

Investment Treaties and Chapter 11 of NAFTA

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Provisions of Chapter 11: National Treatment

- Article 1102: National treatment provision requires governments to treat foreign investors of NAFTA countries no less favorably than domestic investors in like circumstances, with respect to all phases and aspects of investment, including initial investment and sale of investment.

Discussion of National Treatment

- The difficulty of determining "like circumstances" is similar to the problems associated with determining "like products".
- Examples: Suppose that a foreign investor builds a new factory. Is it legal to require that this factory meet stricter environmental standards than existing factories? If new factory is located in environmentally sensitive area is legal to regulate it more strictly? If investor owns no other assets in country can it be obliged to post a bond to insure environmental compliance (e.g. cleanup)?

Provisions of Chapter 11: Most Favored Nation (MFN)

- Article 1103: Most Favored Nation requires governments to treat foreign investors from NAFTA country no less favorably than the best treatment given to investors from other (signatory or non-signatory) nations -- even if this is better than treatment given to national investors.
- This article creates the possibility that the provisions of other (possibly bilateral) agreements could be imported into Chapter 11.

Provisions of Chapter 11: minimum international standards

- Article 1105: Minimum international standards of treatment requires investors be treated "in accordance with international law" and to receive "fair and equitable treatment".
- This provision was intended to protect against egregious violations. The claim that domestic firms were being treated equally badly could not be used as a justification of unreasonable treatment of foreign firms -- thus the need for minimum international standards.

Minimum international standards, continued

- In Metalclad the Tribunal found that Mexico failed to maintain a transparent and predictable investment climate. In July 2001 the Free Trade Commission (the council of three trade ministers) issued an "interpretative statement", to the effect that the requirement to provide treatment in accordance to international law means "customary international law", as distinct from the strictest law (i.e. as distinct from the highest standards).

Minimum international standards, continued

- FTC cannot “amend” Chapter 11, only “interpret” it.
- To what extent is a nation responsible for government acts at a local level? Is a nation responsible for the assurances made by a bureaucrat, regarding the interpretation of a law? Can a Federal official usurp the powers of local officials, by offering an investor assurances?

Provisions of Chapter 11, Performance requirements

- Article 1106: Forbids use of performance requirements, such as domestic content rules or domestic employment requirements, or export requirements. Parties are also forbidden to use performance requirements for domestic investors, but domestic investors can not use the investor-state process

Discussion of prohibition of performance requirements

- The rationale for these prohibitions is that performance requirements reduce economic efficiency, because they interfere with the market outcome.
- There is a broad issue whether these prohibitions are justified. If investment decisions are the result of a bargain (e.g. between a government and a multinational) then the prohibition of performance requirements reduces the bargaining power of governments.

Performance requirements, continued

- Some have argued that an import ban is an implicit requirement to use a locally produced input. For example, Ethyl Vs Canada was arguably a dispute about trade, rather than investment.
- The issue should be whether the input ban violates some other discipline; if so, it is an issue for state to state dispute.
- If the import ban is viewed as an implicit performance requirement, this opens the door to investor to state dispute).

Provisions of Chapter 11 Expropriation

- Article 1110. Foreign investors entitled to compensation from treasuries for expropriations, or any action that is "tantamount" to an expropriation.
- Article 1110 prohibits direct or indirect expropriation unless expropriation is: (i) for a public purpose; (ii) on a non-discriminatory basis; (iii) in accordance with due process of law and Article 1105; (iv) on payment of compensation.

Regulatory Takings

- Fifth Amendment to US Constitution states that private property shall not be taken for public purpose without just compensation.
- The state has the right of eminent domain. If the state wants to take your land (e.g. to build a road) it can do so, but must compensate you.
- If the state restricts your use of land (e.g. to protect an endangered species) it does not have to compensate you (under US law, decided by Supreme Court), even though this action diminishes the value of your land.

Regulatory takings, continued

- Does any law or regulation that diminishes the value of an asset constitute an action “tantamount to expropriation”?
- Traditional exercise of “police powers” permits countries to act in the public interest without this action being considered a regulatory taking.
- Oregon law, current California referendum promote the “doctrine of regulatory takings” (the view that any state action that reduces value of an asset requires compensation).
- The Coase Theorem, again.

Chapter 11 and regulatory takings

- Is Chapter 11 an “end run” around US Supreme Court rejection of doctrine of regulatory takings. It is uncertain how Chapter 11 tribunals will interpret “police powers”.
- Tribunal in Metalclad case decided that the motivation of government action was not relevant, so it did not need to decide whether the (local) government action was consistent with the non-confiscatory exercise of police powers.
- Tribunal in Methanex case did consider the motivation for state law.

The Green article

- Article 1114 (the "Green article") "Nothing in this Chapter shall be construed to prevent a party from adopting, maintaining or enforcing any measure otherwise consistent with this Chapter that it considers appropriate to ensure that investment...is undertaken in a manner sensitive to environmental concerns." (e.g. A government can require environmental impact reports, pollution abatement equipment).

Summary

- Ostensible purpose of ITs is to promote an investment-friendly environment.
- The empirical evidence of actual effect of ITs on FDI is “muddy”.

Main objections to ITs

1. “Ex post” rules (e.g. those on expropriation) reduce a host’s ability and willingness to protect environment.
2. “Ex ante” rules (e.g. those on performance requirements) reduce a host’s bargaining power *vis-a-vis* investor.
3. Trade disputes might be construed as investment disputes, enlarging the scope of investor-to-state litigation.
4. The process is secretive and undemocratic.

The environmental effect of Chapter 11

- The decisions that Tribunals take, and the subsequent appeal court decisions, will determine the effect that the agreement has on environmental (and other) public policy.
- Some of the decisions can be construed as harmful to environmental interests, and others as respectful of those interests.

