

NAFTA's Big Brother

The Free Trade Area of the Americas and the Threat of NAFTA-style "Investor-State" Rules



*"If [the investor's argument is] accepted by the tribunal, no NAFTA [country] could carry out its most fundamental government functions unless it was prepared to pay for each and every economic impact." **

From the US government's filing in the Methanex (Canada) vs the US NAFTA case

In 1994 the leaders of 34 countries of North, South, and Central America and the Caribbean met at the Summit of the Americas in Miami, Florida. It included every country in the hemisphere except Cuba. At the summit, US President Bill Clinton pledged to continue working towards his predecessor's goal of establishing a free trade agreement encompassing the entire hemisphere. In 1998 that initiative, dubbed the Free Trade Area of the Americas (FTAA) - was launched in earnest with each country appointing a senior trade official to a Trade Negotiations Committee.

A draft agreement, incomplete but reflecting substantive progress, will be initialled in early April, 2001, just before the Summit of the Americas meeting of hemispheric leaders in Quebec City. If the ambitious plans for the agreement, shared by the US and Canada, are realized, it will be the most sweeping "trade" agreement in history.

While the FTAA has been portrayed as simply the extension of NAFTA to the entire hemisphere, it is much more than that. In effect, its principal proponents are aiming to combine in this agreement the most powerful liberalizing rules and chapters of all existing trade agreements. Specifically, the FTAA would combine the powerful restrictions on public policy making of the proposed services agreement - the General Agreement on Trade in Services - of the WTO, with the unprecedented protection of corporate property rights found in NAFTA's "investor-state" provisions.

In short, not only would the FTAA expand the current NAFTA to 31 additional countries, but it would include sweeping new measures and clauses that would allow foreign corporations "market access" to all public services and force governments to deregulate those services.

All of these agreements - the FTA, NAFTA and FTAA - are portrayed by governments in the most benign manner as simply about making it easier for countries to engage in the trading of their goods. In fact they are much less about trade than they are about freeing up the movement of capital - or put another way, about the enshrining of corporate property rights in treaties with the legal force of constitutions. They are as much about investment as

they are about trade because they permit corporations to move capital investment to the most advantageous location possible.

NAFTA's Chapter 11 on Investment

One chapter of NAFTA, Chapter 11, deals explicitly with investment (rather than trade) and most importantly includes a mechanism for dealing with "investor-state" disputes. These are disputes between corporations and governments, and it is this mechanism in Chapter 11 that makes NAFTA unique among trade agreements. The failed Multilateral Agreement on Investment - the MAI - contained a similar provision and it was one of the MAI's provisions that provoked such widespread public opposition. The primary focus of NAFTA's investment provisions is to limit governments capacity to enhance or support environmental, health and other public values in the face of commercial interests.

The investor-state dispute mechanism allows foreign corporations to sue governments directly whenever they think their "rights" have been violated by a particular government measure. Ostensibly, the NAFTA provision was intended to secure foreign investors from outright expropriation and from government harassment of foreign companies in the interests of their domestic companies. But in practice it has gone much further.

Key to the investor-state provision is NAFTA's extremely broad definition of "expropriation." By narrow legal definition, expropriation means the actual "taking" of private property, almost always land. But a well-organized effort by corporations in the US during the Reagan era led to a series of Supreme Court decisions that expanded this narrow legal definition to include what is now called "regulatory taking." This Fifth Amendment definition now includes any government regulatory action (law, regulation, rule or policy) that reduces the commercial value of an investment or the expected profit from an investment - including future profits. This new definition of expropriation has found its way into NAFTA's Chapter 11.

In effect, Chapter 11's dispute settlement provisions give foreign corporations the right to *directly enforce an international treaty signed by sovereign governments*, under which the corporations have absolutely no obligations. This underlines the fact that these trade agreements are primarily aimed at restricting governments from regulating or controlling corporations.

These suits, whose decisions go to the heart of government policy-making and national sovereignty, are treated exactly as if they are narrow, contractual disputes between commercial enterprises. Thus they are shrouded in complete secrecy from the beginning of the process to the end.

Because they are presumed to be simply about commercial matters, they explicitly exclude from the proceedings any other public interests potentially

affected by the case. Tribunals are not even obliged to publicly announce their decisions. Governments do not have the right to appear at these star chamber events to defend the laws and regulations that are being challenged, but have to ask for intervener status if they wish to present arguments.

Decisions are made not by judges of the domestic judicial system (who are obliged to take account of the broad public interest) but by a tribunal of trade arbiters who are naturally biased in favour of facilitating trade. Most are trade lawyers, often with firms that serve corporate clients. While their decisions may have a profound effect on health and environmental matters, the tribunal members have no expertise in any area other than trade law. The country being sued chooses one of the tribunal members, as does the country that is the home base of the challenging corporation. The third member is mutually agreed to or appointed by an arbitration body.

There is no way of knowing how many Chapter 11 challenges have actually been launched. But the ones that have been made public - usually by the company making the claim - number fifteen. Each has in common a challenge to a democratically proclaimed law or regulation passed in the public interest. And even if the measure is acknowledged to be in the public interest, compensation is mandatory if it is deemed by a tribunal to be "inconsistent" with NAFTA. Following are some of the more important Chapter 11 cases in various stages of arbitration.

Ethyl Corporation versus Canada

Statement of claim: Oct. 2, 1997

Out-of-court settlement: US\$13 million

This case is perhaps the best known to Canadians as it was the first NAFTA challenge to Canadian law. Canada banned the importation of Virginia-based Ethyl's principal product, a gasoline additive called MMT. Canada had strong evidence, though not decisive evidence, that MMT was both a health hazard and an environmental hazard. It was suspected of being a neuro-toxin, and Canadian auto makers had long complained that it damaged their catalytic converters intended to reduce polluting emissions from car exhaust.

Canadian officials went into the case with considerable confidence, stating that they had no doubt they would win. But despite the fact that NAFTA is supposed to allow governments to pass environmental legislation, it was clear to Canada from the subsequent deliberations of the tribunal that it was going to lose the case. Rather than face a US\$250 million penalty based on future-lost-profits claimed by Ethyl, Canada decided to settle. The settlement had three elements: a US\$13-million payment to Ethyl, the removal of the ban on MMT in Canadian gasoline, and a public apology to Ethyl for implying that its product was hazardous.

The damage to public policy-making done by this particular tribunal ruling was another incremental blow to the "precautionary principle." It is this science-based principle that governments worldwide have been using for several decades to ensure public health. It establishes that government authorities do not have to have absolute proof that a substance is hazardous, and takes into account that such proof can often take decades to reveal itself. Trade agreements, including NAFTA, have been ruling against this principle, putting the burden of proof on governments, rather than corporations.

Sun Belt Corporation versus Canada

Statement of claim: Oct. 12, 1999

Claim: US\$10.5 billion

The Sun Belt Water case involves a California company that, in 1990, was a partner in a scheme to export water by tanker from British Columbia. The plan was temporarily put on hold after a huge public outcry prompted the Social Credit government of the day to place a moratorium on all such exports. Subsequently, in 1996, the newly elected BC government passed legislation banning bulk water removals from water basins.

Sun Belt's Canadian partner in the export scheme, Snow Cap, threatened to take the BC government to court for expropriation. The two settled out of court for under \$400 thousand based on the amount Snow Cap was able to demonstrate it had actually spent on the project. The settlement was in line with the broadly accepted legal definition of expropriation.

Sun Belt tried and failed in Canadian courts to achieve a similar settlement. Instead, it decided to use NAFTA's Chapter 11, whose definition of expropriation is much more expansive. Canada has so far refused to recognize any legitimate claim from Sun Belt and trade analysts suggest that the case is a relatively weak one. Sun Belt is now little more than a name, as calls to its Santa Barbara number simply go to the home of the company's CEO.

But the case itself highlights the fact that this aspect of NAFTA is a fundamental attack on almost every aspect of our democratic institutions - legislative authority, judicial review and the right of the public to participate in decisions affecting them. It also demonstrates the potential problems of an international treaty infringing on areas of jurisdiction that fall to the provinces. If Canada loses a case taken against the effects of a provincial law or regulation it raises questions as yet unanswered by Ottawa. Would the federal government seek reimbursement from a province even if the province had never agreed to the terms of NAFTA (or the FTAA)? What authority would the federal government have to insist that a province alter or annul the offending legislation?

UPS versus Canada Post

Statement of claim: April 19, 2000

Claim: US\$156 million

This case arguably has the most serious implications of any filed to date. The claim made by the giant US courier company accuses Canada Post of giving preferential access to its national network, to its own 96%-owned Purolator. The case is especially egregious because, according to trade lawyer Steven Shrybman, it uses NAFTA strategically as part of its international objective to expand its corporate empire by limiting or eliminating public-sector competition for mail, parcel and courier services. Other Chapter 11 cases are largely defensive in nature.

UPS argues that by allowing Canada Post to make its infrastructure available to its non-monopoly courier and parcel delivery services, it violates NAFTA. If UPS wins this argument it has enormous implications for almost all public services in Canada. According to Shrybman, "UPS claims that Canada Post has taken unfair advantage of its mail service monopoly to support its competitive parcel and courier delivery business. But the co-mingling of monopoly and commercial services is something that occurs, in the modern day, in most areas of public sector service delivery."⁽¹⁾

Private sector corporations have been complaining for decades about "unfair competition" from public service providers. If UPS succeeds in having one such monopoly declared in violation of NAFTA, it would provide a potentially powerful new tool for companies eager to attack the public infrastructures of medicare, education, transportation, sewer and water services, and potentially dozens of provincial crown corporations.

One major example of a crown corporation that could be attacked next, if UPS wins, is the CBC, which also provides a mix of commercial and public services.

Most alarming, says Shrybman, are efforts by UPS "to dramatically expand the ambit of the investor-state apparatus to include NAFTA requirements that should not be subject to foreign investor claims. If it succeeds, foreign investors would arguably be able to directly enforce all NAFTA disciplines, whether arising under the treaty's investment rules, or not."

Metalclad versus Mexico

Statement of claim: Oct. 1997

Award: US\$16 million

This case was brought by an American company against the government of Mexico. Specifically, Metalclad claimed that a decree by San Luis Potosi State declaring its waste disposal site a special ecological zone caused it to lose

that investment and the profits it would have gained. The NAFTA tribunal ruled in favour of the company and awarded Metalclad \$16 million.

There is a long history in this case but its essentials are that Metalclad purchased a Mexican waste disposal company which had flagrantly disobeyed the law in Guadalcazar, the site of Metalclad's proposed waste disposal plant. The site was badly run and had already contaminated the local water supply. Residents, extremely concerned about the repeated failure of the national government to enforce environmental regulations with the previous owner, opposed Metalclad's plans from the beginning. The village refused an operating licence for the plant and the state government later acted to support the village by declaring the site a special ecological zone.

This particular case has a number of very serious implications for Canada, Canadian municipalities and the constitutional division of powers. This case clearly establishes that NAFTA disciplines apply to sub-national governments, including municipalities. NAFTA requires the federal government to leverage sub-national governments into compliance with NAFTA and thereby could change how the respective provincial and federal constitutional powers are exercised. Over time this could have the effect of eroding sub-national governmental authority. The tribunal's decision went so far as to rule that environmental impact considerations, public opinion, and the past record of performance of the proponent were matters outside the jurisdiction of Mexican local government.

It also found that Mexico was liable for the uncertainty Metalclad claimed to have about the nature of the approvals it needed from other levels of government, a duty far beyond any obligation a Canadian court would find. In addition it awarded costs that included those incurred before Metalclad had even applied for necessary local approvals.

In harshly criticizing local authorities for expressing their concern about environmental damage, the tribunal also demonstrated that the language in NAFTA that was explicitly intended to permit governments to introduce environmental protection measures and foster sustainable development does not stand up to the powerful enforcement mechanisms in Chapter 11.

If the Metalclad award is upheld the message it sends is an intimidating one. There are many instances in which foreign corporations are seeking permission to establish facilities in Canada and often these are intended to compete directly with publicly provided services such as health, education and municipal services. The tribunal's ruling essentially states that governments must provide special treatment to such investors: Ottawa would have to advise the foreign investor of all provincial and municipal regulations; municipalities would be prevented from applying environmental criteria to permit applications; previous behaviour of the applicant could not be a negative consideration; even massive public opposition after approval was given would not be a legitimate reason for reversing such approval. All

of this would lead to a "chill effect" in which all levels of government would engage in regulatory self-censorship in order to avoid litigation.

The Mexican government appealed the decision and the case was heard in the BC Supreme Court, the first time a NAFTA case has been heard in a domestic court. The decision is expected sometime in May.

S.D. Myers versus Canada

Statement of claim: Oct. 30, 1998

Claim: US\$20 million

Award: Pending

The case of S.D. Myers, a US waste disposal company, demonstrates in practice what was already very clear in theory: trade agreements, through their extremely powerful enforcement regimes, trump all other international treaties. In this case, Canada ordered a temporary ban on the export of PCB wastes to the US in February 1996. Canada was simply complying with the commitments it made when it signed the Basel Convention on the Transboundary Movement of Hazardous Waste. This treaty pre-dates NAFTA and requires that Canada treat its own hazardous waste while curtailing exports.

Not only does the ruling by the tribunal ride roughshod over Canada's solemn commitments under an important international environmental treaty, it demonstrates just how far such tribunals will go in ignoring domestic laws and regulations. The decision covered a sixteen-month period when the export ban was in place and during that entire period US law held that the transfer of such hazardous wastes into the US was illegal. The ruling demonstrates that such panels and those administering them - appointed officials of the three NAFTA countries - are of the view that not even domestic criminal law is relevant to its decisions. In the normal course of relations between sovereign nations, Canada would have been expected to inform the US that one of its own companies was breaking US law. But if the NAFTA ruling is upheld, Canada will be paying a penalty for refusing to allow a corporation to engage in an activity that violated a neighbouring country's laws.

Critics of the award to S.D. Myers have pointed to several major legal errors in the tribunal's ruling. As a result, the Canadian government has filed an appeal with the Federal Court of Canada based on its claim that the tribunal exceeded its jurisdiction in several key areas.

Methanex versus the United States

Statement of claim: Dec. 3, 1999

Claim: US\$970 million

The cases described above all involved US companies using Chapter 11 to advance their bottom line but Canadian companies are equally prepared to use this powerful tool if it suits their purpose. One such example is Vancouver-based Methanex, one of the world's leading producers of methanol, which is suing the US government over a decision by the government of California to phase out the use of one of its products, MTBE, by the end of 2002.

Because the gas additive reduces pollution in the burning of gas, MTBE is a rapidly growing portion of the market for methanol, consuming nearly one-third of global demand. Methanex controls about a quarter of the world's methanol market. But a US Environmental Protection Agency's report on MTBE revealed it causes tumours in rats.

The California government issued its phase-out decision after discovering that MTBE was leaking into the ground water in Santa Monica, Lake Tahoe and 10,000 wells throughout California. Methanex argues that the real problem is that California - and other states looking to ban MTBE - does not properly enforce its regulations on underground gas storage tanks. Using NAFTA rules it claims that California could have used other effective solutions to the problem that would have been less restrictive.

It is claiming damages based on lost future business and compensation for the fact that Methanex shares lost US\$150 million in value in the ten days following California's announcement.

Trade experts and environmentalists expect the Methanex decision to be a watershed with respect to NAFTA Chapter 11. If it goes in favour of Methanex, it could spark a flurry of similar challenges by companies targeting environmental laws they don't like. That would place the US and Canada under enormous pressure to look at changing the NAFTA agreement.

And More...

We simply don't know how many corporations in Canada, the US and Mexico have taken advantage of Chapter 11 of NAFTA - by far the most powerful corporate tool to challenge democratic governance yet devised. Seven of the cases are against Canada, three are against the US and five are aimed at Mexico. All but one of the challenges so far have come from Canadian and US based corporations. Some of the other cases:

Loewen Group, an enormous Canadian funeral services corporation, has launched a US\$750 million suit against the US, based on what it claims was expropriation through an excessive jury award for damages to smaller, US-based funeral homes. The court awarded punitive damages of US\$550 million.

Mondev International, a Canadian development company, is suing the US for US\$50 million for breach of contract by the city of Boston regarding a mall development and for actions by the state of Massachusetts shielding the local development authority from compliance with a US court ruling.

Pope and Talbot, a US lumber company operating in BC, is suing Canada for US\$507 million based on its claim that the federal government discriminated against it in the allocation of quotas under its Export Control Regime. An initial decision by a NAFTA tribunal ruled that two of the company's claims were without merit. Others are pending.

Halchett, an American company, is known to have made a claim under Chapter 11 based on an allegation that it was denied an airport concession in Mexico. None of the parties involved has agreed to reveal any other information on the case.

The FTAA and the future of the Americas

The cases described above demonstrate what is in store for sovereign governments and their laws and regulations if the FTAA as currently imagined is signed. Canada, a relatively strong and independent country, has already been severely affected by NAFTA's Chapter 11. Most of the countries signing on will be in a much more vulnerable position regarding Chapter 11-type disciplines. Already being forced by the World Bank and the IMF to "liberalize" their economies, they are struggling to maintain any measures that can help strengthen their economies, industries and social programs.

The FTAA with a Chapter 11 investment clause will make such government initiatives next to impossible.

It is important to note that over half the cases to date involve either health or environmental measures. These are areas of public policy that are critical to sustainable development and they are also two areas of policy that are of greatest concern to the public. That they have been identified by corporations as primary targets for elimination or moderation is clear already.

Nearly half the cases involve laws or regulations passed by sub-national levels of government. These municipal and provincial/state governments are excluded from the negotiation of these agreements. Yet the policy areas being targeted by corporations are primarily those in sub-national governments' jurisdiction, particularly in Canada.

If we look only at the fifteen cases launched so far it could be argued that the overall impact of the investor-state provisions of NAFTA has been relatively minor. But the greatest impact is hidden from public view because governments are now quietly engaged in a process of screening new laws and regulations to ensure that they are NAFTA-compliant.

In the US during the Reagan era when the "regulatory takings" movement redefined expropriation, the result was immediate. Local governments were forced to assess new laws out of fear of being sued, often watering down or abandoning initiatives altogether. NAFTA has resulted in the same "chill effect" with provinces in particular passing new measures through a trade filter to estimate what they might cost if challenged.

The current number of cases is likely to increase rapidly. Many corporations were unaware of the power of this provision of NAFTA until recently and most of the cases have been launched in the past three years. As awareness grows of how powerful this tool is, it will be used increasingly as a defence against government regulation and as an offensive weapon in transnational corporations' global strategies.

Adding public services to the targets

The prospects of having a Chapter 11 in the FTAA are even more alarming given that negotiators are hoping to include a broad services chapter in the FTAA. The Department of Foreign Affairs and International Trade (DFAIT) says it has not made a submission to the FTAA's Negotiating Group on Services. But the benchmark for Canada's position on trade in services is the GATS - the WTO's General Agreement on Trade in Services. There is no reason to believe that Canada would pursue a different course in the FTAA than it has already staked out in the GATS.

GATS negotiating guidelines supported by Canada state that no service is off the table "a priori." And the GATS clause on "Domestic Regulation" is being reworded to make government regulations over all services vulnerable to WTO challenges. With the new wording, governments would need to be able to prove that a regulation was "necessary" and that it was the "least trade restrictive" method of accomplishing its objective. But just getting rid of regulations that were too "trade restrictive" would not be enough. Governments would have to bring in new "pro-competitive" regulations - that is, favourable to competition from private corporations.

While the GATS contains a clause that claims to protect government services, its definition is so narrow as to be almost useless. For a public service to qualify as a protected (or excluded) service, it has to be "entirely free" and cannot be in competition with commercial suppliers. In practice that would mean that neither public education nor medicare would qualify as services excluded from the GATS. And we do not know if the services chapter of the FTAA will have even this extremely weak protection.

The WTO itself refers to the GATS as the world's first "multilateral agreement on investment" - in effect, another version of the failed MAI. GATS rules give corporate service providers the right to have a "presence" in Canada - in other words, a right to invest here. If Canada pursues a similar course in the FTAA that means this new agreement could bring together the worst features

of the GATS and NAFTA in a frontal assault on public services. It could open up health, education and other services to giant American service corporations, and give them the right - through a Chapter 11 provision - to sue governments for any measure subsequently taken to enhance or protect those services.

Most of the increased threat to Canada and its public policies does not come from the increased number of countries involved in the FTAA. Most of these countries' corporations lack the resources and expertise to take on these very expensive and complex cases. Only one of the fifteen cases under NAFTA Chapter 11 has been launched by a Mexican company. The major threat will come from the enormous American service industry corporations in the areas of health, education, culture and other services. Indeed, the powerful US Coalition of Service Industries has been given credit for having services included in the WTO. These US giants dominate the private service industry worldwide and they are looking to both the FTAA and the WTO/GATS to pry open public services to private investment.

The future of investor-state provisions?

Officials in DFAIT customarily reassure Canadians about the impact of trade agreements, claiming that governments still have the necessary authority to pursue public policy options. But even the Canadian government now realizes that when it signed NAFTA it did not fully appreciate the impact of the investor-state dispute provisions of Chapter 11. It was not supposed to be this way.

Trade Minister Pierre Pettigrew stated on December 13, 2000, that he would not sign another trade agreement if it contained a Chapter 11 equivalent. He has since enquired of the other two NAFTA countries about changing Chapter 11 to permit legitimate government regulatory activities. The US is not concerned by the chapter, probably because it reflects its own domestic property rights and expropriation laws. Mexico has simply refused to consider a change for fear that the US will seek additional NAFTA changes harmful to Mexican interests. As for the FTAA negotiations, no country other than Canada has expressed any concern about a Chapter 11 clause.

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