CANADIAN ENVIRONMENTAL LAW ASSOCIATION
L'ASSOCIATION CANADIENNE DU DROIT DE L'ENVIRONNEMENT

BILL C-24 FREE TRADE AGREEMENT BETWEEN CANADA AND THE REPUBLIC OF PERU

SPEAKING NOTES FOR DEPUTATION TO THE STANDING COMMITTEE ON INTERNATIONAL TRADE, MAY 26, 2009

CANADIAN ENVIRONMENTAL LAW ASSOCIATION - THERESA McCLENAGHAN, EXECUTIVE DIRECTOR AND COUNSEL

Good Morning, Mr. Chairman and Honourable Members of Parliament. Thank you for inviting me to appear before you this morning to speak to Bill C-24, a Bill before Parliament regarding the recently signed Free Trade Agreement between Canada and Peru.

My organization, the Canadian Environmental Law Association is a federally incorporated not-for-profit environmental non-governmental organization, and an Ontario specialty legal aid clinic. We provide direct legal services to clients including test cases and precedent setting environmental law cases; our clientele includes low income and vulnerable communities and those who would not be able to afford a lawyer. Our mandate includes law reform, public legal education and community outreach.

I have drawn on CELA's extensive background in matters concerning trade and the environment in reviewing the Canada – Peru Free Trade Agreement, particularly the work of the late Michelle Swenarchuk, formerly our Director of CELA's trade and the environment program.

I wish to briefly make three points regarding the Canada – Peru Free Trade Agreement (and I would note that these comments are not necessarily unique to this particular bilateral Agreement).

Firstly, that the provision of direct Investor access to Investor – State claims under an Investment chapter is itself problematic in that it invites repeated challenges of environmental, health and safety regulatory action by Canada and the provinces.

Secondly, that if direct Investor access is to continue to be provided, then the bilateral Free Trade Agreements must be explicitly clarified to apply situations of true expropriation, and made explicitly inapplicable to regulatory action by Canada and the provinces in matters of environment, health, safety and worker protection.

Thirdly, that the proliferation of bilateral free trade agreements both by Canada and by other nations is establishing a patchwork of rules pertaining to the protection (or lack thereof) of the sovereign right of Canada and the provinces (and other nations) to establish environmental,

health, safety and labour rights legislation and regulation as governments see fit. The very existence of such a patchwork makes the assessment of "risk" of trade challenges very problematic to the governments and itself will become a greater chill on appropriate regulatory action for the well-being of Canadians.

Direct Investor Access to Investor – State Claims under an Investment Chapter

It is not necessary to provide direct access to States by Investors in the bilateral free trade agreements, even if one wishes to provide protection against expropriation. The trade agreements normally provide that investors are entitled to the same treatment as nationals and accordingly the domestic law (both common law and statutory) regarding expropriation would be available for recourse. That was the course followed in the second Bi-lateral Free Trade Agreement that the United States negotiated "with a developed country", with Australia, in 2004. The U.S. – Australia Free Trade Agreement gives no direct Investor – State remedy even though it contains provisions regarding expropriation. In the *Final Environmental Review of the U.S. – Australia FTA, July* 2004, the reviewing Committee stated,

> *In recognition of the unique circumstances of this Agreement – including, for example, the long-standing economic ties between the United States and Australia, their shared legal traditions, and the confidence of their investors in operating in each others' markets – the two countries agreed not to implement procedures in this FTA that would allow investors to arbitrate disputes with governments. Government-to-government dispute settlement procedures remain available to resolve investment-related disputes.*

That agreement included provisions which are the "normal" rules regarding expropriation, including that it be for a public purpose, non-discriminatory, and that prompt reasonable compensation be provided and in accordance with due process of law. By 2004, NAFTA had been the subject of some Investor – State challenges and claims for compensation for regulatory action under its investment chapter between private for-profit nationals and each of the signatory Parties (Canada, the U.S. and Mexico), and I would speculate that the negotiators of the U.S. – Australia agreement wanted to avoid these types of claims.

Rather than providing a direct Investor – State remedy, the U.S. – Australia Free Trade Agreement provided for "Consultations on Investor-State Dispute Settlement", article 11.16 of that Agreement. It provides,

> *If a Party considers that there has been a change in circumstances affecting the settlement of disputes on matters within the scope of this Chapter and that, in light of such change, the Parties should consider allowing an investor of a Party to submit to arbitration with the other Party a claim regarding a matter within the scope of this Chapter, the Party may request consultations with the other Party on the subject, including the development of procedures that may be appropriate. On such a request, the Parties shall promptly enter into consultations with a view towards allowing such a claim and establishing such procedures.*

> *For greater certainty, nothing in this Article prevents a Party from raising any matter arising under this Chapter pursuant to the procedures set out in Chapter 21 (Institutional Arrangements and Dispute Settlement). Nor does anything in this Article prevent an investor of a Party from submitting to arbitration a claim against the other Party to the extent permitted under that Party's law.*

In other words, the remedy the U.S. – Australia negotiators settled on was the normal expropriation rules of each country; and in case of complaint with those, one of the Parties could make it the subject, as between the State Parties, of the Agreement's dispute resolution procedures.

By the way, the U.S. – Australia agreement contains an Annex, Annex 11-B to the Investment Chapter regarding the interpretation of Expropriation, and specifically regarding indirect expropriation. As the language in that Annex is essentially the same as in the Canada – Peru Free Trade Agreement, I will deal with it below under my second point.

However, remaining with the first point for the moment, I would submit that the absence of a direct Investor – State procedural remedy under the U.S. – Australia Agreement is itself a protection for the State parties in terms of their ability to regulate with respect to environmental, health, safety and worker protection matters, among other things. If an investor had a true expropriation claim, then it could proceed under the normal domestic law. On the other hand, in order to garner attention for an alleged "indirect expropriation" based on regulatory action by the state, the investor would first have to persuade its own government that it had a legitimate complaint and that the regulatory action in question was one of those "rare circumstances" of indirect expropriation. Since the U.S. – Australia Parties were clearly anxious to protect their own right and ability to carry on with high standards of environmental regulation for example as set out in chapter 19 of that Agreement, I would suggest that they would be very reluctant to pursue a complaint or invoke a dispute resolution procedure under the Agreement. Theoretically one could argue that they might do so in case of very aggregious action, but given the mature democracies of both Parties, I would suggest that this likelihood is vanishingly small. Democratic governments have to consider a range of often competing factors including matters of public interest such as environmental protection, human health, safety and worker rights, as well as the social and economic impacts of their regulatory actions. That is their prerogative.

It would be my recommendation that the right of direct access by investors to a claim against the Parties be removed, and that instead an approach be taken akin to that provided in the U.S. – Australia Free Trade Agreement as excerpted above. In other words, provide access to investors to the Canadian domestic procedures, courts and laws, for cases of "true" expropriation; and do not provide for claims of "indirect expropriation", at least vis a vis regulatory action by Canada or the provinces for environmental, health, safety and worker protection matters.

Providing private investor access to a direct remedy, and to an arbitral panel at that, working with rules which were developed to mediate commercial disputes, interferes with the workings of the Parliamentary system in Canada.

EXPLICIT APPLICATION TO "TRUE" EXPROPRIATION ONLY

CELA has never argued against appropriate provisions for expropriation in domestic or international law. The common law, and now usually, statutory law, provide important protections for property holders for those situations in which the public interest requires the State to take property. Long-standing examples include takings for highways and electrical transmission lines, for example. However, on the other hand, CELA has long disputed arguments that public interest regulation amounts to expropriation or that any compensation is due when activities are curtailed because of public interest regulation. For example, land use decisions, facility approvals, and pollution emission controls are all situations where regulation is valid in the public interest even though those regulatory actions may either impose costs on property owners, or preclude certain activities.

In the event that Parliament approves a Free Trade Agreement with Peru which does provide for direct Investor access to the State with a claim for expropriation, we suggest that this be limited to cases of direct expropriation; and not extended to cases of indirect expropriation. At a minimum, claims for indirect expropriation arising out of public interest legislation or regulation for environmental, health, safety and worker rights ought to be disallowed under the Agreement.

I would suggest this approach instead of the case by case approach provided in the Canada Peru Free Trade Agreement. Even though there is an attempt to clarify that these cases do not amount to indirect expropriation, the very fact that the claim may be brought means that there is uncertainty as to the arbitral panels' rulings; and a regulatory chill may still prevail.

For example, you have heard testimony already about the recent claim being brought by Dow Chemical against Canada for the actions of Quebec in respect of its Pesticide Code. At the time that this claim was filed by Dow, the province of Ontario had enacted amendments to its Pesticides Act dealing with cosmetic use and sale of lawn and garden pesticides and was in the process of consulting with respect to the regulations under that new statute. The Ontario Minister of the Environment felt compelled to make public statements in the media late last year that the fact of the Dow challenge would not cause Ontario to reconsider its approach.

In my opinion, the very fact that these claims can be brought is a problem in its potential to interfere with valid regulatory action in the public interest. The potential for such claims may give greater weight or consideration to the commercial interests represented, even though the contemplated regulatory action by the government is not an expropriation in customary international law or domestic law. And the problem extends, not just to the national government, but also to all of the provincial and territorial governments; and remains an issue even when the government of Canada undertakes to defend the validity of the sub-national (provincial or territorial) action.

Canada does have a very well established, long-standing and robust system of adjudication of awards for situations of direct expropriation. Providing access to investors to the court system to determine such cases is not a problem. But providing a new remedy to investors under the new Bilateral Trade Agreements, by way of access to commercial arbitral panels, for awards that are

predicated claims against governments who have undertaken public interest regulation is definitely a problem.

Does the Canada – Peru Free Trade Agreement provide this explicit limitation, limiting investor claims only to cases of direct expropriation? In my opinion it does not do so. On the one hand the language could be perceived to be an improvement over the language in the NAFTA. However, the Agreement provides in Annex 812.1, that that determination of whether a measure is an indirect expropriation will be determined case by case. It provides several factors, such as the economic impact of the measure, the extent it interferes with investment backed decisions, and the character of the measure and including the provision that:

> *Except in rare circumstances, such as when a measure or series of measures is so severe in the light of its purpose that it cannot be reasonably viewed as having been adopted and applied in good faith, non-discriminatory measures of a Party that are designed and applied to protect legitimate public welfare objectives, such as health, safety and the environment, do not constitute indirect expropriation.*

In addition, the Exceptions chapter 22 provides for the incorporation of the GATT article XX provisions that protect environmental measures necessary to protect human, animal or plant life or health and measures relating to the conservation of living and non-living exhaustible natural resources. And chapter 22 provides that for the purposes of the Investment chapter, nothing in the Agreement shall be construed to prevent a Party from adopting such measures, as long as they are not arbitrary or unjustifiable discrimination nor a disguised restriction on international trade or investment.

As provisions such as Annex 812.1, quoted in part above, have only been included in bilateral trade agreements recently, we have yet to see whether arbitral panels will deny investor claims under the bilateral free trade agreements based on the economic impacts of public interest regulation. It is my view that they will, but not because of this language in some of the recent bilateral free trade agreements, per se. Rather, the arbitral panel ruling in the recent investor claim by Methanex provided sound reasoning as to why public interest regulation is not expropriation. As international lawyer Howard Mann commented following the Methanex decision in 2005,

> "Thus the tribunal has drawn a sharp line: regulatory measures that are for a public purpose, non-discriminatory and enacted in accordance with due process are not, by definition under international law, expropriations. Not being expropriations or measures tantamount to expropriation, they are not, therefore subject to any compensation.[1]"

Similarly, a 2004 OECD study paper on indirect expropriation and the right to regulate stated that:

> "A very significant factor in characterising a government measures as falling within the expropriation sphere or not, is whether the measure refers to the State's right to promote a

[1] Mann, Howard, *The Final Decision in Methanex v. United States: Some New Wine in Some New Bottles*; 2005 International Institute for Sustainable Development (IISD)

> recognised "social purpose" or the "general welfare" by regulation. "The existence of generally recognised considerations of the public health, safety, morals or welfare will normally lead to a conclusion that there has been no 'taking'". "Non-discriminatory measures related to anti-trust, consumer protection, securities, environmental protection, land planning are non-compensable takings since they are regarded as essential to the functioning of the state".[2]

However, on the other hand, the arbitral panel rulings are not binding on subsequent panels. Furthermore, the panels would consider each claim on a case by case basis, as noted. One of the variables will be the fact that now we may have a multiplicity of bilateral free trade agreements between different parties, each of which protects the right of the state to regulate in the public interest in slightly different ways. And in any event, even considering the paragraph provided in the Canada – Peru free trade agreement as set out above, there is much room for a hypothetical determined, well resourced and creative investor to make argument.

Firstly there will be a claim that their case is one of the "rare circumstances". And then they will argue that the measure is very "severe"; that it wasn't "reasonable"; that it wasn't adopted "in good faith"; perhaps that the measure was discriminatory; and possibly that the measure was not designed to protect legitimate public welfare objectives. Other arguments can be anticipated. I would hope, if such claims continue to be provided for in this and other bilateral free trade agreements, that future panels would follow Methanex. But that is only a hope, and I suggest that the better course would be to remove the ability to bring such claims under the free trade agreements in the explicit drafting. In my opinion, providing recourse for true expropriation is sufficient; or at the very least, should not extend to the case of claims based on public interest regulation. In that case, Annex 812.1, "Indirect Expropriation", paragraph (c) should have deleted the first three lines and modified the remaining paragraph so as to then read,

> "Non-discriminatory measures of a Party that are designed and applied to protect public welfare objectives, including but not limited to such matters as health, safety, workers' rights and the environment, do not constitute indirect expropriation."

Furthermore, I would recommend that those claims be precluded and explicitly removed from the jurisdiction of arbitral panels under the investor claims procedures.

PATCHWORK OF POTENTIAL INVESTOR CLAIMS; INCREASED REGULATORY CHILL AND PUBLIC PARTICIPATION ISSUES

The third area of comment is that the proliferation of bilateral free trade agreements both by Canada and by other nations is establishing a patchwork of rules pertaining to the protection (or lack thereof) of the sovereign right of Canada and the provinces (and other nations) to establish environmental, health, safety and labour rights legislation and regulation as governments see fit. The very existence of such a patchwork makes the assessment of "risk" of trade challenges very

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[22] Yannaca-Small, Catherine, "*Indirect Expropriation" and the "Right to Regulate" in International Investment Law*, 2004, Organization for Economic Co-operation and Development, Directorate for Financial and Enterprise Affairs, Working Papers on International Investment November 2004/4 at 16. See also

problematic to the governments and itself will become a greater chill on appropriate regulatory action for the well-being of Canadians.

CELA is in the process of compiling a chart of the environmental provisions, and in particular, the environmental regulation provisions of a large number of bilateral free trade agreements between various nations which have now been negotiated since NAFTA; many in very recent years. Almost all of them have provisions that were not included in NAFTA that espouse the importance of environmental and public interest protection and of regulating to a high standard.

As I have noted, the U.S. – Australia agreement is notable for not providing a direct investor remedy against the state outside of normal customary international law and domestic law remedies. But the other Agreements on the whole do include investment chapters and direct access by investors to make claims for expropriation against state Parties by way of arbitral proceedings. And on the whole they do not rule out claims for indirect expropriation; nor even for indirect expropriation based on public interest regulation. We have yet to see how potential claims may be handled under many of these new Agreements.
As I have noted, the very fact that the claims can be brought is itself problematic and interferes with democratic decision making in the public interest. A further complication is the proliferation of the bilateral agreements and the varying mechanisms for "protecting" environmental regulation. Interpretive annexes versus inclusion in the main agreement; separate environmental agreements in addition to the main free trade agreement; and definitional differences are among the variables.

In addition there are differing provisions with respect to access by the public to such disputes once claims are made. Again, the very fact that issues such as the "reasonableness" or "legitimacy" or "good faith" of decisions made by sovereign democratic federal and provincial / territorial governments in Canada may be put in issue and adjudicated by commercial trade arbitrators is a fundamental flaw in the structure of the Canada – Peru trade agreement, and the other similarly framed agreements[3]. Canadians have the expectation, and the right, to have their governments make public interest regulatory decisions to the best of their ability, as they determine appropriate to do upon a consideration of all of the factors before them. You, as Members of Parliament are in the position to most keenly understand the responsibility that is imposed upon you in making decisions regarding environment, health, safety and worker rights, for example, and I would submit this responsibility includes protecting the public interest decisions of this and future Parliaments, as well as those of your provincial and territorial colleagues, from "investor rights" claims of indirect expropriation.

I hope these comments are of assistance and would be happy to discuss these views further.

[3] For further elaboration of this line of argument, see also Cosbey, Aaron, *NAFTA's Chapter 11 and the Environment: Discussion Paper for a Public Workshop of the Joint Public Advisory Committee of the Commission for Environmental Cooperation of North America*, 2003 International Institute for Sustainable Development