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This One Goes to Eleven

By David Dittman

The North American Free Trade Agreement (NAFTA), which came into effect on Jan. 1, 1994, and is the largest trade bloc in the world in terms of combined GDP of its members, is a free trade and investment agreement that provides investors with a unique set of guarantees designed to stimulate foreign direct investment (FDI) within the hemisphere, especially from the US to Canada and Mexico.

Increasing investment was a central purpose of the deal, and as far as encouraging FDI, NAFTA Chapter 11 is a success.

Between 1983 and 1992, before NAFTA, the stock of FDI in Canada increased by USD44 billion. In the decade after NAFTA, between 1993 and 2002, the stock of FDI increased USD202 billion--354 percent--over the decade before NAFTA.

Chapter 11 greased the flow of money by specifically outlawing a number of performance requirements member states could impose, including exporting a given percentage of goods, achieving a given level of domestic content, transferring technology and providing other limits on the use of foreign exchange.

These types of measures had been used by both Mexico and Canada to encourage development of their domestic economies and to maximize the benefits they obtained from FDI.

NAFTA also included unprecedented guarantees to protect the value of investments and even the rights of corporations to earn profits in the future, arising out of changes in government regulations or policy.

In particular, NAFTA created specific clauses that provide for compensation for lost investments and loss of future profits because of regulations that are “tantamount to expropriation.”

NAFTA essentially represented an ironclad commitment on the part of the Mexican and Canadian governments to a development strategy hinging on attracting foreign investment by harmonizing investment deregulation with standards in the US.

NAFTA Chapter 11 also gives investors the right to take investment disputes with NAFTA member states to arbitral tribunals rather than to domestic courts of law. The process it established was meant to be used; it was designed to give investors faster,

cheaper paths to quick resolutions.

As it often is with government--let alone multi-government--intentions, it hasn't worked out that way. On average, it takes almost three years from the beginning of the case to the Final Award on Merits. This is approximately three times longer than NAFTA timetables suggest and two to three times as long as the World Trade Organization (WTO) Understanding on the Rules and Procedures Governing the Settlement of Disputes.

This is the route Marvin Gottlieb, a longtime *CE* subscriber, has chosen to travel. Gottlieb has filed a Notice of Intent to Submit a Claim to Arbitration Under Section B of Chapter 11 of the North American Free Trade Agreement based on the Canadian government's decision to begin taxing income trusts at the entity level in 2011.

Gottlieb's claim is focused entirely on energy trusts because public representations and statements by Finance Minister Jim Flaherty, in particular, establish a clear fact pattern supporting the conclusion that Canada specifically targeted American investors in oil and gas trusts for elimination. You can read the notice [here](#).

Outside a courtroom or arbitration hearing, whether a politician's words have any meaning is comedy gold for Stephen Colbert and Jon Stewart. But a politician's words have been given effect by NAFTA Chapter 11. Whether public statements by relevant elected authorities may be relied upon justifiably by investors in formulating decisions is a question theoretically framed by a binding instrument.

NAFTA investor-state cases proceed very slowly and are very costly. They proceed much more slowly than NAFTA Binational Panel review under Chapter 19, than NAFTA state-to-state dispute settlement under Chapter 20 and state-to-state dispute settlement under the WTO.

There's good news for the long term because Canada recently passed legislation implementing the International Centre for Settlement of Investment Disputes (ICSID) Convention, a tool that could speed up the investor-state dispute resolution process.

Canada's implementation of the ICSID Convention will enable foreign investors suing the Canadian government under Chapter 11 or to use the institutional arbitration mechanism available under ICSID.

The main advantage of conducting arbitration under the ICSID Convention is that it contains its own review and enforcement mechanisms. Awards issued under the ICSID Convention are binding on the parties and not subject to review except as provided for under the ICSID Convention.

Decisions rendered under an ICSID arbitration are effectively final. An administrative "appeal" may be made to the ICSID Secretary-General for an annulment of award but only on one of five narrow enumerated grounds: that the tribunal wasn't properly constituted; that the tribunal has manifestly exceeded its powers; that there was

corruption on the part of a member of the tribunal; that there has been a serious departure from a fundamental rule of procedure; or that the award has failed to state the reasons on which it's based.

Awards can't be challenged outside of ICSID, and national courts have no power to review an ICSID Convention award. Parties to the ICSID Convention are bound to recognize the award as binding and to enforce it as if it were a final judgment of a national court.

The Canadian government hasn't yet indicated a timetable for ratification of the treaty. Only four provinces and one territory have passed similar implementing legislation: Ontario, British Columbia, Newfoundland and Labrador, Saskatchewan and Nunavut.

With its announcement of the passing of the act, the government issued an "invitation" to the provinces to adopt implementing legislation.

Once Canada ratifies it, foreign investors in Canada will be able to use the dispute resolution mechanisms under the ICSID Convention via investment treaties or investment contracts. Jurisdiction of the ICSID Convention is limited to those instances where a foreign investor's home state and the host state where the investment is made are both ICSID member countries.

The investment dispute settlement provisions of NAFTA Chapter 11 generally provide that disputes between investors and the host government may be resolved through arbitration under the ICSID Convention. But until ratification, recourse must be made to the less-defined, more-circuitous Additional Facility Rules of ICSID or the ad hoc United Nations Commission on International Trade Law Rules.

Among the parties to NAFTA, only the US has ratified the ICSID Convention, meaning that, until Canada's ultimate ratification, NAFTA Chapter 11 arbitration under the ICSID Convention remains unavailable to both Canadian investors in the US and American investors in Canada. As of now, we're left with a time-consuming process.

Any investor would readily admit that time is money, and states recognize this. Compared to the national treasuries of Canada, Mexico or the US, virtually all private investors who may avail themselves of the NAFTA Chapter 11 protections would be considered poor. Unlike Canada, for example, a private investor doesn't have an unlimited budget and may not be able to afford the luxury of pursuing a case purely to establish a precedent.

Gottlieb is there because he wants to collect damages owed as a result of Canada's alleged breach, damages that could approach USD5 billion. But Flaherty, et al., are likely to rely on this imbalance to prolong the process, increase costs and possibly thwart justice in the hope Gottlieb will, as a business decision, simply give up in the face of unending delays and mounting expenses.

If you owned any Canadian energy trusts on Oct. 31, 2006; if you're a citizen of the US or Mexico, or hold dual citizenship in Canada and another NAFTA member country; and if you'd like to pursue a compensation award based on losses incurred after the Canadian government announced it would start taxing specified investment flow throughs (SIFT), which include energy trusts, in 2011, go [here](#) and provide your information.

It may take a while, but there are many pounds of flesh worth extracting.

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