Hastings International and Comparative Law Review

Volume 23
Number 3 *Spring/Summer 2000*

Article 7

1-1-2000

Investment, Environment and Dispute Settlement: Arbitration under NAFTA Chapter Eleven

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Let me begin by thanking the symposium organizers and Professor Dodge for having me. I very much appreciate your invitation, and not just because you have saved me from shoveling the snow from my back lane again. As I leafed through recent issues of the *Hastings International and Comparative Law Review*, I noted that a former Canadian Prime Minister, Kim Campbell, spoke at a symposium here in recent years. I am honored to be in her company, so to speak, though I would have cut my wrists with a rusty razor before voting for her or her party.

Canadians always encourage each other to visit the United States and speak to Americans. Perhaps it is because, as one of my colleagues put it to me: "your visit will, at least temporarily, raise the IQ levels of both countries."[2] She forgets that I will soon do her annual performance appraisal.

International trade dispute settlement has been of continuing interest to Canadians and Americans as long as our countries have existed. Over a hundred years ago, and before he made the mistake of visiting Buffalo, New York (a mistake Toronto fans of the NFL make with surprising regularity), President McKinley heard another Canadian Prime Minister, Wilfrid Laurier, observe that "international problems can be settled in one of two ways only: either by arbitration

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2. With apologies to former New Zealand Prime Minister Robert Muldoon.

or by war."[3]

Fortunately, the negotiators of NAFTA Chapter 11 chose the former option for investor-state disputes, although I know from personal experience that the arbitrations are bellicose and fought with no quarter. This is one of the features that distinguish investor-state dispute settlement from NAFTA Chapter 20 state to state dispute settlement. As an aside, this is a feature of Chapter 11 arbitrations that the negotiators did not anticipate and did not in my view make adequate provision for by a properly articulated set of procedural rules. In their absence, at times one yearns for other forms of dispute settlement, such as the medieval "trial by ordeal" or "trial by individual combat."

Canada's early experience with Chapter 11 has been in two cases involving what have been described as "environmental measures." Because of the political sensitivity in my country of anything labeled an environmental matter and any government intervention even ostensibly for environmental goals, these cases have received particular attention. A brief examination of each discloses a wealth of interesting issues, unsettled questions, and creative interpretations. But whether they really amount to a specific threat to environmental law and policy-making is not certain, at least to me.[4] I do acknowledge that public servants in all areas are watching developments with interest. But public policy inertia (perhaps I am redundant) is not caused by Chapter 11.[5] As Francis Cornford observed over ninety years ago, "Every public action, which is not customary, either is wrong, or, if it is right, is a dangerous precedent. It follows that nothing should ever be done for the first time."[6]

The two Canadian cases I will discuss bear remarkable similarity (although this may be because the same counsel acted for the claimants in each case). Three substantive Chapter 11 obligations were alleged to have been breached in each case: national treatment (NAFTA Article 1102); performance requirements (NAFTA Article

3. Sir Wilfrid Laurier, Canada, England and the United States (speech in Chicago, Oct. 9, 1899) *in* THE WORLD'S GREATEST SPEECHES 382-83 (Copeland et al. eds., 4th ed. 1999).

4. *But see* J. Martin Wagner, *International Investment, Expropriation and Environmental Protection*, 29 GOLDEN GATE U. L. REV. 465 (1999).

5. As Carlos Garcia Fernandez of SECOFI reminded us earlier this afternoon, for the NAFTA Parties, foreign investment disputes are exceptional while successful foreign direct investment is by far the rule.

6. Francis Corford, *in* MICROCOSMOGRAPHIA ACADEMICA (1908), *reprinted in* OXFORD QUICK REFERENCE QUOTATIONS 82 (1st ed. 1999).

1106); and expropriation (NAFTA Article 1110). (Breach of minimum standard of treatment (NAFTA Article 1105) was also alleged in the second case.) In both cases, the good faith of the law-makers was challenged. In both cases, the claim for damages was not limited to damages the claimant alleged it had suffered in Canada, the territory in which an "investment" gave rise to claims; in both cases, the claimant asserted damages that it had suffered outside of Canada.[7]

The first of these two cases was brought by Ethyl Corporation. Based in Virginia, Ethyl manufactured MMT (methylcyclo-pentadienyl manganese tricarbonyl), a fuel additive designed to increase the octane level in unleaded gasoline. Ethyl's wholly-owned Canadian subsidiary, Ethyl Canada, imported concentrated MMT into Canada, processed it and distributed it across Canada to gasoline refineries. In 1993, automobile manufacturers began complaining that MMT was damaging emission control monitoring systems in new cars. There has never been conclusive proof of this. Nevertheless, in 1996, the federal parliament passed a law effectively prohibiting the import of MMT into Canada and the interprovincial trade in MMT within Canada. Ethyl brought a Chapter 11 complaint.

The second case was brought by S.D. Myers, Inc. It operates a PCB waste treatment and recycling facility in Tallmadge, Ohio. After over five years of seeking to open the U.S. border to imports of Canadian PCB wastes, it managed to secure from the EPA an "enforcement discretion" enabling it to import, notwithstanding the then fifteen-year ban on imports imposed by the Toxic Substances Control Act (TSCA).[8] The enforcement discretion was also granted to any other American company meeting the same conditions S.D.

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7. The S.D. Myers case also raises a fundamental issue about what qualifies as an "investment." Briefly, Canada's position is that S.D. Myers did not have one in Canada, was merely seeking to provide cross-border services, and, therefore, has no legal basis for its Chapter 11 claim. The tribunal's decision on this point may be the most significant for future cases.

[*Editor's Note:* On November 13, 2000, as this issue was going to press, the tribunal issued its award on liability. It found in favor of S.D. Myers, Inc. In a complex ruling (including a lengthy minority opinion), the full tribunal held that Canada had violated NAFTA Article 1102 (national treatment) but not Article 1110 (expropriation). Split 2-1, the tribunal also held that Canada had violated Article 1105 (minimum standard of treatment). On a different 2-1 split, the tribunal rejected the claim that Canada had violated Article 1106 (performance requirements). The matter will now proceed to an assessment of damages. A case comment on the award is likely to appear in a future issue of the *Hastings International and Comparative Law Review*.]

8. 15 U.S.C. §§ 2601-2692 (1994).

Myers met, and about ten did. Canada was never consulted by the EPA on this abrupt reversal of long-standing policy. S.D. Myers did not advise the government of Canada that it was seeking an enforcement discretion, although it was quite active in Canada seeking Canadian customers for its treatment and recycling services in Ohio. It alleges it did so in part through a Canadian "affiliate," S.D. Myers (Canada).

Canada reacted by closing its border to exports of PCB wastes. The measure was an "interim order" under the Canadian Environmental Protection Act.[9] The purpose of the measure was for Canada to evaluate an open border for PCB waste exports to the United States and to ensure a seamless regulatory regime between the two countries. Less than fifteen months later, the interim order was replaced by a regulation permitting exports under carefully prescribed conditions.[10]

In October 1998, just before the three-year limitation period for Chapter 11 claims expired,[11] S.D. Myers brought a Chapter 11 complaint against Canada. Ironically, the U.S. border was closed five months later, after a decision of the United States Court of Appeals for the Ninth Circuit.[12] In the meantime, S.D. Myers had received seven shipments of Canadian PCB wastes at its Ohio facility.

Ethyl's complaint was settled prior to any consideration of the merits.[13] The hearing of the merits of the S.D. Myers complaint took place the week of February 14, 2000. Judgment was reserved.

In each of these cases, the complaint alleged breach of national treatment (Article 1102). This obligation is comparative: a NAFTA Party must accord a foreign investor treatment that "is no less favorable" than that accorded to domestic investors who are "in like circumstances." One important issue is the following: if a measure is not discriminatory on its face, can a claim be made for de facto

9. PCB Waste Export Interim Order, P.C. 1995-2013, *replaced by* Regulations Amending the PCB Waste Export Regulations, SOR/97-108 (Feb. 4, 1997), C. Gaz., pt. II, vol. 131, no. 4, at 161 (Dec. 2, 1997) (made pursuant to R.S.C. 1985, c. 16 (4th Supp.)).

10. PCB Waste Export Regulations (1997), C. Gaz., pt. II, vol. 131, no. 4, at 163 (Dec. 2, 1997).

11. North American Free Trade Agreement, Dec. 8, 17, 1992, Ch. 11, Arts. 1116(2), 1117(2), 32 I.L.M. 605, 642-43 (1993).

12. *See* Sierra Club v. EPA, 118 F.3d 1324, 1327 (9th Cir. 1997).

13. After a recommendation of a dispute settlement panel under Canada's Agreement on Internal Trade. Three provinces successfully challenged the same federal measure challenged by Ethyl. Panel Award, on file with author.

discrimination? It certainly was by S.D. Myers. But what if the foreign investor is the only actor in a particular sector? Ethyl was the only producer of MMT. Ethyl Canada was the only importer, processor, and distributor in Canada. MMT was a singular product. If there are no domestic investors with which to compare a foreign investor, how can the foreign investor receive "less favorable treatment" than, let alone be "in like circumstances" with, domestic investors?

S.D. Myers' alleged Canadian competitors, companies named Chem-Security and Cintec, treated and disposed of PCB waste *in Canada.* But neither S.D. Myers nor its alleged Canadian affiliate did. Chem-Security and Cintec never sought to arrange for transboundary shipments of PCB wastes. That is what S.D. Myers was doing from its facility in Ohio. S.D. Myers was an American company asking for protection from a Canadian measure for its operations and activities *in the United States.* Canada's position was that this is clearly not the object or purpose of the Investment Chapter in the NAFTA.

In both of these cases, the complaint alleged breach of performance requirements (Article 1106). The NAFTA lists all prohibited performance requirements; neither import bans (complained about by Ethyl) nor export bans (complained about by S.D. Myers) are listed as prohibited performance requirements. Canada's position was that for Article 1106 to apply, the performance requirement must be directly connected to the investment. Did the interim order impose a requirement on S.D. Myers Canada or S.D. Myers, Inc. (which never themselves owned any Canadian PCB wastes) to buy Canadian goods or services or to achieve a certain level of Canadian content?

In essence, S.D. Myers claimed for the effects of alleged performance requirements on the investments of *other* "investors," those who actually owned Canadian PCB wastes. Nothing in the NAFTA authorizes a foreign investor to claim and secure damages for the alleged imposition of performance requirements on others, including that foreign investor's putative and potential Canadian customers.

Canada also took the position that if the impugned measure might be a prohibited performance requirement, it was saved by the provisions of Article 1106(6)(b) and (c) resembling the GATT Article XX exceptions for measures "necessary to protect human, animal or plant life or health," and measures "necessary for the conservation of

living or non-living exhaustible natural resources."

In both of these cases, the complaint alleged expropriation of its "investment" in Canada (Article 1110). In the Ethyl case, Canada argued in its statement of defence that there had been no expropriation because Canada was exercising a legitimate regulatory or "police" power recognized by international law. The legislation in question was enacted for the maintenance of health, for the conservation of clean air, and for the protection of the environment. Canada also argued that the legislation was shielded by Article 1114(1), which provides that no provisions of Chapter 11 shall be construed to prevent a NAFTA Party from making measures it considers appropriate to ensure that investment activity in its territory is undertaken in a manner sensitive to environmental concerns—so long as the measure is "otherwise consistent" with Chapter 11. I believe that the greatest shame in the premature end of the Ethyl proceeding was that the tribunal was not given the chance to opine on the meaning and application of this difficult-to-understand provision. My own hopes and fears about Article 1114 call to mind the reply of Niels Bohr, the great Danish physicist, when asked whether he really believed a horseshoe hanging over a door would bring him luck. He replied, "Of course not, but I am told it works even if you don't believe it."[14]

In the S.D. Myers case, the allegation of expropriation was treated differently. First of all was the fact that S.D. Myers (Canada) continued to operate after the alleged date of expropriation. Indeed, that activity must have continued because S.D. Myers received seven shipments of Canadian PCB wastes after the impugned measure was issued. The second point was legal: under international law, can a temporary measure be expropriative? Even the jurisprudence of the Iran-United States Claim Tribunal, a body born from a violent revolution and having the authority to compensate for both "expropriation" and diminution in value, seems to suggest that temporary measures will hardly ever trigger compensation.

The third interesting point is that this was an explicit claim for compensation for a measure "tantamount to" expropriation.[15] In an

14. Niels Bohr, *in* A. Pais, INWARD BOUND (1986), *reprinted in* OXFORD QUICK REFERENCE QUOTATIONS, *supra* note 6, at 31.

15. In the Ethyl case, the claim appears couched in the statement of claim as one of "direct" expropriation, although the original Article 1119 notice of intent alleged "substantial interference with Ethyl Corporation's control and enjoyment of its investment in Ethyl Canada" and claimed that "this interference is a measure

Article 1128 submission on a Question of Interpretation filed in the *Metalclad* Chapter 11 case,[16] the United States argued that "tantamount to" expropriation did not expand the established international law content of "expropriation." Rather, for great certainty, the phrase was a drafting convention used to ensure capture of all means of "indirect" expropriation. Mexico explicitly agreed with this interpretative approach. This approach supported Canada's basic position. It remains to be seen whether the tribunal in S.D. Myers will accept this tri-lateral position, or whether the NAFTA Parties will have to enshrine it in an Article 1131(2) binding interpretation.

Canada's position also included reliance on its sovereign powers under international law to regulate in the public interest, sometimes called "police powers." The sudden opening of the U.S. border by means of enforcement discretion triggered the Canadian measure. Canada believed PCBs are a significant danger to the health and the environment when exported without appropriate assurances of safe transportation and destruction, or contrary to Canada's international obligations. In particular, Canada believed that the measure was consistent with its obligations under the Basel Convention on the Control of Transboundary Movements of Hazardous Wastes and Their Disposal.[17]

The impugned measure also enabled Canada to ensure PCB waste was covered under the 1986 Agreement of the Government of Canada and the Government of the United States of America Concerning the Transboundary Movement of Hazardous Waste.[18] If states that are not all parties desire to permit trade in PCB wastes, the Basel Convention requires a bilateral agreement to permit their transboundary movement. PCB wastes were not covered by the Canada-U.S. Agreement at the time it was executed. It was not until three months after the EPA granted the first enforcement discretion that Canada received notification by diplomatic note that the United

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tantamount to the expropriation of Ethyl Canada."

16. Submission of the Government of the United States of America, at 2-9, Metalclad Corp. v. United Mexican States, ICSID, No. ARB(AF)/97/1 (1999) (on file with author).

17. *See generally* Basel Convention on the Control of Transboundary Movements of Hazardous Waste and their Disposal, Mar. 22, 1989, U.N. Doc. UNEP/IG.80/3, 28 I.L.M. (1989) (adopted 1989, in force May 5, 1992, ratified by Canada Aug. 29, 1992, in force for Canada Nov. 26, 1992).

18. Oct. 26, 1986.

States took the position that the Canada-U.S. Agreement covered PCBs. Until then, any exports of PCB wastes to the U.S. could have contravened the Basel Convention.

Let me point out here that Canada's reliance on the Basel Convention was not based on NAFTA Article 104(c). It provides that the obligations of the Basel Convention should prevail to the extent of any inconsistency with the NAFTA—but only on its entry into force for Canada, Mexico and the United States. While a signatory, the United States has not ratified the Basel Convention. As a result, it appears difficult to argue the Article 104(c) override.

In the S.D. Myers case, the complaint also alleged breach of the minimum standard of treatment by Canada (Article 1105). There were two central allegations: (1) the measure was made in bad faith; and (2) Canada failed to meet its legal duty to consult with S.D. Myers or Myers Canada according to its Regulatory Policy.[19] The former is largely a question of fact, but one of those argued by Canada to be relevant was that meeting its Basel Convention obligations was one of the reasons for Canada's action. On the latter, the main legal question was, Did that regulatory policy provision modify the legal requirements of the Canadian Environmental Protection Act? From a factual point of view, how could Canada be expected to consult with S.D. Myers (Canada), a company Canada did not know about? Why should it have consulted with American companies granted enforcement discretions when they were not Canadian PCB owners, or PCB "exporters" for the purposes of Canadian law?

Even if there were mistakes in the making of the impugned measure, how did they amount to the egregious sort of denial of justice or other error that violates any known international law standard? In international law, it is presumed that a government measure is valid and complies with its own laws. In the *Desona* Chapter 11 award, the tribunal dismissed the claim for breach of "minimum standard of treatment" with instructive analysis of the sort of *serious* misconduct that might constitute a breach of NAFTA Article 1105.[20] The tribunal suggested as examples refusal by the domestic courts to entertain a suit; undue delay; administering justice

19. Issued by Regulatory Affairs Division, Program Branch, Treasury Board Secretariat, Nov. 9, 1995.

20. *See* Azinian v. United Mexican States, ICSID, No. ARB(AF)/97/2 (1999), *in* 14 ICSID REV. 538, 568 (1999).

in a seriously inadequate way; clear and malicious misapplication of domestic law; lack of good faith on the part of the domestic courts; and judicial findings on evidence so insubstantial, or so bereft of a basis in law, so as to be arbitrary or malicious. The tribunal stated at paragraph 83:

> To put it another way, a foreign investor entitled in principle to protection under NAFTA may enter into contractual relations with a public authority, and may suffer a breach by that authority, and *still not be in a position to state a claim under NAFTA*. It is a fact of life everywhere that individuals may be disappointed in their dealings with public authorities, and disappointed yet again when national courts reject their complaints. It may safely be assumed that many *Mexican* parties can be found who had business dealings with governmental entities which were not to their satisfaction; Mexico is unlikely to be different from other countries in this respect. NAFTA was not intended to provide foreign investors with blanket protection from this kind of disappointment, and nothing in its terms so provides.[21]

Where does all this leave us? Will Chapter 11 prove to be of overarching concern to environmental regulators? On the one hand, the development of Chapter 11 jurisprudence is likely to be difficult, and this is bound to muddy the waters before it clarifies them. Chris Thomas of Vancouver, who has acted for Mexico on all of its Chapter 11 cases, advances a number of reasons why Chapter 11 interpretation will not come easily. First, the composition of Chapter 11 tribunals will have an impact on the awards. There has not been a great deal of cross-fertilization between the largely separate worlds of GATT/WTO trade law, private international commercial arbitration, and international investment dispute settlement under bilateral investment treaties (BITs) and the ICSID. Thus, in some cases the arbitrators will be presented with treaty concepts and legal issues for the first time.

Second, NAFTA's text is complex. It is derivative of the GATT and bilateral investment treaty practice. The express incorporation of certain GATT rules and agreements expected to result from the then-ongoing Uruguay Round of Multilateral Trade Negotiations, the relationship to other international treaties such as the Basel Convention, the extensive use of reservations in order to grandfather existing measures that would otherwise be inconsistent with its

21. *Id.* at 562.

obligations, among other things, make the Agreement challenging to interpret. To a trade lawyer familiar with the GATT and WTO Agreements, it can be navigated (although not necessarily with ease). It may be more difficult to understand for the arbitrator who comes to a dispute without much experience in the field.

Third, unlike the ordinary bilateral investment treaty, Chapter 11 falls within a much broader agreement containing extensive disciplines on trade in goods and services. The interaction between Chapter 11 and the other chapters of the Agreement will require careful analysis by tribunals. For example, tribunals will be confronted with the task of analyzing the interaction between cross-border trade in services (under Article 1213) and investment (as defined in Article 1139). The Parties differentiated between the two. Whether tribunals will give effect to the distinctions drawn in the architecture of the NAFTA remains to be seen.[22]

But is this really of *greater* concern to environmental regulators than to their colleagues in other fields of government authority and action? I think not. It is worth even questioning the premise that the early Chapter 11 cases really have much to do with environmental law and policy in the first place: Are the Ethyl and S.D. Myers cases really "environmental" cases at all? The Ethyl case might be more accurately seen as an internecine fight of big business, pitting the oil industry against the automotive industry. The S.D. Myers case dealt with an export ban of a good, PCB wastes, which happens to be regulated as a hazardous waste, but is a "good" with economic value nonetheless—a good that is arguably subject to the trade in goods or cross-border services chapters of the NAFTA (Chapters 3 and 12, respectively), and not the investment chapter at all. It has certainly been S.D. Myers' position all along that the impugned measure had little to do with the environment and lots to do with protecting Canadian industry and Canadian jobs.

Moreover, I note that the newest Chapter 11 claims against the three NAFTA Parties appear to have little to do with environmental matters. For Canada, the most recent case alleges monopolistic behavior by Canada Post (a federal Crown corporation) in the provision of courier services, abetted by allegedly favorable treatment by the Canada Customs and Revenue Agency, the federal customs

22. Joseph de Pencier, *Investor-State Arbitration Under NAFTA Chapter 11*, at 2-3 (draft of paper delivered before Canadian Bar Association, Toronto, Can., Mar. 6, 2000).

and taxation authority. For the United States, a Canadian property developer has complained about its treatment at the hands of a municipal property regulator and the state courts. For Mexico, the last two cases of which I am aware deal with excise taxes on cigarettes and the treatment of debt-holders of a domestic bank's paper by federal authorities.

So I would urge caution in drawing conclusions about Chapter 11 and environmental matters quite yet. As Sir Francis Drake said, "There must be a beginning of any great matter, but the continuing unto the end until it be thoroughly finished yields the true glory."[23]

23. Sir Francis Drake, Dispatch to Sir Francis Wilsingham (May 17, 1587), *in* OXFORD QUICK REFERENCE QUOTATIONS, *supra* note 6, at 2.

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