# Advice on the application and implications of the North American Free Trade Agreement (NAFTA) to the proposed Whites Point Quarry and Marine Terminal Project

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1. Statement of Work

I have been asked to write a Report advising the Joint Review Panel, established by the federal Minister of the Environment and the Nova Scotia Minister of the Environment and Labour, on the implications that the North American Free Trade Agreement (NAFTA) may have on the management of the Project's environmental effects. Specifically, this Report is to include an overview and analysis of the application of the NAFTA to the Whites Point Quarry, a discussion of the outstanding questions and issues pertaining to the effect of the NAFTA on the Quarry, and a review of the requirements or means by which such questions and issues might be addressed. Again, the purpose is to assess the implications of NAFTA for the proposed Quarry.

2. NAFTA: An Overview

a. Purpose of NAFTA. NAFTA is an international treaty established between Canada, Mexico and the United States in the early 1990s, at a time when all three Parties were exploring means to liberalize and expand their economies to their trading partners. The general purposes of the NAFTA, as with most treaties, can be found in the Preamble to the treaty, and in the case of the NAFTA this includes both economic and non-economic values. Examples of economic values would be "to create an expanded and secure market" for countries' goods and services, to



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"promote sustainable development", to "create new employment opportunities and improved working and living standards", and to "ensure a predictable commercial framework for business planning and investment." These general purposes were followed up with objectives stated in Chapter One of the Agreement, which included: eliminate barriers to trade, promote conditions of fair competition, protect intellectual property rights, increase investment opportunities, and create effective procedures to implement the Agreement. These general purpose provisions in NAFTA will be referred to again later in this Report in the discussion of public sector inputs to the environmental assessment process..

In addition to the general purposes of NAFTA, the Agreement has specific purposes dealing with investment that are particularly important in assessing the impact of NAFTA on the Whites Point Quarry. In the language referred to above, one can see the NAFTA sought to promote increased investment opportunities especially through the creation of a predictable commercial framework for business planning and investment. The Whites Point Quarry specifically raises the issue of foreign investment in Canada from the United States (a NAFTA Party), hence the investment rules of the Agreement will be of central importance in this Report.

The reason why Canada might accept to include investment in an Agreement that dealt mainly with trade can be seen in economic data on the Canadian economy. Foreign direct investment (FDI) accounts for about 30 per cent of Canadian employment and approximately 75 per cent of its manufacturing exports. The United States is Canada's largest source of investment into Canada, and more than 50 per cent of Canada's outgoing foreign investment goes to that country. Foreign investment is a critical component in foreign trade, and without the capacity to invest abroad Canada's exporters would find their capacity to trade compromised.

The upshot is that trade and investment are of major importance to the Canadian economy, which has encouraged successive Canadian governments to promote these activities through international agreements.

b. Effects of NAFTA. Overall, the language of NAFTA has sought to create a more open and less restrictive trading and economic relationship between the NAFTA partners. This has had two effects that impact on an assessment and future operation of a quarry at Whites Point. One effect is that NAFTA has established an ambiance in Canada that is supportive rather than antagonistic to economic growth and development, and moreover is supportive of international trade as a means to promote the domestic economy. This does not mean that Canadians will give up on environmental or other goals, but only that economic values rank high on the list that Canadians seek to achieve. Without doubt NAFTA has been controversial throughout its existence, but successive governments (responding to what they perceived were the wishes of Canadians) have given firm support to NAFTA, even when deeply frustrated by difficulties in relationships with other partners, such as in the case of softwood lumber.

A second effect of NAFTA would come to the fore should the proposed Whites Point Quarry be approved and commence operations. NAFTA is mainly a long set of trade rules, and the quarry would entail export trade with the United States. NAFTA (as well as the WTO) would govern this trade, and would require, among other things, that Canada not apply export restrictions or export subsidies, or that the company itself not engage in actions that are called "dumping" (ie, selling at less than the domestic price or the cost of production). In this regard, the Whites Point Quarry would be no different from any other exporter in Canada. As the importer, the United States would also face constraints, and would be obliged for example to

accord Most-favoured Nation and National Treatment practices to the Canadian imports. It is unlikely these rules regarding trade would have much bearing on the current environmental assessment of the proposed Quarry, but it is worthwhile to be reminded that NAFTA attempts to establish a complete legal trade regime in which goods and services can be exchanged between the three NAFTA partners.

c. Effects of NAFTA: Investment. The most important implications of NAFTA for the management of the Whites Point Quarry is in investment. The proponent Bilcon is a foreign investor from the United States, and as such its proposed investment falls squarely under the aegis of NAFTA. NAFTA Chapter-11 contains a set of rules on foreign investment that are among the most advanced rules in international law. The purpose of these rules is to create a secure and predictable legal environment in order to promote foreign investments between the NAFTA partners. The purpose is not, however, to prevent or encumber governments from taking regulatory actions that are necessary to protect citizens or to promote environmental or other concerns.

It is useful to review the rules of NAFTA Chapter-11. In doing so one can see that these rules pertain essentially to investment and not to environment which is the main concern in the Whites Point Quarry case. However, there are situations where the NAFTA investment rules might arguably impact on government actions or policies directed toward the environment, which will be examined later in the Report.

The main rules of Chapter-11, which are binding on NAFTA governments, are:

*Article 1102, national treatment, that is, the requirement to treat investors from a NAFTA country no less favourably than domestic investors are treated in like circumstances.

*Article 1103, most favoured nation treatment, that is, the requirement to treat investors no less favourably than the best treatment offered in like circumstances to investors from a NAFTA or any other country.

*Article 1105, minimum standard of treatment, that is, the requirement to treat investors according to international law, including fair and equitable treatment.

*Article 1106, constraints on performance requirements, that is, the requirement not to place conditions on foreign investment, such as the obligation to export a given level of goods or services.

*Article 1110, constraints on expropriation, that is, the requirement not to expropriate an investment directly or indirectly except for a public purpose, on a non-discriminatory basis, in accordance with due process of law and Article 1105, and on payment of compensation.

The above rules are reasonably robust, but what has made NAFTA Chapter-11 striking in international law is that the Agreement provided a dispute settlement mechanism with the capability to enforce the rules. This mechanism had two important characteristics: first, private investors investing in another NAFTA country who felt that country's government(s) had abridged Chapter-11 rules had the right to initiate a legal action against the government(s); and second, that the legal action could be conducted in an international tribunal process maintained by the World Bank or the United Nations, and not in the domestic courts of the country where the investment was located. The NAFTA Agreement provided that a tribunal could make a final award against a Party (ie, a NAFTA country) that would consist of monetary damages or a restitution of property. It should be obvious that NAFTA Chapter-11 was intended to have teeth, and that the Parties were serious about creating an international legal regime that would facilitate

the flow of foreign investment between the Parties.

NAFTA Chapter-11 created new legal rights for investors, and it is not surprising that those investors (and their lawyers) lost little time in taking advantage of these rights. A flurry of cases followed the signing of NAFTA, and governments (particularly the Canadian government) were surprised to find that NAFTA's investment rules could be invoked in connection with any government laws or policies, and not just those that explicitly dealt with foreign investment. Certain NGOs, including those that had opposed NAFTA politically from the outset, were quick to claim that Chapter-11 was an invasion of Canada's sovereign right to regulate its economy, society and environment for the benefit of all Canadians. Certainly the arguably inflated claims of some investors in arbitral proceedings helped to create the impression that Canada and its NAFTA partners had lost control of a traditional and important area of governmental power. The upshot of this concern over Chapter-11 dispute settlement is that it is essential to examine how NAFTA investment rules are actually applied in arbitral tribunals, in order to understand what are the implications of the NAFTA for the environmental assessment of the Whites Point Quarry.

3. Implementation of NAFTA Chapter-11 Investment Rules

a. Arbitral Cases. Since NAFTA came into force, there have been 47 cases brought by investors against NAFTA governments. This number of cases reflects a high level of dispute settlement activity. The distribution of these cases over the three NAFTA Parties has been roughly equal, namely, Canada-15 cases, United States-15 cases, and Mexico-17 cases[1]. Of

[1] Data are compiled from the DFAIT website <www.dfait-maeci.gc.ca>, and from

these 47 cases, 32 are continuing or inactive or withdrawn by the complainant (Canada-11, USA-11, Mexico-10), leaving some 15 cases that have been concluded under the procedures of NAFTA Chapter-11.

Of the 15 concluded cases, 10 have been "won" by government as respondents, in the sense that the claim brought by an investor as complainant was dismissed, and in two cases with court costs awarded against the complainant. In the remaining 5 cases, investors as complainants have "won", in the sense that the complainants were awarded damages to be paid by governments. As for the breakdown of "wins" and "losses" for individual NAFTA governments, the data are as follows: Canada, won-1, lost-3: USA, won-4, lost-0; Mexico, won-5, lost-2. One case that was listed as a Canadian loss (Ethyl) was technically settled out of court prior to any award being adjudicated by the Tribunal, however the Federal Government paid damages to the investor and as well offered a public apology.

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information collected by Scott Sinclair of the Canadian Centre for Policy Alternatives and available on the Web through Google.

The types of governmental measures challenged in Chapter 11 cases is of some interest given the context of an environmental assessment of the Whites Point Quarry project. Data collected and coded by Scott Sinclair suggest that 13 of the 47 Chapter-11 cases, or over one-quarter, dealt with regulations concerning environmental protection. No other category of regulations approaches this level in Sinclair's data. There is no doubt that environmental measures are the kind of regulations that could attract a Chapter-11 complaint, but care should be taken in this analysis. One might assume an environmental measure is anything a senior official claims to be "environmental", and yet in the S.D.Meyers case lost by Canada, the Tribunal concluded that the regulation that was the subject of the complaint was "intended primarily to protect the Canadian PCB disposal industry from the U.S. competition" and that "there was no legitimate environmental reason for introducing it."[2] This kind of analysis has raised questions about the bona fides of some other "environmental" cases that have been lost by Canada or Mexico. On the other hand, there has been no question raised about the genuine environmental nature of the Methanex case, in which a Canadian company challenged a California phase-out of a gasoline additive MTBE which incontrovertible data showed to contaminate ground and surface water throughout the state. In this case, the Tribunal dismissed the case and ordered the investor to pay U.S. government legal costs plus the full costs of the arbitration.

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[2] Cited in Julie Soloway "NAFTA's Chapter 11: Investor Protection, Integration, and the Public Interest" in John J. Kirton and Peter Hajnal (eds) Sustainability, Civil Society and International Governance: Local, North American and Global Contributions (London: Ashgate, 2006) 137-76.

b. <u>Analysis of Arbitral Cases.</u>

There are a number of observations that can be taken from the brief history of NAFTA Chapter-11 cases. One is that bringing a complaint against a government is surely no cakewalk for a foreign investor. The process is slow, expensive and time-consuming, and based on the evidence so far there is substantially less than a fifty-fifty chance a complaint will be successful. In the early days of Chapter-11 proceedings there was considerable speculation by worried officials and NGOs that Chapter-11 would produce a situation of "regulatory chill" where governments would be hesitant to undertake reasonable and necessary regulations for fear they might be liable to an arbitration and potentially costly damages. This scenario has not materialized. Instead, what we have now is a history of legal behaviour that hopefully can lead to more dispassionate assessment. In the early days when the Chapter-11 process was starting up, the only information one had were the claims made by corporate lawyers on behalf of their clients. Given the competitive nature of the legal profession, these claims were often intemperate, one-sided and extreme, and they were worrisome. However, it ought to be obvious that the way to evaluate a dispute settlement mechanism is in the actual results produced by arbitral tribunals and not in the initial claims made by self-interested parties in the cases. Simply put, the Chapter-11 process looks a lot less scary from the perspective of government regulation in 2007 than it did in 1997.

A second observation from the history of Chapter-11 deals with the rules and how they are interpreted. The Chapter-11 rules were reviewed in an earlier section of this Report. Of the six rules listed from Chapter-11, only three have been the basis of negative rulings against governments, namely, Article 1102 (national treatment), Article 1105 (minimum standard of

treatment), and Article 1110 (expropriation and compensation).

Article 1102 is the most straightforward of these three rules, it involves a comparison of the treatment given a foreign investor with that given a domestic investor, and the main complication is likely to be whether the comparison is applied in "like circumstances". There is no easy answer or common legal test for whether like circumstances prevail, it is essentially a matter for judgment on the facts. Article 1105 (minimum standard) is an absolute rather than a relative concept, but again there is no standard definition or simple legal test for this concept. Minimum standard of treatment may be a term that is most easily understood in the negative, such as an absence of due process of law, or the existence of procedures that are arbitrary, patently unfair or even capricious. For example, in the Pope and Talbot case, the Tribunal noted that the Softwood Lumber Division of DFAIT had ordered a "verification review" of the company's records, and contrary to normal practice had required the company to transport all its corporate records from Oregon to Canada, an action the Tribunal found violated Canada's obligation to provide "fair and equitable treatment" under Article 1105. Similar examples of a lack of evenhandedness were found in other cases where the decision went against governments on Article 1105.

Article 1110 (expropriation and compensation) is a rule that is invoked in almost all the cases brought under Chapter 11, yet a negative ruling against governments was made in only one case, namely, Metalclad (Mexico). This case was controversial because it was an example of an indirect expropriation, that is, not a direct takeover of a property, but rather an indirect takeover through the mechanism of a questionable environmental decree that would preclude the [landfill] use to which the property was to be put. In its opinion the Tribunal held that expropriation could

be "covert or incidental interference with the use of property which has the effect of depriving the owner of [its] use...."[3] This was a fairly expansive interpretation of expropriation which probably was not consistent with the approach taken in most other tribunals, and it may have been encouraged by the fact that the Tribunal in this case also found that Mexico did not provide an acceptable minimum standard of treatment for the investor. The conclusion that can be reached is that tribunals are not quick to find governments in violation of Article 1110, and if they do there may be other factors at work that contribute to the souring of the relationship between the government and an investor.

It is commonly said that the law governing relations between investors and governments is "fact-specific". In the three articles reviewed above, there are indeed rules, but how the rules will be interpreted in a given case can be substantially dependent on the facts of the case. Then too, there is no stare decisis in the awards made by arbitral tribunals, meaning that tribunals are not bound to follow the legal precedents of previous tribunals. That said, tribunals do work hard to establish coherence in the legal interpretations that they make. Now that a body of case law is developing around Chapter-11, it will be easier for governments in the future to understand their rights and obligations in dealing with foreign investors.

4. <u>The Whites Point Environmental Assessment Process</u>

Various materials produced by the environmental assessment process have been forwarded to my attention. I will take this opportunity to offer comment on what I have

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[3] Cited in Soloway, <u>Ibid.</u>

received.

a. <u>Submission by the proponent Bilcon</u> Bilcon's Environmental Impact Statement at section 6.6.1 contains a brief review of the implications of the NAFTA, particularly Chapter-11, for environmental policy in Canada. Generally I find the section to be an accurate statement of the situation and I have no major concerns to express.

Bilcon has noted the phrase "measure tantamount to expropriation" that is included in NAFTA Article 1110 as part of the definition of expropriation, as being a phrase that greatly concerned environmental activists in Canada because it appeared to expand the concept of expropriation and thereby to limit arguably the right of governments to take necessary regulatory actions that might affect private property. This language was address in Pope and Talbot, where the Tribunal held that "tantamount" meant "equivalent to", and that anything that was merely equivalent to something else was incapable of expanding its meaning. This interpretation, which was supported in a subsequent case, appears to have removed this concern from the environmental movement. In any case, it is probable that the history of the case law on expropriation in Chapter-11 is a better indicator of the significance of this concept than the use of the word tantamount in the definition.

b. <u>Presentation by DFAIT</u> The presentation on NAFTA Chapter-11 was made by Mr. Gilles Gauthier. I have read over the notes for his presentation, and the transcript of both his presentation and the question and answer session that followed. The presentation was concise and professional, and it provided a good description of the main elements of Chapter-11. The responses to questions were accurate and informative.

In the question and answer session Mr. Gauthier referred frequently to the framework

represented by Chapter-11. If I could add anything, it would be that the framework is indeed a body of rules that the NAFTA Parties expect each other to follow, and perhaps more emphasis could be put on the rules themselves. Thus, if a question came up about whether NAFTA would permit a government to take a particular action, such as establishing project-specific measures involving whale avoidance, the first thing might be to ask whether there are rules that would prevent such an action, and the second is to examine any jurisprudence that existed on that rule. If there were no rule and the Agreement was silent on a particular question, then presumably the government could take the action.

c. Comments from the public I have examined some 10 letters or submissions from the public, which seem to raise two important issues. One is that the Whites Point Quarry seems to be perceived very much in the context of NAFTA, international trade, relations with the United States, and even notions of globalization. In one sense this perception is accurate, since the project will involve trade with the United States, and it does raise the spectre of mineral resources in Nova Scotia being extracted and transferred to a large industrial centre. But what I find interesting and perhaps discouraging is how little this proposed project seems to be assessed in terms of the economic and social needs of the Digby area itself. Canada has a long history of mining and mineral extraction, and presumably the Quarry project would provide employment that would be welcome in a rural part of this province. Possibly the project might also have important sociological impacts as well as economic implications. However, these issues do not seem to be addressed in the public commentaries. Should this project come on stream, one wonders whether the area will be prepared to take fullest advantage of the opportunities that it might bring.

A second issue is an assumption about the Whites Point Quarry project that seemed to run through most of the submissions that I read, namely, that if this project went ahead, NAFTA would require the Province to accept any future proposals to establish a similar quarry. As one commentator put it, "if this project goes through NAFTA will not allow us to say no until the whole of the North Mountain is gone, from Digby to Cape Split."

This statement is simply not correct. There is nothing in NAFTA that would prevent an independent evaluation, either environmental or otherwise, of a major new commercial activity in the province. What is interesting however is how widespread the belief is that NAFTA would have the power that is attributed to it in the statement above. Perhaps the reason for this is that members of the public have internalized the notion that NAFTA stands for fair and equitable treatment of individuals and particularly companies, and that therefore any agreement with one company to approve a quarry proposal means that other companies with similar proposals must be granted the same right. To examine this idea in light of Chapter-11 jurisprudence, one could say, first, that the requirement for fair and equitable treatment in Article 1105 mainly means that companies must be treated in accordance with due process of law, or that they be treated by governments in a non-arbitrary manner. It does not mean that they must receive the same benefits another company might have received in its negotiations with government. Second, the requirement of Article 1102 to provide treatment no less favourable to foreign investors than that provided to domestic investors might lead some to think that benefits like environmental approvals would have to be given to successive investors, but this interpretation would ignore the condition that like circumstances must apply. It is unlikely that any two investors would present the same circumstances, and in any case, once one quarry were established, the situation

would automatically be changed between the second and the first. This argument comes close to being silly, but at least it shows that within the legal structure of NAFTA Chapter-11 rules, the idea that NAFTA requires successive commercial ventures to be approved is simply not valid.

5. Conclusion

This Report on the implications of NAFTA for the Whites Point Quarry project has been prepared in the context of an environmental assessment of the aforementioned project. Presumably the main concern of the Federal and Provincial governments is to insure that the project is fully reviewed on environmental grounds, and the inquiry about NAFTA is mainly to determine whether the rights provided by Chapter-11 to foreign investors could create unexpected problems for the conduct of the environmental review. In other words, is there any reason to be concerned that the environmental review could give rise to an action under Chapter-11 of NAFTA?

This Report has summarized the rules of NAFTA Chapter-11, and it has briefly reviewed the jurisprudence that has developed over the past decade. On the basis of an analysis of both the rules and the case law, I do not believe any foreign investor associated with the project would have either opportunity or interest to invoke the provisions of NAFTA Chapter-11. If Canadian governments were concerned on this point, the most certain way to insure Chapter-11 does not get mixed up with this essentially environmental matter is to follow scrupulously the rules that are laid down in Chapter-11. Of great importance is Article 1105 (minimum standard of treatment), and the best way to head off possible problems from this Article is to insure that all governmental procedures associated with the Whites Point Quarry project are conducted

consistent with due process of law and reasonable transparency.