THE NEED FOR REFORM

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instead of a year later. If the Chapter 19 panel determination had been made by a binding WTO DSB panel, the world trading community would have had a stake in ensuring that the United States could not simply change the rules as they did.

We believe that a tendency exists to discount the WTO DSB as a potential route of reform because of the experience with the GATT mechanism in the past. It is now time to give the multilateral dispute settlement mechanism a second chance.

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ENDNOTE

1. The authors have provided a detailed analysis of the Softwood Lumber III Extraordinary Challenge decision, as well as potential reforms of the Chapter 19 mechanism in Gastle & Castel, *Should the North American Free Trade Agreement Dispute Settlement Mechanism in Antidumping and Countervailing Duty Cases be Reformed in the Light of Softwood Lumber III?*, Law and Policy in International Business, Vol. 26, Spring 1995, pp. 823-896.

NAFTA AND INVESTMENT: AN ECONOMIC CONSTITUTION?

BY BARRY APPLETON

While generally considered to be strictly a trade agreement, it comes as a surprise to many to find that a large part of the NAFTA's three-thousand-plus pages is devoted to the protection of investment, services, and intellectual property. Indeed, so strong are these protections that the NAFTA can properly be called the most far-reaching international investment agreement in the world.

What makes the NAFTA so remarkable is not just its very broad definition of investment, but also its unique process to protect the "rights" of NAFTA investors. The NAFTA imposes obligations upon its signatories in a number of investment areas. The difference is that if these obligations are not met, individual investors have direct legal rights that can be brought to a tribunal without the agreement of their home government.

The NAFTA's "investor state" dispute settlement process, a central component of the agreement, provides for a fast and effective means of settling disputes between investors and governments by bypassing domestic courts. Designed to provide protection for foreign investors in developing countries, the investor-state dispute process focuses strictly on settling investment disputes between individuals and governments.

The use of arbitration is not new in international law. Countries have relied upon it to settle their disputes for hundreds of years. What is new is that the NAFTA makes this formerly country-only process available to all North American private citizens and their businesses. What is surprising is that these governments have agreed to accept the decisions of these international tribunals to discipline their conduct.

The NAFTA requires that there be some international element involved in an investment dispute. Under the agreement, any individual or business resident in a NAFTA country can launch a claim against the government of another NAFTA country. Thus, Canadian investors are not eligible to bring disputes against the government of Canada, but American or Mexican investors are. A major exception to this rule is that Canadian corporations "owned or controlled directly or indirectly" by a citizen of another NAFTA country can bring a claim against a Canadian government.

The bizarre result is that foreign companies or investors are able to access the NAFTA investor-state process to protect their rights while Canadians are not. This is not just an academic quandary. In

WHAT RIGHTS DOES THE NAFTA PROTECT?

The thousands of pages that make up the NAFTA are divided into twenty-two chapters and supplemented by thousands of pages of annexes. The Agreement contains one chapter dealing with trade in goods but five chapters dealing with investment and services (one chapter each on investment, cross-border services, telecommunications, financial services, and intellectual property).

The NAFTA investment chapter imposes stringent obligations on member governments regarding investments from other NAFTA countries. The NAFTA defines an investor as a NAFTA citizen (private or corporate) that "seeks to make, is investing or has made an investment."

The types of investment rights covered include:

National Treatment: Foreign investors must be treated at least as well as domestic ones. This means that neither formal nor substantive rules can be structured in such a way as to give an advantage to domestic companies.

Most-Favoured Nation Treatment: Any special treatment given to non-NAFTA country investors must also be extended toNAFTA investors.

Minimum Standards of International Treatment: Investors and their investments must be given due process, fairness, and other protections.

Limits on Performance Requirements: Rules that require ll loca local hiring, local sourcing, or a percentage of local content are severely limited or prohibited against all foreign investments (not just NAFTA-based investments).

Full Compensation on Expropriation: Full, swift, and fair compensation must be paid after any expropriation or any act that is similar to expropriation. In some circumstances, excessive government regulation could constitute an act "tantamount to expropriation."

These obligations apply to national and subnational governments as well as to Crown corporations that exercise any authority given to them by governments.

the first NAFTA investor-state case, a Mexican company challenged the Government of Canada over certain federal pharmaceutical approval regulations. The company alleged that the Canadian rules unfairly prohibited its access to courts and ultimately to the Canadian market. These same regulations affect hundreds of Canadian companies, but they are ineligible to bring a NAFTA action because they are Canadian. In essence, foreigners are treated better than Canadians under these rules.

While states and provinces are not themselves members of the the NAFTA, North American "subnational" governments often engage in covert practices designed to help local business.

Claims can be raised regarding the widest possible variety of investments, including businesses (incorporated and non-incorporated), shareholdings, loans made to foreign companies for more than three years, real estate, intellectual property, and goodwill. All of these investments would be protected by the NAFTA.

INVESTORS' RIGHTS

NAFTA investors are entitled to dispute governmental acts that harm their investments. These rights must be respected by governments in their legislation, regulation, policies, and practices. While states and provinces are not themselves members of the the NAFTA, North American "subnational" governments often engage in covert practices designed to help local business. Such actions are covered under the NAFTA and will, no doubt, be a fertile source for future investor-state disputes, as will be areas where the intersection of public and private rights may differ among the NAFTA countries. Such disputes are inevitable when dealing with cultures as different as those of Canada, the United States, and Mexico. Areas that may immediately raise concerns are health care delivery, and public secondary and post-secondary education.

The potential class of trade-related litigants has increased from two under the Canada-U.S. Free Trade Agreement to millions under the NAFTA.

NAFTA investor-state panels consist of three arbitrators and are appointed by the disputing parties. They can award financial compensation to investors who have been harmed by inappropriate governmental action. The panels do not have the power to strike down infringing laws, but they can award damages that can quickly motivate governments to amend their legislation. The awards of these panels are not subject to any appeal.

There is little doubt that this NAFTA dispute system will play a major role in how business is done in North America over the next decade. The potential class of trade-related litigants has increased from two under the Canada-U.S. Free Trade Agreement to millions under the NAFTA. All these newly empowered litigants will be unfettered by the constraints of diplomatic niceties. In conferring rights and remedies, the NAFTA investment provisions have quietly created an economic constitution that protects the elite rights of foreign NAFTA investors investing in each NAFTA country.

The impact of these NAFTA cases will not go unnoticed by governments. Faced with ever-decreasing amounts of discretionary spending, governments will begin to modify their policies so that they can avoid the high damage awards that panels could assess. With an enlarged class of potential litigants free from the shackles of diplomacy, NAFTA investor-state disputes are certain to become part of doing business North American-style.

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EXAMPLES OF POTENTIAL NAFTA INVESTOR-STATE CASES

One highly publicized example of government action presents an excellent illustration of the types of situations that could be the basis of an investor-state claim. A review of Bill C-22, the legislation killing the privatization of Toronto's Pearson International Airport, discloses that it was carefully drafted to avoid constituting an expropriation under Canadian law. The NAFTA defeats this careful wording by extending the definition of the term "expropriation" to include acts "tantamount to expropriation." The NAFTA requires a speedy process for payment whenever there is a measure tantamount to expropriation, which was not followed in the Canadian legislation in this case. American investors in the Pearson consortium could challenge Canada's actions before a NAFTA panel, while the majority of Canadian investors cannot. The Pearson Airport privatization example illustrates that foreign investors operating in Canada enjoy greater rights in challenging domestic measures than do Canadians.