Court File No. 01-CV-208141

ONTARIO
SUPERIOR COURT OF JUSTICE

B E T W E E N:

THE COUNCIL OF CANADIANS, and DALE CLARK, DEBORAH BOURQUE, and GEORGE KUEHNBAUM on their own behalf and on behalf of all members of the CANADIAN UNION OF POSTAL WORKERS

Applicants

- and -

HER MAJESTY IN RIGHT OF CANADA, AS REPRESENTED BY THE ATTORNEY GENERAL OF CANADA

Respondents

AFFIDAVIT OF STEPHEN CLARKSON

I, Stephen Clarkson, of the City of Toronto, HEREBY AFFIRM that:

1. I am currently and have since 1964 been a professor in the Department of Political Economy (now Political Science) at the University of Toronto.

2. As the copy of my curriculum vitae attached as Exhibit "A" to this affidavit will confirm, I have undertaken research and written extensively on a variety of contemporary political affairs over the course of my academic career, including the publication of several books and dozens of scholarly articles and chapters in academic books on various aspects of Canada's political economy. The central focus of my scholarly work over the past three decades has been the Canada-US relationship in the context of the growing pressures deriving from the economic integration of North America's three national economies. In the past two decades, much of this work and analysis has explored the impacts and implications of free trade in North America within the context of new forms of global governance such as the World Trade Organization (WTO) and in contrast with the highly institutionalized system of continental governance created by the European Union (EU).

3. For these reasons I have knowledge of the matters to which I herein depose.

4. The purpose of this affidavit is to present the key conclusions I have drawn from my assessment of free trade in the North American context as these relate to the investor-state suit provisions of Chapter 11 of the 1994 North American Free Trade Agreement (NAFTA). A more complete assessment of these and related issues can be found in the articles I have attached as Exhibits "B" and "C" to this affidavit. These articles are respectively titled: "Systemic or Surgical? Possible Cures for NAFTA's Investor-State Dispute Process" (2002) 36 Canadian Business Law Journal 1-20, and *Canada's Secret Constitution: NAFTA, WTO and the End of Sovereignty* (Ottawa: Canadian Centre for Policy Alternatives, 2002).

5. As a political economist, I try to understand the relations between states and markets in order to locate specific issues of public policy within their power systems. To assess the significance of the investment disciplines of NAFTA's Chapter 11 first requires that I locate this trade agreement within its international context. Once having established its genealogy, we can then consider its controversial process for investor-state arbitration.

I HISTORICAL CONTEXT

6. Prior to the advent of the 1989 Canada-United States Free Trade Agreement (CUFTA), Canada's international trade obligations were set out in the General Agreement on Tariffs and Trade (GATT), to which it and more than one hundred other nations were Parties. GATT had initially been negotiated in 1947 to complement the Bretton Woods Agreements, which set up the World Bank and the International Monetary Fund in 1944. Its provisions were essentially limited to government policy and law concerning international trade in goods. Compliance with the provisions of GATT was a matter of goodwill among the Parties to the Treaty.

7. During the mid-1980s, however, the United States tabled an agenda to dramatically expand the GATT framework to include areas of economic and social regulation that had never previously been the subject of international trade disciplines, and which often had little, if anything, to do with international trade in a conventional sense. Its motivations for doing so were complex and multifaceted: enormous and growing trade deficits; the need to secure access to strategic resources such as oil and gas; and the global ambitions of its domestic corporations.

8. To accomplish these strategic objectives, the United States adopted a three-pronged strategy – unilateral, multilateral and bilateral – to contain what it regarded as the excessive and interventionist policies of foreign governments by requiring them to abandon export controls on energy and other strategic goods, while opening their own markets in areas where American transnational corporations (TNCs) had developed global superiority.

9. ***Unilateral Measures*. Washington strengthened its already powerful unilateral measures in the form of anti-dumping and countervailing duties laws, which were often invoked**

either for its own protectionist purposes or to pressure other countries to abandon policies that it regarded as too restrictive to American exports, investment or service providers.[1]

10. ***Multilateral Measures*. At the international level, Washington hoped to exploit the** comparative advantage its domestic corporations had acquired in high-tech and knowledge-driven industries by expanding the scope of the global trade rules. The US wanted GATT to cover foreign investment so as to improve conditions for US TNCs' overseas operations; services, to open space for US TNCs in countries which had not established competitive or open markets in such areas as telecommunications, health care, insurance, electricity or cultural industries; and intellectual property protection, to globalize the patent and copyright protections granted under US law.

11. ***Bilateral Measures***. At the same time, the United States pursued bilateral negotiations with specific trading partners with which it was able to establish precedential agreements that then provided a model or prototype for multilateral negotiations. Thus, in 1986, as it tabled proposals to expand the GATT framework, it was also engaged in bilateral negotiations with Canada that would culminate a scant two years later with the signing of the Canada-United States Free Trade Agreement (CUFTA).

12. CUFTA represented a radical departure from conventional notions of where the demarcation between domestic and international trade policy naturally belonged. For the first time a trade agreement brought the vast but uncharted territory of business services under international disciplines which to that point had applied only to goods. Thus the obligation to provide "national"

[1] Sylvia Ostry, *Getting to First: The Post-Cold War Trading System* (Chicago: University of Chicago Press, 1999).

or non-discriminatory treatment was now to apply not just to goods or products but to such services as banking operations and insurance contracts, legal and architectural work, education and health care.

13. Another novel feature of CUFTA was the incorporation of rules concerning foreign investment and investors within the framework of an international trade agreement. Pursuant to these "disciplines", Canada committed itself to treating US investors the same way it treated domestic citizens and corporations – a concession that Canada had long resisted because of its economy's high proportion of foreign direct investment. Finally, it prohibited broad categories of government regulation,[2] even in the case where these were entirely non-discriminatory in both design and application.

14. By committing itself to offering US companies the same incentives that it might give domestic firms, Canada abandoned the kinds of industrial strategies that had formerly formed the core of much of federal and provincial economic policy activity.

15. Finally, CUFTA established rules for energy trade, which assured US consumers virtually unfettered access to Canadian energy resources for as long as the agreement remained in place and at no higher price than that paid by Canadian consumers. Canada thus was prohibited from imposing export controls on oil, gas and electricity except in times of shortage, but even then exports could not be restricted to any greater extent than domestic supplies were rationed in Canadian markets.

16. The second phase of North America's evolution as a trade bloc represented a simultaneous broadening and deepening of the system already established by CUFTA. NAFTA broadened the

[2] NAFTA Article 1106, for example, prohibits broad categories of regulations described as "performance measures". It is important to recognize that these constraints establish a blanket prohibition against such measures whether these discriminate against foreign investors or not.

free trade regime to include Mexico and also expanded CUFTA's limits on its signatory governments by expanding its institutional structure, adding a chapter creating extensive intellectual property rights, changing the dispute settlement mechanism, extending the coverage of its investment provisions, and adding to those investment disciplines a new dispute resolution procedure that empowered Canadian-, US- and Mexican-based corporations to sue the governments of other NAFTA Parties.

17. One critical consequence of expanding the framework of international trade law in this manner was to extend the threat of international economic sanctions to a host of domestic policies and laws concerning services and investment, which previously had been entirely matters of national or local concern. Under these regimes, a municipal zoning ordinance may become the subject of an international claim, as may groundwater protection legislation, cultural programs to support library services, and even the pension plan of postal workers.[3]

18. The significance of these changes went well beyond simply changing economic policies. NAFTA's new set of formal legal constraints on the three parties created at the continental level of North America a new legal order by which its member states were to be bound. In other words, NAFTA has established new and comprehensive disciplines to which the policies, laws and constitutional norms of its member states now have to conform.

II TRADE AGREEMENTS AS CONSTITUTIONS

[3] All of these examples are taken from investor-State claims initiated pursuant to Chapter 11 procedures. See *United Parcel Services of America Inc. v. Canada*; *Metalclad Corp. v. Mexico*; and *Methanex Inc. v. the United States*. These cases are summarized in *Private Rights, Public Problems,* published by the International Institute for Sustainable Development and the World Wildlife Fund, 2001.

19. When a country signs a treaty it ***internationalizes*** **the state's legal order to the extent that domestic laws are harmonized with the norms embodied in the accord. Before the advent of the new global trade order, literally hundreds of international treaties, conventions and other instruments had little if any effect on the constitutional norms of the nation state, whose legal sovereignty was barely compromised by such international commitments.[4] Weak enforcement mechanisms allowed a state to ignore or abrogate its international commitments. Nor was a government bound to comply with a ruling by an international body that it considered adverse to its interests or incompatible with its culture. Even as determinedly a team player as Canada has occasionally been willing to flout international law that challenges a constitutional norm.[5]**

20. The discussion of the constitutionality of trade agreements is generally confused by three distinct applications of the concept "constitution":

i) each international organization – whether intergovernmental (operated by states which concede no sovereignty to the new institution)[6] or supranational (granted legal and

[4] John H. Jackson, *The World Trading System: Law and Policy of International Economic Relations* 2nd ed. (Cambridge, MA.: MIT Press, 1997), 32.

[5] When a UN committee censured the government of Ontario for not extending to all religious schools the state funding that it gives Catholic public schools, it was challenging a key element of the 1867 confederal bargain that guaranteed Roman Catholics in the provinces the preservation of their educational system.

[6] The Canada-U.S. Permanent Joint Board of Defence is an example of a typical intergovernmental organization whose existence depends on the continuing collaboration of the constituent partners.

bureaucratic autonomy from the founding members who give up some sovereignty in the process)[7] – can be analyzed in terms of its own constitution;

ii) taken together, the totality of all international agreements, together with the organizations which they may establish (often set up to deal with functionally specific issues such as the management of radio frequencies or civil aviation or world health), can be considered as comprising the global constitution;

iii) the impact on a particular nation-state of one or all of these international obligations may affect that state's constitution.

The focus of this affidavit is constitutionalism in this third sense concerning one international agreement – **NAFTA.**

[7] The European Court of Justice is an example of a supranational organization, because – although established by the constituent states of the European Union – it operates autonomously, its judges and administrators having secure terms of office.

21. In sharp contrast with most international agreements, NAFTA creates a new mode of economic regulation with such broad scope and such unusual judicial authority that it has transformed the political order of the three states that are parties to it.[8] The coercive force of these regimes is also significantly influenced by the relative dependence of a nation's economy on international trade. It is also influenced by the extent of foreign investment in the national economy. Canada is particularly susceptible to such influences on both accounts.

22. For the following reasons, NAFTA so closely conforms to the conventional notions of what comprises a constitution that it can best be understood as creating a supraconstitution for Canada.

23. As rule books that determine how political systems operate, constitutions generally contain five basic components:

(a) *Norms.* **Understood as regularized constraints on behaviour, supralegislative norms are contained in constitutions to put certain values beyond the reach of legislators and officials.**

(b) Institutions. **Constitutions define the parameters of formal rule-making institutions, their administrative agencies and enforcement or compliance regimes.**

(c) Limits. Constitutions also set limits to the powers of the institutions that they create.

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[8] **The same assessment applies to the World Trade Organization and the international agreements that are organized under its administration. Indeed, the state-to-state enforcement mechanisms are significantly stronger than their corollary in NAFTA.**

(d) *Rights.* The corollary of these limits are the rights with which the system's citizenry are endowed.

(e) Judiciary. To interpret the ambiguities inherent in the norms, limits and rights and to resolve eventual disputes a judicial system is required.

24. The following discussion applies this model to show how NAFTA effectively functions as a constitutional instrument.

(a) Norms.

25. Constitutions typically entrench certain inviolate principles or norms that are above the reach of any politician to alter, and NAFTA has done this by establishing several government-inhibiting principles which apply to all policies, regulations and actions of member states. In agreeing that CUFTA should enshrine the principle of ***national treatment,* or *most favoured nation treatment,*** Canada was not simply reiterating a commitment that it had made for goods in GATT, but was agreeing to **apply these normative trade rules to** investments and services as well.

26. The absolute protection of private property[9] established by NAFTA provisions concerning expropriation (which I discuss further under "rights") establishes another norm that is superimposed on statutory, common law and constitutional principles concerning property.

27. Thus, certain key international trade disciplines establish supraconstitutional norms because they are established as a superior legal order, binding broad spheres of government policy law and action. These may or **may** not be reflected in the domestic laws of the nation state, but can be enforced by

[9] NAFTA Article 1110 establishes an absolute right to compensation, at fair market value, whenever a government measure is determined to have "directly or indirectly" expropriated a foreign investment or is "tantamount to nationalization or expropriation".

international sanctions regardless of their status under, or consistency with, domestic laws or constitutional norms.

(b) Institutions.

28. In contrast to free trade in the European Union, NAFTA did not create executive, legislative or bureaucratic institutions of any continent-wide substance. NAFTA's central institution, the Free Trade Commission, has no permanent location or resources to speak of, and amounts to little more than periodic meetings of the Ministers of Trade of the three Parties.[10] NAFTA's decision-making was to be by consensus, which meant that each "party" retained a veto over common business.

29. Two collateral institutions were also established as adjuncts to NAFTA. One, the North American Commission for Labour Cooperation (NACLC) is overseen by an executive comprised of the three national governments' labour ministers.[11] The other, the **North American Commission on Environmental Cooperation**, is similarly constituted under the direction of the Parties' respective

[10] The North American Free Trade Commission consists of the three countries' trade ministers who retain final authority to supervise NAFTA's institutional mechanisms, resolve disputes over interpreting its text, and take whatever steps might be necessary for its future development.

[11] Rafael Fernández de Castro and Claudia Ibargüen, "Las instituciones del TLCAN: una evaluación a los cinco años," in Beatriz Leycegui y Rafael Fernández de Castro, eds., *Socios naturales? Cinco años del Tratado de Libre Comercio de América del Norte* (Mexico: ITAM, 2000), 515-32.

federal environmental officials. Neither regime engenders a meaningful enforcement regime, and both administer agreements which are largely hortatory. Moreover, the mandate of these regimes is to ensure the effective enforcement of domestic labour and environmental laws, but neither requires environmental or labour legislation be raised to any threshold as a matter of binding obligation.

(c) Limits.

30. NAFTA **contains two types of supraconstitutional limits on member states'** domestic institutions, including governments at all levels, administrative agencies and tribunals, and state entreprises. Positive "thou shalt" provisions ***prescribe*** **how members must rewrite, for example, their laws on intellectual property. Negative "thou shalt not" clauses, such as limits to regulating foreign direct investment, *proscribe* a wide range of practices.**

31. One manifestation of NAFTA's supraconstitutional effect can be found in the specific amendments made to domestic policies, laws and regulations in order to bring them formally into compliance with NAFTA disciplines. Normally, changes in laws and regulations are made by governments within the institutional and legal framework established by their internal constitutions and in response to demands from below by the electorate or specific functional constituencies. Unlike these normal amendments to statutes made by sovereign legislatures, which can further amend or revoke their acts in response to changing domestic considerations, statutory amendments incorporating international trade norms can be validly amended only if the external regime changes its rules by international agreement. Otherwise, democratically legitimate government actions deemed by the appropriate arbitration procedures to violate the international agreement in question will subject that government to sanctions or penalties.

32. However, whether or not domestic law and policy is formally amended, it must still comply with the trade rules or expose the Party to international sanctions for non-compliance. As noted, Canada's

NAFTA obligations are binding on it, whether or not it has chosen to ensure conformity of its domestic laws and policies.

33. The coercive force of Canada's commitments under NAFTA and other international trade agreements can be found in the nature and character of the sanctions that may be visited upon it, should it fail to comply with those commitments. It is not uncommon, for example, for international trade sanctions to be claimed in the billions of dollars with potentially ruinous economic disruption to the domestic economy, particularly for one as dependent upon foreign trade as is the case in Canada.

34. Moreover, the principle of cross retaliation allows such sanctions to be targeted strategically where they will have greatest effect. For example, when the US threatened sanctions because it objected to Canada's response to an adverse WTO ruling concerning certain cultural policies to protect Canada's magazine publishing industry, it proposed **to target $1 billion of Canadian exports to the United States. Steel exports from Canada, much of these** produced in the riding of Canada's Heritage Minister, **were to bear the brunt of these threatened** sanctions - certainly no coincidence.[12]

[12] 'Pitch for Bill C-55: Canadian Magazine Publishers Argue in Washington That Bill Does Not Violate Free Trade,' *Maclean's* (March 8, 1999), 42.

35. Another form in which the binding influence of these international trade agreements asserts itself can be found in the regulatory chill which has now become a common feature of policy formation, in which domestic initiatives are vetted formally or informally for their potential for generating damaging suits mounted by foreign governments or corporations. The Canadian government has in fact already backed off legislation because of Chapter 11's provisions. Illustrative of Chapter 11's anti-regulatory impact was the federal government's abandonment of its attempt to eliminate the use of the gasoline additive MMT. Ethyl Corporation of Virginia, producer of this octane-enhancing chemical, had been unable to persuade Washington to request a dispute panel under Chapter 20, NAFTA's regular process for resolving conflict between governments. Since the U.S. Environmental Protection Agency had since 1977 banned MMT as a dangerous neurotoxin, Washington was unwilling to expend political capital on contesting Canada's right to ban trade in the same substance. Using Chapter 11's provision on investor-state disputes, Ethyl was able to bypass its government's reluctance to fight on its behalf. It put forward a claim that Ottawa's legislated ban on the fuel additive had cost it U.S.$250 million in lost business and future profits.[13]

36. The MMT case revealed how Canadian environmental policy, once thought to be the purview of the sovereign legislature, has been taken hostage by continental governance. Under the supraconstitutional aegis of Chapter 11, the issue is no longer the classic Canadian question of *which* level of government – federal or provincial – can initiate an environmental regulation. The issue now became *whether any* level of government could initiate such legislation if it jeopardizes the interests of a foreign company.[14] Far from the polluter's paying to rectify the externalities that it caused, Chapter 11's expropriation clause leads to the polluter's being paid to keep on polluting. A copy of Professor Schneiderman's articles on this subject "NAFTA's Takings Rule: American

[13] Elizabeth May, 'Fighting the MAI,' in Andrew Jackson and Matthew Sanger, eds., *Dismantling Democracy: The Multilateral Agreement on Investment and Its Impact* (Toronto: CCPA and Lorimer, 1998), 32-47.

[14] David Schneiderman, 'NAFTA's Takings Rule: American Constitutionalism Comes to Canada,' *University of Toronto Law Journal* 46 (1996), 535.

Constitutionalism Comes to Canada," and "Investment Rules and the New Constitutionalism", are attached respectively as Exhibits "D" and "E" to this affidavit.

(d) Rights.

37. As the corollary to limiting government, a state constitution establishes specific rights for its citizens, whether individual or collective. But the only "citizens" whose rights in Canada were extended by continental governance are corporations and individuals who can claim the status of foreign investors, or investments of foreign investors. These individuals and entities not only have rights and entitlements under NAFTA unavailable to Canadian citizens (corporate or otherwise) but have also been accorded a unilateral right to enforce those rights against the State Parties to NAFTA (investor-State claims).

38. Before the establishment of such an extraordinary remedy, a company whose business was hurt because of a foreign government's action had either to defend itself within that state's legal system or to persuade its own government to launch a trade complaint if there were grounds for doing so. NAFTA's major innovation was to put the arbitration machinery of international commercial regimes at the direct service of foreign investors to enforce rights established by an international treaty to which they were not parties, and under which they had no obligations.[15]

39. Article 1110 provides that no government may "directly or indirectly expropriate or nationalize" or take "a measure tantamount to expropriation or nationalization" except for a "public purpose," on a "non-discriminatory basis," in accordance with "due process of law and minimum standards of treatment" and on "payment of compensation."[16] **This provision has now been invoked to**

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[15] Richard C. Levin and Susan Erickson Marin, 'NAFTA Chapter 11: Investment and Investment Disputes,' ***NAFTA: Law and Business Review of the Americas*** **83, no. 2 (summer 1996), 90.**

[16] NAFTA, Article 1110.

challenge a diverse array of policy and regulatory actions taken by federal, provincial or municipal governments that have now been cast as expropriating foreign investments. This Chapter 11 prohibition of actions "tantamount to expropriation" was itself tantamount to a new constitutional right to property but only for the benefit of foreign corporations.[17] It has proven the most controversial of the external constitution's provisions, because it allows foreign corporations to invoke secretive international dispute procedures to challenge a broad spectrum of domestic policy and legal matters, from the delivery of postal services to the regulation of gasoline fuel additives.

40. In 1980, when Parliament debated what rights should be included in the proposed new Charter of Rights and Freedoms, property rights were excluded on the grounds that they were adequately protected under the common law. **In other words, the right to property was not to be absolute in Canada, but conditioned by broader societal objectives. Thus, the public interest in sound land-use planning would have priority over the interests of local entrepreneurs and developers to maximize the use and value of their property interests. But under NAFTA, private property protection is absolute and an American investor can now launch a suit for damages against the city in question, arguing that the value of its property had been "expropriated."[18]**

(e) Judiciary.

41. Norms, limits on institutions, and citizens' rights rapidly become dead letters without a judicial system to interpret and apply the constitution's texts, and to authorize meaningful sanctions in cases of non-compliance. Without a means of adjudication, the expansion of international trade regimes

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[17] Schneiderman, supra note 14.

[18] Of course, Canadian firms operating in the United States and Mexico would benefit from this right

would probably not have been more consequential than the legions of the International Labour Organization's many conventions. Thus, the new generation of international trade agreements, of which NAFTA is a prototype, constrains sovereign authority much more substantially than did GATT both because of their expanded breadth and because of the effectiveness of their dispute-settlement mechanisms.

42. Trade liberalization is typically promoted as a means for depoliticizing disputes that erupt from to time between nation states. Trade agreements such as NAFTA were to address this challenge by establishing **binding international rules that would be immune to the political manipulation that so often characterized the use of US domestic trade remedies. However, with the exception of investor-State claims, NAFTA's judicial effect has not been to empower a continental level of governance. For example, under Chapter 19, a Party may seek review of another's anti-dumping determinations, but only for the purpose of ascertaining whether such measures are consistent with the domestic law of the party imposing such measures.** The effectiveness of Chapter 20 procedures for resolving state-to-state disputes is limited because panel findings are only advisory and so ultimately return to the political arena for solutions to be negotiated.[19] Although weak in its capacity for adjudicating inter-governmental trade disputes, NAFTA has established with Chapter 11 an unprecedented and powerful mechanism through which foreign corporations may enforce the broad constraints of that treaty.

III NAFTA'S CHAPTER 11 INVESTOR-STATE DISPUTE SETTLEMENT

43. Chapter 11's investor-state dispute process introduces private international commercial legal processes into the sphere of Canadian public law. In effect, this dispute mechanism destatizes an

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to attack American or Mexican regulations that they allege 'expropriated' their property.

[19] For example, it took Mexico from 1995 to 2001 to have a Chapter 20 process rule that the United States should honour its NAFTA obligation to allow Mexican truckers to ply their trade in the American market – a

aspect of public law by internationalizing in a privatized format the domestic legal process which previously dealt with conflicts over public policy. Not only has Chapter 11 added to the Canadian constitution a new corporate property right that treats corporations unequally, depending on their nationality; it has imported an existing arbitration mechanism designed to handle international commercial disputes, turning it into a device to constrain governments' public policy-making capacity.

44. Canada's obligations under Chapter 11 are amenable to both State-to-State and investor-State enforcement. The former would proceed under Chapter 20 and ultimately depends upon the willingness of the Parties to implement an adverse ruling that might arise from such a dispute proceeding. The investor-State dispute process, on the other hand, is independent of political control and for that reason and others which follow, is much more constraining of sovereign policy and legislative initiatives. Thus, while the underlying disciplines remain the same, investor-State litigation exerts a more coercive influence over a broad sphere of domestic policy and law in several ways.

Arbitral Awards are Binding and Enforceable

45. To begin with, unlike state-to-state procedures, investor-State Tribunals are empowered to make damage awards which are binding and enforceable in Canada, and in more than a hundred nations that provide for the recognition and enforcement of international arbitral awards.

The Unpredictable and Ad Hoc Nature of Investor-State Litigation Creates a Chill Over Broad Areas of Policy and Law

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ruling that is still being stalled by challenges in American courts.

46. Because it is entirely independent of the political process and has no formal institutional structure to impart coherence, the approach taken to interpreting NAFTA disciplines by Tribunals convened under Chapter 11 procedures varies considerably from case to case. Moreover, the absence of any doctrine of judicial precedent leaves each Tribunal to fashion its own approach to interpreting NAFTA disciplines.[20] The broad, novel, and often ill-defined character of many NAFTA disciplines exacerbates this problem. Policy and law makers wishing to steer clear of NAFTA prohibitions have to navigate a course through a virtual mine field where the hazards are constantly shifting.

[20] See the following articles by two of Canada's most experienced international trade practitioners. Jon R. Johnson, *Essential Disciplines of the National Treatment Obligation under NAFTA Chapter Eleven*, http://www.dfait-maeci.gc.ca/tna-nac/treatment-en.aspmans. J.C. Thomas, NAFTA Chapter 11 to date: The Progress of a Work in Progress, Discussant's Comments, in Laura Ritchie Dawson, ed., *Whose Rights?: The NAFTA Chapter 11 Debate* (Ottawa: Centre for Trade Policy and Law, 2002).

47. There is considerable evidence that the threat of Chapter 11 litigation is sufficient to warn governments away from policy and regulatory initiatives that may be entirely lawful under Canadian law. An illustrative case is Ottawa's debacle over cigarette packaging. In the mid-1990s, the federal government tabled proposals to ban differentiated cigarette packaging as a natural extension of its prohibition on cigarette advertising Although the tobacco industry claimed that branding served no purpose other than to promote competition among brands for existing smokers, the government maintained that branding was targeted at lifestyle marketing and thus promoted increased sales and smoking.[21] After being threatened with a Chapter 11 claim for expropriation, government officials thought better of their plans.

48. In at least two of the cases brought against Canada, Ottawa has quickly settled with the disputing investor.[22] In one of those, Canada actually rescinded regulations effectively banning the use of a toxic fuel additive, offering the disputing investor what amounted to a public apology for having regulated the substance in the first place.[23] In addition to the $19 million paid to the disputing investor as part of the settlement, and the costs of unsuccessfully defending the measure, the

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[21] Susan Goodeve, ACanada Commits to Trade Liberalization,@ Section 2194 in Peter Haydan and Jeffrey Burns, eds., *Foreign Investment in Canada* (Scarborough: Carswell, 1996).

[22] See the Ethyl case, supra note 3, and also Trammel Crowe Company v. Canada which can be found at http://www.dfait-maeci.gc.ca/tna-nac/gov-en.asp.

political embarrassment of having to beat a hasty and public retreat also exerts a brake on the enthusiasm for pursuing future environmental and public health initiatives that may aggrieve foreign investors.

49. Adding further to the chilling effect of these international disciplines, and as noted by Professor Sornarajah in his affidavit sworn in support of this proceeding, the range of government action that may be subject to foreign investor claims extends beyond that for which legal sanctions would be available under the common law. Thus, even parliamentary debate about the need for an environmental regulation can attract litigation by the manufacturer of the impugned substance for damage to its goodwill.

***Judicial Sovereignty**: the Privatization of Legal Disputes Concerning State Action*

50. Judicial sovereignty is another casualty of this extraordinary addition to the Canadian legal order. Depending on the exigencies of the particular case where the place of arbitration is chosen to be somewhere other than Canada in a case challenging a Canadian measure, no judicial supervision may be exercised by Canadian courts.

51. When the U.S. waste-disposal company Metalclad used Chapter 11 to attack the environmental order made by a Mexican village that had shut down its landfill site, the

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[23] While the evidence of harm associated with the use of the particular substance MMT is equivocal, most other member nations of the OECD have relied upon the precautionary principle to ban the use of this fuel additive.

arbitrators, who met in Washington, ruled in the firm's favour. Because the tribunal had named Vancouver as its nominal address, the Mexican government's only recourse was to the Supreme Court of British Columbia under provincial legislation providing for the review of foreign arbitral awards arising from commercial disputes.

52. For Canadian governments, this subverts any notion that the decision of a Tribunal will ultimately adhere even to the most fundamental notions of justice that reside in the fabric of its constitutional democracy. Because arbitral awards may be set aside for being incompatible with the public policy of the state chosen as the place of arbitration, this may have the absurd result of having the courts of a nation with no connection to the dispute assessing whether the award is consonant with its public policy – not that of the State defending its measure, or even the host-state of the disputing investor. Yet this is precisely what occurred in the Metalclad case.

The Internationalization of Legal Norms

53. Since American corporate law tends to dominate international commercial law cases, conflicts between U.S. corporations and the Canadian state will inexorably cause U.S. legal definitions to infiltrate Canadian legal standards and force Canadian governments to operate as if American law on "regulatory takings" applied to them. While some observers expected that Canadian, American and Mexican jurisprudence would interpret "expropriation" differently in each country,[24] **it is generally acknowledged that panel findings will impose the U.S. interpretation instead of the other two signatories' legal notions.**[25]

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[24] Richard Dearden, 'Arbitration of Expropriation Disputes between an Investor and the State under the North American Free Trade Agreement,' *Journal of World Trade* 29, no. 1 (Feb. 1995), 127.

[25] 'The term "expropriation" includes, but is not limited to, any abrogation, repudiation, or impairment by a foreign government of its own contract with an investor with respect to a project, where such abrogation, repudiation or impairment is not caused by the investor's own fault or misconduct, and materially adversely affects the continued operation of the project.' United States Foreign Assistance Act of 1969, section 238, cited in Richard C. Levin and Susan Erickson Marin, 'NAFTA Chapter 11: Investment and Investment

54. Investor-State litigation violates many values held dear in the common law tradition. Transparency is yet another victim in the secret world of commercial arbitration. Proceedings are held in camera. The pleadings, evidence and argument may be kept secret if either party objects to their publication. The same is true of the Award itself, and while NAFTA accords the Parties the explicit right to release tribunal awards, nothing requires them to actually do so.

55. The notion of fairness **to the interests of non-parties is entirely absent from the arbitral model. No consideration for the participation of third parties is offered by either NAFTA disciplines or the arbitration rules which they invoke. While tribunals may yet accord a third party an opportunity to make submissions on public interest grounds, this is certain to be permitted only on the most restrictive terms.**[26]

International Arbitral Tribunals Lack Objectivity and Independence

56. The sociology of the panelists' selection makes it more likely that they will respond to the legal arguments privileging the norms of international commercial law. As the investor and the state each have the right to appoint one arbiter, and since the panel's chair is chosen by these two appointees, it is likely that there will be just one Canadian adjudicating suits launched against Canadian governments. This suggests that, when a norm of international corporate law comes into conflict with a Canadian legal standard, the latter is likely to be overridden.

57. The private international commercial judicial community may also be seen as having a vested interest in promoting the development of a largely autonomous but privatized global domain of

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Disputes,' ***NAFTA: Law and Business Review of the Americas*** **83, no. 2 (1996), 97.**

[26] UPS v. Canada, note 3.

corporate law.[27] The lack of judicial independence for international arbitral tribunals raises questions about their objectivity, and a legitimate concern that the self-interest of adjudicators influences the outcome of disputes. In the Desona case[28] for example, though the tribunal found the disputing investors guilty of fraudulent conduct and that their claim was entirely lacking in merit, it ordered no costs against them. Whatever the reasons for this ruling, it clearly sends a message to would-be disputing investors that they may not be penalized for bringing forward even the most unmeritorious of claims.

The Lack of Reciprocity Increases Exposure to Investor-State Claims

58. Unlike State-to-State procedures, NAFTA's Chapter 11gives foreign investors substantial new rights without imposing any corresponding restraints or obligations. Thus, recourse to investor-state litigation is untempered by many of the considerations that would intervene to prevent State-to-State claims, including the fact that NAFTA disciplines also bind the complaining state.

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[27] Dezalay and Garth, Dealing in Virtue: *International Commercial Arbitration and the Construction of a Transnational Legal Order*, University of Chicago Press, 1996.

[28] Robert Azinian et al. v. United Mexican States, Award, International Centre for Settlement of Investment Disputes, Additional facility, case No. ARB(AF)/97/2.

59. The new system is also skewed because corporations were given new rights and opportunities that citizens of the three countries did not enjoy. Moreover, no balancing obligations have been imposed on them by continental-level institutions with the clout to regulate their behaviour, redistribute some of their winnings through taxing the winners, or to monitor the newly created continental market that has begun to emerge.[29] Nor were Chapter 11's new corporate rights balanced by a requirement to promote the public interest by protecting the environment or public health.

In sum:

60. Taken together, the factors I have described conspire to cast a broad shadow over the landscape of domestic policy and law. Governments, which now must chart a course through the uncertain terrain of international trade disciplines, which may be invoked or threatened with few constraints by foreign corporations discontented with Canadian policy and law. The impact is to constrain the authority of Canadian governments at all levels as definitively but more arbitrarily than do the norms and limitations imposed by Canada's constitution and its common law norms.

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[29] Stephen Blank and Stephen Krajewski, "U.S. Firms in North America: Redefining Structure and Strategy," *North American Outlook* 5:2 (February 1995).

10 I make this affidavit in support of an application and for no other or improper purpose.

AFFIRMED before me at the City of Toronto, in the Province of Ontario, this 26th day of May, 2003.

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STEPHEN CLARKSON

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A commissioner for taking affidavits, etc.

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