activity in the ordinary course of government business
		But it is Schwartz that expressly declines to provide an actual ruling on this question in the case because of the political impacts such a ruling might have
Pope and Talbot	96-99	Non-discriminatory regulations within the scope of the police powers are covered

	99	Tribunal rejects Canada's claim that non-discriminatory exercise of the police powers is beyond the reach of Chapter 11 • goes to far • regulations can be exercised in a way as to become creeping or indirect expropriations • therefore cannot have a blanket exception
Metalclad	111	The Tribunal need not decide or consider the motivation or intent of the adoption of the Ecological Decree"

Table 3: Types of Property Rights

Azinian		N/A
S.D. Myers	92-93	S.D. Myers Inc went into Canada to extend the useful life of its US based facility and investment had rejected establishing a Canadian facility due to declining markets
	193 243	In National treatment context, note theme prevalent across judgment: -the measure had prevented Myers from carrying on its planned business undertaking
	232	Say that it could be that market share in Canada constituted an investment, but do not rule on it (In Schwartz's opinion we see this issue has actually been delayed to the damages phase of the case.)
	284	Loss of a competitive advantage is not enough here
	286-287	Business opportunity delayed is not equal to a expropriation in this case
Schwartz	45-46	Lost market share issues being left for compensation phase
Pope and Talbot	96	Access to market share, including through trade is a protected property right - look at "the Investment's business activities"
	98	"the ability to sell lumber to the United States is not an abstraction, but a very important part of the business and asset base."
Metalclad	104-105	"Participating or acquiescing in the denial of the right to operate the landfill notwithstanding the fact that the project was fully approved and endorsed by the federal government which had exclusive authority over this decision."
		Is the property right the right to operate or the right to operate because it was granted by the federal authority?