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Note on NAFTA Commission's July 31, 2001, Initiative to Clarify Chapter 11 Investment Provisions

On July 31 2001, the Trade Ministers of Canada, the United States and Mexico (the North American Free Trade Commission) announced that they had agreed to the interpretation of certain provisions of Chapter 11, the controversial investment chapter of the North American Free Trade Agreement (NAFTA). Based on the International Institute for Sustainable Development's extensive analysis of Chapter 11's environmental implications to date, this note addresses what the Commission's statement says, what it means and what remains to be done. The Commission's statement is available at www.dfait-maeci.gc.ca/tna-nac/NAFTA-Interpr-e.asp.

What does the statement say about transparency?

The statement says that there is nothing in the NAFTA rules (with limited exceptions) that restricts Parties from releasing, or that compels them to keep confidential, any documents submitted to or issued by a Chapter 11 Tribunal. It further says that there is nothing in the rules of arbitration (Chapter 11 disputes are heard under either of two existing international sets of rules: ICSID or UNCITRAL) that imposes such restrictions either, other than certain, very limited specific exceptions. Finally, it pledges that the Parties to a Chapter 11 dispute will "make available to the public in a timely manner all documents submitted to, or issued by, a Chapter Eleven tribunal." This pledge is subject to three possible exceptions, one of which is vitally important: except for "information which the Party must withhold pursuant to the relevant arbitral rules, as applied." The implications of this exception are discussed below.

What does this mean?

The first two statements are simply legal facts. There is indeed nothing in the NAFTA or the arbitral rules that imposes a general confidentiality of documents (beyond the limited exceptions referred to). But they are important statements nonetheless, since they shift the focus to the appropriate place—the additional rules of procedure, such as confidentiality orders, that each Tribunal establishes for the proceedings at the outset. It

is within these rules, agreed to in each case by the disputing Parties, that every Tribunal to date has established high levels of secrecy.

The third statement is not a fact, but a positive commitment. It obliges the Parties to make all the case documents available in a timely manner. This level of access, to put it in context, is beyond even what the Methanex Tribunal had agreed to grant IISD in the event that it is successful in its petition to intervene in that case as a friend of the court.

But the exception noted above is critical. In effect, it makes the statement that Parties will release all documents submitted to and issued by the Tribunal, unless the arbitral rules established by the Tribunal prohibit such an action. Given that all tribunals to date have established strong rules of secrecy, does this mean that the statement is completely empty?

Not necessarily. We will have to wait to see how this statement interacts with the confidentiality orders issued by the Tribunals. Clearly, the intent of the Ministers is to impose openness on the proceedings, but their statement does not specifically direct Tribunals to adopt open procedures in future (their legal power to do so is unclear in any case). They would be subject to embarrassing criticism if their much-trumpeted statement had no impact on transparency in the end. Consequently, the statement will also impose a duty on government lawyers acting in these cases to support open access to the documents, something that has not always been the case to date. At a minimum, the statement will precipitate debate among the Parties about the drafting of confidentiality orders where previously, secrecy was assumed.

What does the statement say about Article 1105?

Article 1105 says that the NAFTA Parties should treat investors of other Parties “in accordance with international law, including fair and equitable treatment ...” The statement clarifies an important issue. It states that the obligation for a “minimum standard of treatment” is no more onerous than that granted under customary international law. It further says that a breach of some other NAFTA provision, or of the provisions of some other international agreement, do not necessarily constitute a breach of Article 1105. The three Ministers have the power to issue such interpretations of NAFTA provisions that are then binding on all future Chapter 11 Tribunals—and arguably on existing ones—by virtue of Article 1131 (2).

What does this mean?

With this interpretation, Article 1105’s key problem seems to have been repaired. In several Chapter 11 cases the argument has been made that because a government breached rules in other parts of NAFTA, or even in non-NAFTA law such as the WTO’s Technical Barriers to Trade Agreement, it has automatically breached its obligations on minimum standards of treatment. This broad interpretation of minimum standards of treatment—essentially giving firms the right to litigate any international law obligation—has not been seen outside of the NAFTA context.

The statement puts an end to this. It brings us back to an interpretation of minimum standards of treatment that corresponds to customary international law, which has generally reflected basic rights of fairness and due process. The possibility still remains that individual rulings on this provision will be troubling, but the direction set out here seems clear and should be welcomed.

Of specific interest to the provinces:

The statement includes a specific recognition of the ability of the NAFTA Parties to communicate freely with states and provinces about all ongoing Chapter 11 litigation. This has been an issue of contention in at least two Canadian Chapter 11 cases, where Canada had to seek special permission to allow distribution to all provinces of documents covered by a confidentiality order. This permission was granted in one case and denied in another. The uncertainty should now be resolved, ensuring full access by the provinces to all litigation material during the course of the litigation. This provides a special window for the provinces to monitor the development of Canadian positions in these cases, and ensure they are appropriate for their own regulatory circumstances.

What still remains to be done?

ISD's public criticisms of Chapter 11 cover the process of arbitration as well as the substance of the provisions as interpreted to date. While the statement is a welcome advance in meeting our concerns, much work remains to be done in both areas.

On substance, the statement covered only one of the four problematic Chapter 11 provisions, and not even the foremost among them. The three left to address are:

1. *Article 1110: Expropriation.* In a number of Chapter 11 cases it has been argued successfully that a regulation can be considered tantamount to expropriation, even if it is non-discriminatory and undertaken for a valid public purpose. Again the Chapter 11 Tribunals have broken new ground here, ignoring the traditional exemptions for so-called "police powers"—the rights of governments to regulate in the broad public interest. The final effect is to make governments liable for any significant damages caused to investors by their regulations, an imposition of the "takings" doctrine that is sure to chill new environmental lawmaking. The NAFTA Ministers need to state clearly that non-discriminatory laws serving broad public interests such as environment and public health should enjoy the police powers exemption from Article 1110 obligations.

2. *Article 1106: Performance Requirements.* This obligation normally prevents governments from requiring investors to fulfill certain economic requirements as a condition of entry and operation. These include requirements to purchase local inputs, to export a certain percentage of output, to transfer proprietary technologies and so on. But at least one firm has argued under Chapter 11 that an import or export ban can in fact constitute a performance requirement, specifically, the requirement to source the banned product locally or use only domestic services for further treatment or development of a

product. While there was no ruling on this argument, this provision risks becoming another wide open back door for firms to litigate trade-related obligations in an investment agreement. The Ministers should issue an interpretation to avoid this potentially troubling potential development.

3. *Article 1102: National Treatment.* This provision obliges the NAFTA Parties to treat investors from other Parties no worse than they treat domestic ones “in like circumstances.” The Ministers need to define “like circumstances” and to specify what types of operations will be compared to determine “no worse” treatment. On the latter point there has already been a ruling whose standard was set by comparing quite different operations. On the former point, consider four factories on a stream whose emissions are regulated such that the stream is at capacity for receiving pollution. If the government denied a foreign investor permission to set up a fifth such operation in the same place, would that violate national treatment? The firm would in fact be receiving treatment worse than that accorded the existing firms. This obligation is more complex for investment than it is for trade in goods.

On process, the success of the statement will depend on whether it is reflected in future orders of the arbitral Tribunals. However, even if we assume the best possible result for the statement, there still remain areas for improvement. The statement addresses only the issue of public access to documents after the arbitration is commenced. There is a need to ensure access to documents created before the arbitration even begins, in particular the notices of intent to arbitrate. As well, there is a need to actually override the rules of arbitration that prevent public access to hearings. There is also a need for fair and systematic rules for allowing *amicus curiae* (friend of the court) participation in hearings. Finally, the exceptions to transparency remaining in the process after the statement should be narrowed to just those exceptions allowable in a domestic court setting: national security, serious invasion of privacy and so on.

Conclusion

The statement is important in that it addresses areas of Chapter 11 that sorely need fixing. But it may be too early to break open the champagne for at least two reasons. First, it is far from clear how successful the statement will eventually be in opening up the process of arbitration. This we will only discover over time. Second, the statement only addresses a small subset of the problems with Chapter 11 leaving untouched, for example, the explosive question of what constitutes expropriation.

The Canadian government press release accompanying the statement notes that “The Ministers... directed trade experts to continue their work examining the implementation and operation of Chapter 11, including developing recommendations as appropriate.” To those familiar with the protracted and inconclusive battles in the U.S. administration over what to do with Chapter 11, and with the years of Mexican rejection of the mere idea that there might be a problem, this note is as remarkable as the statement itself. It is undoubtedly a testimony to the strength of public concern. The statement and the agreement to further review the outstanding issues provide, for the first time, a common

recognition by the three NAFTA Parties that Chapter 11 is substantively and procedurally flawed from the legal and policy perspectives, throwing open the debate on what any provisions on investment in the Free Trade Area of the Americas might, or indeed should, look like.

A great deal of the credit for the statement should go to Canada's Minister of Trade Pierre Pettigrew, who has long expressed concerns about the workings of Chapter 11, and whose efforts were key in securing this agreement. While much remains to be done to make Chapter 11 compatible with the objective of effective domestic environmental management, at least we can begin to see the outlines of the road from here to there.

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