IN BRIEF

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The North American Free Trade Agreement: Chapter 11

INTRODUCTION

One of the key worries within the environmental non-governmental organization (NGO) community is the perception that international agreements governing trade may conflict with, and may subsequently trump, international agreements governing the environment. A related problem is seen in the *North American Free Trade Agreement* (NAFTA), Chapter 11, where trade law is seen to trump not just international environmental agreements, but also a country's domestic ability to implement regulations, particularly in the areas of environment and health.(1) The following paper outlines NAFTA Chapter 11 and some of the controversy surrounding it.

CHAPTER 11

Chapter 11 of NAFTA was designed to protect the interests of foreign investors,(2) with the continuing goal of liberalizing international investment. This chapter establishes a mechanism for the settlement of investment disputes that attempts to achieve equal treatment of investors in accordance with the principles of international reciprocity and due process before an impartial tribunal.

A number of provisions in Chapter 11 have raised concerns, notably that:

1. Chapter 11 could undermine efforts to enact new laws and regulations in the public interest, in particular those that would protect the environment and human health.
2. Chapter 11 could require governments to pay compensation to polluters to stop polluting, even if the continuation of their activities would adversely affect public health and welfare.(3)

While the article that has attracted most attention is Article 1110, other obligations such as Article 1102: National Treatment, and Article 1103: Most-Favored-Nation Treatment, have also caused apprehension.(4)

ARTICLE 1110: EXPROPRIATION AND COMPENSATION

Article 1110 is the main source of critics' concerns that Chapter 11 is counter to the Rio Declaration "polluter pays" principle and may cause regulatory chill. It states:

> 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:
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> (a) for a public purpose;
> (b) on a non-discriminatory basis;
> (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.

The key issue regarding this article is what exactly "tantamount to expropriation" means. What constitutes the legitimate exercise of government, which may cause economic pressures for selected firms and/or sectors, as opposed to a situation warranting the payment of compensation?(5) If "tantamount to expropriation" is too broadly defined, then it may become difficult for governments to introduce regulation without being sued by companies who believe their ability to make a profit has been expropriated. A narrow definition, on the other hand, might allow greater leeway for governments to regulate, but create a disincentive for foreign

investment. Chapter 11 also sets out a dispute settlement mechanism in order to resolve such issues. The dispute settlement mechanism itself, however, has led to controversy.

THE DISPUTE SETTLEMENT MECHANISM

The process set out in Chapter 11 for settling investor-state disputes has come under considerable scrutiny from both supporters and critics of Chapter 11.

The process has been criticized for its lack of legitimacy, accountability and transparency. It allows only a very limited form of review; there is no opportunity for appeal; and there is little legal precedent for these cases.[6]

It has also been argued that the selection process for the three-person jury is flawed: the panellists are not drawn from a permanent list of arbitrators, meaning that there is no consistency; the choosing of jurors by each party can lead to bias; and it is difficult to avoid conflict of interest in jurors.

As part of Canada's efforts to achieve a more transparent investor-state dispute settlement process, the Department of Foreign Affairs and International Trade provides detailed information on NAFTA Chapter 11 cases and the dispute settlement process on the "Dispute Settlement" section of its web site at: http://www.dfait-maeci.gc.ca/tna-nac/nafta-e.asp.

REGULATORY CHILL

Critics worry that the expression "tantamount to expropriation" has been interpreted too broadly and that companies are now using the investor protection provisions not as protection but as an aggressive mechanism, either to prevent governments from introducing legislation, and/or to seek compensation for forgone future profits as well as any immediate losses. A similar issue was raised in the recent Romanow Report.[7] The report considers the possibility that, should private enterprise be encouraged in the health sector, future governments might have to compensate such enterprises if a decision were made, for the public good, to change regulations under which they were operating or to make such services public again.

There are also examples of proposed regulations, for one reason or another, having been dropped after threats of Chapter 11 suits. In December 2001, the Government of Canada proposed a regulation to "prohibit the display of 'light' and 'mild' descriptors on tobacco packaging." Phillip Morris International Inc. (representing several tobacco companies) submitted a document to the Government of Canada protesting the ban and citing Chapter 11.[8] If Canada had been required to compensate Phillip Morris under Chapter 11, the legislation might have been too expensive to apply. The proposed regulation was never fully developed. Plain packaging regulations for tobacco products were also sidelined, which some have attributed in part to the threat of a Chapter 11 suit.[9]

Supporters of Chapter 11, however, point to the fact that very few cases have been brought before the tribunal and that the amount of money involved is very small in comparison with the benefits of increased trade to the economy. This would seem to suggest that Chapter 11 might not have enough teeth to cause a regulatory chill.[10] On the other hand, it could be that regulations are simply not being brought forward for fear of a Chapter 11 suit.

CLARIFICATION

According to the Department of Foreign Affairs and International Trade,[11] Canada endorses the principle of investor protection in trade agreements; however, the government acknowledges that some clarification is required. As a result, Canada has been working with its NAFTA partners to clarify certain provisions, which would give future tribunals a better understanding of Chapter 11's obligations, as originally intended by the drafters. NAFTA contains mechanisms to allow for this type of clarification, or codification, without re-opening the Agreement.

CONCLUSION

Chapter 11 of NAFTA has, for some, become the focus of a campaign against globalization, which they believe emphasizes trade rules over environmental agreements. They are concerned that Chapter 11 will create a regulatory chill, in that governments will be reluctant to introduce regulation in the public interest because of the potential expense of compensation.

Governments have acknowledged unease regarding the lack of clarity of Chapter 11 obligations; however, they generally still support the investor protection provisions of NAFTA. Supporters of these provisions believe that it is too early in the process to decide

whether there is a problem, and they point to the economic benefits of free trade, which they claim have been substantial in comparison with the costs of Chapter 11 suits.

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(1) See for instance the Canadian Centre for Policy Alternatives, http://www.policyalternatives.ca/publications/trade.html.

(2) A foreign investor is defined as any person or company who makes an investment into another NAFTA Party. Investments, in the NAFTA context, are defined as all types of financial investments, shareholding, secured debts and traditional foreign direct investment. See International Institute for Sustainable Development (IISD) and World Wildlife Fund, *Private Rights, Public Problems: a guide to NAFTA's controversial chapter on investor rights*, IISD, Winnipeg, 2001, http://www.iisd.org/publications/publication.asp?pno=270. The "investment" definition is considered broad by those opposed to Chapter 11.

(3) *Ibid*.

(4) *Ibid*.

(5) A. Cosbey, "NAFTA's Chapter 11 and the Environment: A Briefing Paper for the CEC's Joint Public Advisory Committee," June 2002, http://www.cec.org/files/PDF/JPAC/JPACCh11paper02-E-rev1_en.pdf.

(6) *Ibid*.

(7) Commission on the Future of Health Care in Canada (Roy J. Romanow, Commissioner), *Building on Values: The Future of Health Care in Canada*, November 2002, http://www.hc-sc.gc.ca/english/pdf/care/romanow_e.pdf.

(8) Phillip Morris International, "Phillip Morris Submission to Canada on NAFTA's Chapter 11 Provision," 18 June 2002, http://www.tobacco.org/Documents/0203pmnafta.html.

(9) Bill Moyers, "Trading Democracy," transcript, *NOW with Bill Moyers*, 2 January 2002, http://www.pbs.org/now/transcript/transcript_tdfull.html.

(10) M. Hart and W. Dymond, "NAFTA Chapter 11: Precedents, Principles and Prospects," 2002, http://www.carleton.ca/ctpl/ch11papers/hartdymond.htm. See also Department of Foreign Affairs and International Trade, "NAFTA Chapter on Investment (Chapter 11) – Clarification Initiative," *Government of Canada Investment Policy Bulletin Issue 1,* September 2001, http://strategis.ic.gc.ca/SSG/ii00027e.html#nafta.

(11) This paragraph is based on Department of Foreign Affairs and International Trade, "NAFTA Chapter on Investment (Chapter 11) – Clarification Initiative" (September 2001).