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Canada seeks to reform NAFTA’s investor-state dispute settlement chapter

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Our previous international trade brief outlined the Canadian government’s objectives for the North American Free Trade Agreement (NAFTA) renegotiations and what the implications are for Canadian businesses. In this brief, we discuss the sharp rise in U.S. government lobbying in the run up to the NAFTA renegotiations, the reform of Chapter 11 (the investor-state dispute settlement chapter of NAFTA), and a Trade Case Alert relating to certain polyethylene terephthalate resin from China, India, Oman and Pakistan.

The Canadian government has stated that one of its priorities in the renegotiations of NAFTA is to reform Chapter 11, the investor-state dispute settlement chapter. Although the United States has not directly referenced Chapter 11 in its negotiating priorities, its stated objectives on the dispute settlement provisions indicate that there may be some common ground between Canada and the United States.

INVESTOR-STATE DISPUTE SETTLEMENT UNDER CHAPTER 11

Chapter 11 has not achieved the notoriety that Chapter 19 of NAFTA has in the recent months leading up to the start of the renegotiations, but from a Canadian public policy perspective, it has been one of the most controversial chapters since the implementation of NAFTA. When the dispute settlement provisions were introduced into NAFTA, it was expected that Mexico would be the country that would face the largest number of claims under Chapter 11. Instead, Canada has been the subject of the highest number of investor-state arbitration claims, and a number of public interest groups have been strongly opposed to the rights provided to NAFTA investors under this chapter.

The Chapter 11 investor-state arbitration mechanism allows investors of a NAFTA country to bring proceedings directly against the government of another NAFTA party for alleged breaches of its obligations under the treaty. The dispute settlement procedure is intended to provide investors with timely recourse to an impartial international tribunal. It replaces the need for governments to take on claims on behalf of their nationals in a government-to-government dispute resolution process that would result in proceedings before international tribunals, such as the International Court of Justice.
Some of the key protections provided to investors under Chapter 11 include the following:

- Investors of NAFTA countries and their investments must be accorded no less favourable treatment than that accorded to domestic investors (“national treatment”) and to investors of any other country (“most-favoured-nation treatment”), with respect to the establishment, acquisition, expansion, management, conduct, operation, and sale or other disposition of investments.
- NAFTA parties must provide investors of other NAFTA countries a minimum standard of treatment in accordance with international law, including fair and equitable treatment and full protection and security for investments.
- NAFTA parties are prohibited from directly or indirectly nationalizing or expropriating investments of an investor of another party, or from taking a measure that is tantamount to nationalization or expropriation, unless certain requirements have been satisfied.

**CANADA’S TRACK RECORD**

To date, Canada has faced claims under Chapter 11 only from U.S. investors. It has been reported that Canada has been sued 39 times since NAFTA was implemented in 1994 (approximately half of the total number of 84 challenges under NAFTA against all three nations). Notwithstanding the number of claims, Canada has paid a total of C$215 million in compensation, the bulk of which has been paid by way of settlement. In several cases, the measures in dispute were those of provincial governments, such as the claim by AbitibiBowater Inc. where the Canadian government agreed to settle the case and pay $130 million in relation to expropriation by the Government of Newfoundland. The United States, on the other hand, has not yet lost a single case. The most recent case filed against the United States by a Canadian investor, TransCanada Corporation, for more than $15 billion in connection with the cancellation of the Keystone XL Pipeline, was withdrawn after President Trump reversed the decision of the previous administration thereby allowing the project to proceed.

**PROPOSED REFORMS**

On August 14, 2017, Canadian Foreign Affairs Minister Chrystia Freeland indicated that Canada will be seeking to reform Chapter 11 such that it would confer on governments an “unassailable right to regulate in the public interest” without being subject to a successful NAFTA Chapter 11 claim. Exactly what this means and whether this reform, if implemented, will make NAFTA parties less prone to challenges under Chapter 11, will undoubtedly be the subject of debate among international investment law experts, academics and policy makers.

Although reform of Chapter 11 is not one of the United States’ stated priorities it has indicated [PDF] that the dispute settlement provisions in NAFTA should “include general exceptions that allow for the protection of legitimate U.S. domestic objectives, including the protection of health or safety and essential security, among others.” Moreover, the United States has also indicated that it seeks to eliminate what it has referred to as the greater rights accorded to foreign investors relative to domestic investors within NAFTA.

**BROADER IMPLICATIONS**

Minister Freeland’s statements concerning the reform of Chapter 11 should also be considered with regard to the broader implications for Canada’s similar investment protections provisions in other free trade agreements and bilateral investment agreements known as foreign investment promotion and
protection agreements (FIPAs).

In addition to a number of free trade agreements, such as NAFTA, which contain investor-state arbitration provisions, Canada also has 43 FIPAs that are in force, signed but not ratified, or completed but not as yet signed. Canadian businesses rely heavily on the investor-state dispute resolution processes contained in Canada’s FIPAs when making investments in less developed countries, as many of these countries have rudimentary domestic legal systems and government decisions are typically highly politicized. FIPAs can be used in negotiations with governments to fend off measures that are harmful to investments of Canadian investors or to seek compensation for harm inflicted by foreign government measures.

To date, 44 publically reported claims have been filed by Canadian investors under foreign investment agreements including NAFTA. Not all such proceedings are publicly reported, and, as such, the number of actual disputes may be much larger. In addition, in some cases, Canadian investors can use FIPAs to achieve fairer settlements and compensation from foreign governments, without proceeding to arbitration.

The Canadian government has recognized the importance of FIPAs as it has prioritized negotiating and ratifying a larger number of new FIPAs in recent years. This is consistent with the position of Canada becoming a net foreign direct investment exporting country from its previous status as a net foreign direct investment importing country. Moreover, the high awards obtained by Canadian investors that have pursued claims under FIPAs also demonstrate the importance of the agreements. Awards in the range of US$1 billion in a single arbitration are not unusual – and stand in stark contrast to the total C$215 million paid by Canada over a 23 year period, more than half of which was paid to settle one case that was due to undeniably improper actions of the Government of Newfoundland. As the Canadian government embarks on significant renegotiations of NAFTA’s Chapter 11, it will need to balance the protections it seeks to regulate domestically and advance public policy goals with the legitimate expectation of Canadian businesses (and their owners and other stakeholders) making investments overseas. Canadian investors need free trade agreements and FIPAs to ensure that their long-term investments are protected through high standards of treatment and effective dispute resolution mechanisms.
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