Investor versus state

Canada's trade and investment treaties are undermining democracy and regulation at home and abroad

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WHEN THE NORTH American Free Trade Agreement (NAFTA) came into force 21 years ago, there was plenty of debate about its likely impact on jobs, energy and sovereignty. The environmental movement of the day nearly scuttled the deal on fears it would severely curtail the ability of governments to set strong environmental protection and conservation policies. But these groups were split down the middle by a government proposal for what we can now conclusively call a useless environmental side-agreement, paving the way for NAFTA's ratification.

Unfortunately, at the time much less attention was paid to an obscure investor–state dispute settlement (ISDS) provision in the treaty's investment chapter. It set up a process through which foreign investors could choose to settle disputes with government through binding private arbitration instead of national courts. The rationale for granting this extraordinarily sweeping right to foreign investors was that Mexican courts were prone to corruption and political interference. But to date, only a handful of the 78 investor–state lawsuits filed under NAFTA challenge the decisions of Mexico's courts.

Instead, foreign investors have used NAFTA's ISDS process to target a broad range of government measures in North America — especially in the areas of environmental protection and natural resource management — on the grounds that

they violate the treaty's broadly worded investor protections. Canada has faced 36 ISDS claims, more than any other developed country in the world.[2] Since 2005, we've been hit by 70% of all NAFTA investor lawsuits.[3] One particularly egregious case, in which Canada lost, provides an excellent example of why countries around the world are turning their backs on excessive investor rights in treaties like NAFTA.

Environmental policies declared illegal

The federal government repeatedly claims that NAFTA and other free trade and investment deals "do not compromise the environmental protection measures that Canada has implemented."[4] Contradicting this claim in March 2015, a NAFTA tribunal ruled that a joint federal-provincial environmental assessment, which led to a U.S. firm being denied a permit to build a massive quarry in a sensitive coastal area in Nova Scotia, violated the company's NAFTA investor protections. The U.S. investor, Bilcon, is now seeking over $300 million in damages from the federal government.

In 2007, after three years of extensive study and public consultation involving all interested parties, a joint federal-provincial environmental assessment panel recommended against the quarry and related marine terminal due to their negative environmental and socioeconomic effects. The governments of Nova Scotia and Canada accepted that recommendation, denying approval for the controversial project. It was a rare move for a federal panel, illustrating the seriousness of the environmental concerns.

Bilcon did not appeal any decisions related to the project thorough the domestic courts, even though it had the right to pursue a federal court review of the environmental panel's finding. Instead, and with the help of Canadian lawyer Barry Appleton, it bypassed the Canadian courts and went directly to NAFTA investor–state dispute settlement. The NAFTA tribunal ruled 2–1 that both the environmental assessment process and the subsequent decision to block the project violated the firm's NAFTA guarantees to minimum standards of treatment and national treatment.

Though no Canadian court had ruled on the matter, the NAFTA tribunal determined that the environmental assessment panel had violated Canadian law. The majority on the tribunal felt the criterion of "community core values," which it construed as the primary basis of the environmental assessment panel recommendation against the project, was outside the panel's legal mandate. They also condemned the environmental panel's decision to recommend against the project outright without suggesting changes that might have mitigated its negative impacts and allowed Bilcon to proceed.[5]

The minimum standard of treatment protections in NAFTA and other treaties have been rightly criticized as inherently subjective, allowing arbitrators to apply their own preferences and prejudices. Without a doubt, the Bilcon ruling validates these concerns. The tribunal, chaired by a German jurist, was not qualified to judge whether or not Canadian law had been broken. According to many experts, the majority's interpretation of Canadian law was almost certainly wrong. The tribunal "lacked, with the exception of the dissenting member, even a basic understanding of the legal context within which the decisions it was asked to rule on where made," according to environmental law professor Meinhard Doelle.[6]

NAFTA chapter 11 gives private for-profit arbitrators the power to usurp the role of the Canadian courts, which were precluded from ruling on this matter because of the investor's own decision to bypass them. This travesty of justice exemplifies how the ISDS regime privileges foreign investors, elevating them above citizens, legislatures and the courts in violation of the basic principle of equality before the law.

Yet, as the tribunal's dissenting member also stressed, even if federal environmental assessment legislation had not been followed to the letter (which was unproven), this should never have been deemed a violation of NAFTA's guarantees of minimum standards of treatment under customary international law. It is the position of all three NAFTA governments that such standards should be interpreted cautiously and only in cases involving the most egregious state conduct.

The Bilcon majority's ruling that the federal and Nova Scotia governments violated NAFTA's national treatment (non-discrimination) rule is also deeply worrying. It equates cases where investors are treated differently to full-fledged discrimination based on nationality. Governments frequently treat investors differently for perfectly legitimate reasons. An investment in an environmentally sensitive region, for example, may be treated differently than an investment in another less fragile or more highly industrialized area, whether the investor is a foreign corporation or a Canadian entity.

The NAFTA tribunal scrutinized examples of what it considered to be comparable projects involving Canadian investors in quarries or marine terminals that had either not been subject to full environmental assessment, approved with mitigation measures or approved outright. This satisfied two arbitrators, with the third again disagreeing, that Bilcon had been treated less favourably in violation of the national treatment rule.

Deciding if the proponents (investors) of completely unrelated projects were treated better or worse is difficult and inherently subjective. The tribunal's decision to equate different, allegedly less-favourable treatment with nationality-based discrimination is troubling. This ruling demonstrates in graphic terms how ISDS enables private arbitrators to hold elected governments to impossible standards

of consistency whereby any difference in treatment can be likened, at the arbitrator's discretion, with nationality-based discrimination. Democratic regulation is paralyzed by such presumption.

The environmental assessment panel did its job thoroughly and professionally. It acted well within the legal mandate established jointly by the provincial and federal governments. Its well-reasoned and considered recommendations were welcomed by the majority of residents and acted upon by both levels of government. But the NAFTA ruling has now tainted this all-too-rare victory for environmental protection.

While Bilcon did not get to build its massive quarry, the NAFTA ruling won by the U.S. investor has blown a huge hole in the Canadian environmental assessment process. The dissenting member of the tribunal objected to the majority's ruling as being a "significant intrusion into domestic jurisdiction" that "will create a chill on the operation of environmental review panels." Fittingly, he described it as "a remarkable step backwards" for environmental protection.[7] Unless this ISDS threat is removed, the prospect of second-guessing and punitive monetary damages will cripple future environmental assessment panels, which have already been considerably weakened by Canada's current federal government (see Kinney chapter).

Global backlash to investor "rights"

Cases like this NAFTA lawsuit from Bilcon are fuelling a growing global backlash against ISDS. Alarmed by increasingly aggressive corporate recourse to investor–state arbitration to challenge public policy and regulatory measures, many governments around the world are seeking to extricate themselves from this anti-democratic feature of modern trade and investment treaties. Opposition is strongest within Latin America, where Ecuador, Bolivia and Venezuela have withdrawn from the World Bank body responsible for administering investor–state arbitrations and are terminating their bilateral investment treaties.

Brazil has never ratified a treaty that included ISDS; Argentina, which still faces billions of dollars in unresolved claims from its 2001 financial crisis, is a vocal critic. South Africa intends to end the use of ISDS in its trade and investment treaties. After being hit with a series of contentious claims, India has expressed similar misgivings. Indonesia has also indicated it will let its existing treaties that include ISDS expire.

The former Australian government, after a thorough independent review, officially spurned ISDS, although the subsequently elected conservative government has reversed that stand. Even in Europe, where ISDS was conceived in the post-col-

onial era, the German and French governments have indicated they would prefer that ISDS be left out of impending commercial treaties with the U.S. and Canada.

Despite a bruising experience under NAFTA chapter 11, Canada is oddly (to put it mildly) moving in the opposite direction to much of the world and global public opinion on ISDS. For example, the current federal government boasts it has concluded or negotiated over two dozen Foreign Investment Promotion and Protection Agreements (FIPAS), including a controversial and highly imbalanced pact with China, which the federal cabinet quietly ratified in the fall of 2014.[8] New trade agreements inked with South Korea and the European Union also include comprehensive investment protection chapters and ISDS, as does the impending Trans-Pacific Partnership Agreement (TPP).

The federal government has also pressured the provinces into agreeing to Canadian ratification of the Convention on the Settlement of Investment Disputes between States and Nationals of Other States (ICSID Convention), which will make tribunal awards even easier to enforce, in part by removing the right of domestic courts to review tribunal decisions on procedural grounds, such as conflict of interest or corruption.[9]

The use of ISDS by Canadian mining companies

None of this is radically inconsistent with the trade policy of past governments. In fact, most of the trade and investment treaties concluded by the Conservatives since 2006 were started by the previous Liberal government. Perhaps we can say that, consistent with the Conservative's 2006 platform, this government has sped up the rate at which it negotiates investment treaties. Public statements suggest its main objective is to create a "predictable" investment climate in countries where Canada has mining or energy resource interests, and the record of Canadian ISDS cases abroad backs this up.[10] Unfortunately for those countries, and for Canada, the government's staunch support for the ISDS regime fundamentally weakens the democratic space and development options of present and future governments (see Engler case study).

The inclusion of ISDS in pacts with major capital-exporting countries such as the EU, China and South Korea is especially troubling and will certainly accelerate the growth of ISDS claims against Canada. The Canada–EU Comprehensive Economic and Trade Agreement (CETA) actually contains expanded protections for investors regarding fair and equitable treatment, which is the most often invoked article in NAFTA chapter 11 disputes, and the most successfully used in global investment disputes. The CETA also expands the grounds, beyond NAFTA, upon which foreign investors can challenge financial regulation.[11] Under NAFTA

chapter 11's most-favoured nation obligation (NAFTA Article 1103), U.S. and Mexican investors will be able to take advantage of CETA's beefed-up investor protections. If completed, the pending Trans-Pacific Partnership agreement will further boost investor rights, while deepening the pool of investors eligible to use ISDS.[12]

Supporters of this aggressive expansion of investor rights and ISDS often point out that governments do not always lose, with respondent states prevailing in about half of cases. What they neglect to mention is that investment protection treaties and ISDS are completely one-sided. Governments can be sued, but there are no corresponding obligations for foreign investors or mechanisms to hold them — frequently wealthy multinational companies — accountable for their behaviour. In a brilliant analogy, Manuel Perez Rocha at the Institute for Policy Studies likens ISDS to, "playing soccer on half the field. Corporations are free to sue, and nations must defend themselves at enormous cost — and the best a government can hope for is a scoreless game."[13]

Another commonly heard argument is that it would be impossible to persuade developing countries to accept ISDS if Canada and other developed countries did not fully embrace it as part of their overall trade agenda. In reality, Canadian investors have had very little success winning cases using ISDS, notably against the U.S. but also in cases involving developing countries.

This is generally a good thing. High-profile cases pursued by Canadian investors abroad are bringing Canada and Canadian firms into disrepute. For example, Pacific Rim challenged the El Salvador government for its moratorium on gold mining (enacted to protect the country's scarce water), drawing global criticism. In the summer of 2015, Gabriel Resources, another Canadian firm, decided to sue the Romanian government over its decision to block the environmentally destructive and publicly unwanted Rosia Montana gold mine. There are far more appropriate options than ISDS for foreign investors to manage risk, including private and publicly backed risk insurance.

ISDS supporters also argue that some NAFTA tribunals have ruled in favour of the state's right to regulate, proving concerns about regulatory chill are unjustified.[14] It's true that some NAFTA tribunals have rejected investor challenges to government regulation.[15] The Methanex ruling in particular has been praised, even by critics of NAFTA chapter 11, as a well-reasoned defence of the state's police powers and right to regulate.[16]

The fact remains, however, that tribunals, unlike domestic courts, are not bound by the law of precedent. The basic defect in ISDS is that arbitral tribunals have complete freedom to interpret broadly worded investment protections as they see fit. And if they stray from reasonable interpretations, or concoct rationales to support their own biases or prejudices, they are completely beyond the reach of domestic

courts and legislatures. This radical judicial autonomy may make sense in commercial arbitration, where both parties have provided explicit consent to submit a specific matter to dispute settlement. But it is perverse where states have unwisely provided unconditional consent to submit any matter, including those that concern public law, policy and regulation, to final, binding arbitration.

Conclusion

We now have two decades of experience with ISDS through NAFTA chapter 11 and in Canadian investor lawsuits filed against foreign governments. Clearly, the broadly worded investment rights in these treaties, of which Canada has dozens in place and as many more waiting to be ratified, give foreign investors a coercive tool to deter legitimate public interest regulation and to seek compensation when governments have the courage to proceed with regulation despite this intimidation. Democratically elected governments are being forced to pay to govern.

Canada is already one of the world's top targets under ISDS, and the number and frequency of claims are growing rapidly. The majority of these disputes deal with sensitive regulatory or policy matters. Current trends, unless checked politically and legally, will only worsen. Canadians and their elected officials should be deeply concerned. Unfortunately, in stark contrast to opinion in much of the world, there is surprisingly little political debate about the corrosive influence of NAFTA chapter 11 and ISDS on public policy and democracy in Canada. Instead, prevailing trade and investment policy is entrenching ISDS even more deeply.

As Naomi Klein argues persuasively in her latest book[17], meeting humanity's global challenges, including reining in multinational financial firms or addressing the existential threat posed by rapid climate change, will require more (and more assertive) government intervention and regulation. Extreme investor rights agreements are relics of an era when market fundamentalism — the belief in the virtues of fully liberalized markets — was the prevailing political wisdom. It is time to move on.

Endnotes

1 This chapter is adapted from two previously published pieces, "Investor vs. State" in the July-August 2015 issue of *the CCPA Monitor* and *Democracy under Challenge*: *Canada and Two Decades of NAFTA's Investor-State Dispute Settlement* (Canadian Centre for Policy Alternatives, January 2015). The author wishes to thank Stuart Trew for editorial assistance on this chapter.

2 Scott Sinclair, *NAFTA Chapter 11 Investor-State Disputes to January 1, 2015*, www.policyalternatives.ca/publications/reports/nafta-chapter-11-investor-state-disputes-january-1-2015. Canada has been sued more than any other developed country and is the sixth most sued country overall. See UNCTAD. "Recent

Developments in Investor-State Dispute Settlement (ISDS)". May 2015. p. 4. unctad.org/en/PublicationsLibrary/webdiaepcb2013d3_en.pdf.

3 Sinclair, *Democracy under Challenge: Canada and Two Decades of NAFTA's Investor-State Dispute Settlement*. p. 31.

4 See, for example, "The Trans-Pacific Partnership: Myths and Realities." Department of Foreign Affairs, Trade and Development, http://www.international.gc.ca/trade-agreements-accords-commerciaux/agr-acc/tpp-ptp/myths.aspx?lang=eng.

5 *Clayton/Bilcon v. Government of Canada*, *Award on Jurisdiction and Liability*. March 17, 2015.

http://www.international.gc.ca/trade-agreements-accords-commerciaux/assets/pdfs/disp-diff/clayton-12.pdf

6 Meinhard Doelle. "Clayton Whites Point NAFTA Challenge Troubling." https://blogs.dal.ca/melaw/2015/03/25/clayton-whites-point-nafta-challenge-troubling/.

7 *Clayton/Bilcon v. Government of Canada*, *Dissenting Opinion of Professor Donald McRae*. March 10, 2015. http://www.international.gc.ca/trade-agreements-accords-commerciaux/assets/pdfs/disp-diff/clayton-13.pdf.

8 For a complete list, see Foreign Affairs, Trade and Development Canada. "Opening New Markets: Trade Negotiations and Agreements." Accessible at: http://www.international.gc.ca/trade-agreements-accords-commerciaux/index.aspx.

9 Gus Van Harten. "Harper's Boon to the Arbitration Industry." 14 Nov 2013. *The Tyee*. Accessible at: http://www.thetyee.ca/Opinion/2013/11/14/Harper-Arbitration-Industry/.

10 See Hadrian Mertins-Kirkwood. *A Losing Proposition: The Failure of Canadian ISDS Policy at Home and Abroad*. Canadian Centre for Policy Alternatives. August 5, 2015. www.policyalternatives.ca/publications/reports/losing-proposition.

11 See "Financial Services" in *Making Sense of the CETA: An analysis of the final text of the Canada–European Union Comprehensive Economic and Trade Agreement*. Scott Sinclair, Stuart Trew and Hadrian Mertins-Kirkwood, eds. Canadian Centre for Policy Alternatives. September 25, 2014.

12 WikiLeaks. "Secret Trans-Pacific Partnership Agreement (TPP) - Investment Chapter." March 25, 2015. https://wikileaks.org/tpp-investment/.

13 Manuel Pérez-Rocha. "When Corporations Sue Governments." *New York Times*. December 3, 2014. Accessible at: http://www.nytimes.com/2014/12/04/opinion/when-corporations-sue-governments.html?partner=rss&emc=rss&_r=0.

14 See Barrie McKenna. "In free-trade deals, sovereignty rules." Globe and Mail. August 29 2014.

15 A sceptic, however, might observe that the most deferential rulings (such as Methanex and Apotex) have involved claims against the U.S. The Chemtura case, won by Canada, is an exception.

16 Howard Mann. "The Final Decision in Methanex v. United States: Some New Wine in Some New Bottles." International Institute for Sustainable Development. August 2005. Accessible at: http://www.iisd.org/pdf/2005/commentary_methanex.pdf.

17 Naomi Klein. *This Changes Everything*. Alfred A. Knopf Canada. 2014.