HERMAN & ASSOCIATES - TRADE LAW MEMO
NAFTA INVESTMENT DISPUTES – UPDATE

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Introduction and Summary

NAFTA re-negotiations are entering their most difficult phase in Montreal, 23-28 January 2018, with attention centred on the poison pill proposals initially put on the table by the US Trade Representative (USTR) in October 2017.

These include, but are not limited to, eliminating Chapter 19 binational panel reviews, changing automotive rules of origin to increase US content, requiring dollar-for-dollar reciprocity in government procurement and adopting a 5-year sunset for the new agreement.

While not quite as newsworthy, the US also wants to end the investor-State dispute settlement (ISDS) system under **NAFTA Chapter 11,** making it applicable only if governments decide to opt into the system.

The strategy is to **eliminate recourse for US persons investing in Mexico or Canada**, making it more attractive for them to keep their money in the United States.[1] The US stance follows Mr. Trump's "America First" policy aimed at on defending US sovereignty and opposition to, if not hostility towards, international tribunals such as those enshrined in the NAFTA.

For reasons not entirely clear, **Canada wants to keep Chapter 11**, but proposes enlarging it to provide for appeals and a permanent investment court, modeled after provisions in the Canada-EU *Comprehensive Economic and Trade Agreement* (CETA). Canada believes CETA model is a more "progressive" version of the ISDS system and

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[1] "In his own words: Lighthizer lets loose on business, Hill opposition to ISDS, sunset clause" *World Trade Online*, 19 October 2017.

responds to growing public concerns about legitimacy and predictability in panel decisions.[2]

The US side will have none of that.

Given the diametrically opposed positions on the NAFTA investment chapter - and on other critical issues - it's difficult to know how the negotiations play out over the days and weeks ahead.

With these seemingly irreconcilable views, an explanation of the background and state of play under Chapter 11 seems appropriate. This paper reviews the **basic elements** of that system and looks at **outcomes** in terms of Canada's win/loss record against compensation amounts actually claimed by US investors over NAFTA's 23-year history.[3]

What this review shows are **mixed results**. US investors have succeeded in obtaining outcomes (both awards and agreed settlements) worth several hundred million dollars. Canada, on the other hand, has successfully defended many claims, paying out a **relatively small fraction** of the total amounts claimed over this period.

Notable in this history is that Canada has been the target of US investor claims much more frequently than Mexico. In addition, **Canadian claimants have never won an investment arbitration against the United States**. This raises numerous questions, including whether maintaining Chapter 11 is in Canada's interest.

Overall Context

The Chapter 11 process starts with an investor from one of the NAFTA countries filing of a **Notice of Intent** under NAFTA Article 1119. Initiating the process in earnest, however, requires the subsequent filing of the actual **Claim to Arbitration** under Article 1120. Numerous Intent Notices have been filed by American claimants, but many have been withdrawn or have not been proceeded with.

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[2] "CETA: EU and Canada agree on new approach on investment in trade agreement", European Commission Press Release, 26 February 2016: http://trade.ec.europa.eu/doclib/press/index.cfm?id=1468.

[3] This summary is based on the record of Chapter 11 arbitration claims and awards found on the Global Affairs Canada web-site at: http://www.international.gc.ca/trade-agreements-accords-commerciaux/topics-domaines/disp-diff/gov.aspx?lang=eng.

Successful Chapter 11 claims result in **monetary awards** in favour of the investor. Arbitrators cannot order NAFTA governments to repeal or eliminate impugned measures, although often the result will be followed by changes to a law, regulation or policy found to have offended NAFTA obligations.

The Global Affairs Canada web-site, updated to January 2018, shows **26 US investor cases** against Canada, 4 of which have been withdrawn or inactive.[4] Previously, a total of 39 cases where Notices of Intent had been filed were listed by Global Affairs but these have since been removed from the Department's web-site.[5]

Of the 22 claims that have gone beyond the Notice of Intent phase, **16 have reached conclusion**. Two of these were settled out of court, as it were, Canada agreeing to pay the investor compensation: ***Ethyl Corporation*** ($20 million) and ***Abitibi-Bowater*** ($130 million).

US Investor Claims Ended or Concluded

Of the remaining cases on the Global Affairs roster,

- two were withdrawn by the claimants under consent awards: ***St. Mary's VCNA*** (zero awarded versus US$275 million claimed); ***Dow AgroSciences*** (zero awarded versus $2 million claimed);
- one was terminated by the panel because the claimant failed to pursue its claim: ***Centurion Health Corporation.***
- five were won by the US investors:

  S.D. Myers (2000-2002) - $6.0 million plus costs versus $53 million claimed;

  Pope & Talbot (2001) - $408,000 plus costs versus US$500 million claimed;

  Windstream Energy (2012) - $25 million versus $656.5 million claimed;

  Mobil Investments and Murphy Oil (2015) - $19 million versus $66 million claimed; and most recently,

[4] http://www.international.gc.ca/trade-agreements-accords-commerciaux/topics-domaines/disp-diff/gov.aspx?lang=eng.

[5] Global Affairs does not yet include the Notice of Intent dated 14 November 2017 filed by Omnitrax Enterprises Inc., claiming damages to its rail-line to Churchill, MB. Also not listed is a 2015 Notice filed by CEN Biotech respecting Health Canada's denial of its application to be a licensed producer of marijuana.

Clayton/Bilcon (2015) - no final damages award has yet been made, versus US$443 million claimed.

Seven Chapter 11 claims were **dismissed** by arbitrators (with several millions of dollars of costs in favour of Canada in several instances). The following lists those dismissed cases and the amounts originally claimed:

UPS (2007) - US$160 million
Chemtura Corporation (2010) -US$79 million
Merril & Ring Forestry (2010) - $50 million
V. G. Gallo (2011) - $105 million
Detroit International Bridge Co. (2015) – US$3.5 billion
Mesa Power (2016) - $658 million
Eli Lilly (2017) - $500 million

To tally all this up, of the 17 completed arbitrations against Canada, 7 were dismissed, 1 was terminated by the panel; 2 were settled by agreement and 2 were settled with no payment of compensation. US **investors succeeded in 5 out of the 17 completed proceedings**.

Six cases remain to be completed, either by final compensation awards or by decisions on the merits.

Without looking into the reasons for the dismissal of US investor claims or totalling compensation awarded successful cases, the straight win/loss record under NAFTA Chapter 11 is **weighted in Canada's favour**.

Totalling Up the Money

The damages awarded in the 5 successful claims in *Mobil Investments*, *Murphy Oil, Pope & Talbot, Windstream Energy* and *S.D. Myers* amount to approximately **$58 million**.[6] The above awards are not by any means trivial but are a small fraction of the billions in compensation originally claimed.

The $58 million doesn't include the agreed settlements in *Ethyl Corporation* and *AbitibiBowater*[7] or the damages yet to be awarded in the *Clayton/Bilcon* case, where

[6] This is exclusive of interest and costs which can add several millions to the totals.

[7] Some commentators add these settlement amounts to the totals awarded against Canada in their tallies. However, it is misleading to do so, since both cases were resolved without any final disposition by NAFTA panels. In the AbitibiBowater case, Newfoundland, which had expropriated the

the investor has claimed a whopping US$443 million (C$554 million). Depending on the final award in that case, the ledger could obviously change considerably.[8]

In the somewhat unlikely case that the *Clayton/Bilcon* claim succeeds in its entirely and the settlements in *Ethyl Corporation* and *AbitibiBowater* are added to the totals, successful Chapter 11 claims against Canada would be in the order of **$742 million**.

This is clearly a very substantial amount when viewed in absolute numbers. However - while it may not be fully comforting - it must be viewed against the **$5.5 billion** in damages originally claimed by these US investors.[9]

Cases Ongoing Against Canada

As of early 2018, there are six Chapter 11 claims against Canada on the Global Affairs roster that are yet to be finalized. Two of these – *Mobil Oil II* and *Clayton/Bilcon* - have been concluded on the merits but, as noted, compensation has yet to be decided by the panels.

Of the 5 remaining cases to be dealt with on their merits, some involve substantial sums as well as major issues of public policy. These are at varying stages of maturity (showing the date the Notice of Intent was filed):

- ***Mercer International*** (2012) - $232 million
  Mercer alleges that it was denied the same benefits under agreements entered into by BC Hydro with its competitors causing Canada to be in breach of its national treatment obligations under the NAFTA.

company's property, agreed to pay compensation from the outset. The dispute was not that compensation was owing but on the timing and methodology to be used in evaluating the amount.

[8] That case involved the denial of a quarry permit by the Nova Scotia government. The majority of the panel found that the permit denial was not in accordance with due process and therefore contravened Canada's NAFTA obligations, with a strong dissent by panel member Donald McRae, who forcefully said the panel erred in finding the impugned Nova Scotia regulation to have breached the NAFTA.

[9] In all, payments made by Canada under final awards to date amount to **approximately 6.4%** of total damages claimed over NAFTA's 23-year lifespan. If the final award in *Clayton/Bilcon* comes close to the $554 million the company is seeking, it would increase that percentage a fair amount but still bring it to **approximately 13.5%** of the total $5.5 billion claimed by American investors.

- ***Lone Pine Resources*** (2013) – US$119 million
  The investor claims that Quebec's moratorium on hydrocarbon development on the St. Lawrence riverbed is in breach of articles 1105 (Minimum Standard of Treatment) and 1110 (Expropriation) of the NAFTA.[11]

- ***Murphy Oil II*** (2014) - $25 million
  This case flows from the 2012 award referred to above and are therefore grouped together. The claims concern ongoing damages resulting from Canada-Newfoundland and Labrador Offshore Petroleum Board's Guidelines on Research and Development Expenditures which require operators of offshore petroleum projects to contribute a certain percentage of their revenue to research and development and education and training in Newfoundland and Labrador.

- ***Resolute Forest Products*** (2015) – at least $70 million
  Resolute's claim relates to measures by Nova Scotia and Canada in support of a paper mill located near Port Hawkesbury, Nova Scotia. Resolute contends those measures discriminated in favor of the Port Hawkesbury mill and resulted in the closing of the Resolute mill in Shawinigan, Québec, in 2014, depriving Resolute of its investment.

- ***Tennant Energy*** (2017) – $116 million
  Tennant alleges that Ontario's administration of the Feed-In Tariff program (FIT) was non-transparent and opaque, and that Tennant was treated unfairly with respect to their project in Ontario. In addition, Tennant alleges that government records documenting the nature and extent of the alleged unfair energy regulatory measures were intentionally destroyed.

The Global Affairs website for unexplained reasons doesn't list two additional cases where Notices of Intent are reported to have been filed:

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[11] The hearing on the merits in *Lone Pine Resources* (ICSID Case No. UNCT/15/2) took place before a three-member arbitral tribunal from 2-13 October 2017 in Toronto and was open to the public. As Chapter 11 allows, the hearing is being administered by the International Centre for the Settlement of Investment Disputes (ICSID), based in Washington, DC. https://icsid.worldbank.org/en/Pages/News.aspx?CID=250/ It is expected that the panel's decision will be many months in the future.

- ***CEN Biotech*** claims $4.8 billion in damages resulting from Health Canada's denial of its application to be a licensed producer of marijuana.[12]

- ***Omnitrax Enterprises Inc***. claims in excess of $150 million in damages resulting from a decrease in traffic on its rail-line service to Churchill, MB, as a result of the Canadian government dismantling the Canadian Wheat Board.[13]

Save for *Murphy Oil II* and the relatively modest claim of $25 million in compensation, the foregoing list of claims against Canada involve substantial damages and while these are inflated in typical fashion, if one or more succeed the impact on the public purse could be significant and the balance on the win/loss ledger will change rather dramatically.

Cases Filed Against the US and Mexico

In contrast to the 26 active cases filed against Canada by US investors,[14] there have been 17 cases filed by Canadian investors against the United States. The Canadian total amalgamates several Softwood Lumber cases as one.[15] No Mexican investors have invoked Chapter 11 against the United States.

A number of these Canadian investor claims were ultimately withdrawn, several as part of the 2006 settlement of the Softwood Lumber dispute. Of those that went to conclusion, **none were successful**.[16]

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[12] "Thwarted License for Medical Marijuana Facility in Canada Leads to Threat of NAFTA Claim by U.S. Investors", *International Arbitration Reporter*, 23 November 2015.

[13] Notice of Intent, 14 November 2017 reproduced in *International Arbitration Reporter*, 14 November 2017.

[14] As noted above, at one point in time, Global Affairs listed a total of 39 claims where Notices of Intent has been received.

[15] The record of cases filed against the US is found on the State Department website at: https://www.state.gov/s/l/c3741.htm.

[16] A useful tabulation of all NAFTA Chapter 11 cases and their outcomes is maintained by the Public Citizen's *Table of Foreign Investor-State Cases and Claims under NAFTA and Other U.S. "Trade" Deals* (October 2016), found at: https://www.citizen.org/sites/default/files/investor-state-chart_7.pdf.

There have been twenty-three Chapter 11 cases filed against Mexico, all by US investors. Several were never pursued; several are pending. Five claims have been successful with awards against Mexico amounting to some US$204 million.[17]

Why Has Canada Been Most Often Targeted?

The rationale for including Chapter 11 in the NAFTA was to ensure US investors had avenues of recourse against Mexico, whose legal protection for foreign investors was considered less than reliable. The fact that there have been more American NAFTA claims against Canada than Mexico thus raises questions. There are a number of possible explanations:[18]

- The first is that it's **relatively easy** for a US investor to sue Canada. We have the same legal traditions – common law – and speak the same language, unlike a claim against Mexico, for example, which would have to be pursued in Spanish and, as an additional factor, Mexico has a less easily understood civil law system.

- Second, the Canadian system is **open and transparent**. Canadian government documents can be accessed without too much hindrance and even where not immediately available due to confidentiality, Canada's access to information laws can make these available without too much fuss.

- Third is a combination of the **generally litigious nature of US companies**, combined with the fact that retaining Canadian counsel to pursue a NAFTA claim is generally less costly than hiring a US law firm and, as an added bonus, the exchange rate factor is advantageous when paying legal bills in Canadian currency.

- A final factor is the **contingency fee system** used by law firms combined with availability of **third-party financing** through different mechanisms, a phenomenon that has a growing influence on stimulating investor claims, not only in the NAFTA context but in other jurisdictions around the world.

[17] The successful claims were: *Metalclad* (1997), *Feldman Karpa* (1999), *Corn Products* (2003), *ADM/Tate & Lyle* (2004) and *Cargill* (2004). Public Citizen, *ibid.*

[18] The following points are taken from the author's Blog, "Canada and Investment Disputes: Tallying the Numbers" (6 April 2016) at www.hermancorp.net.

In contrast to the 26 American claims against Canada under the NAFTA, it is worth mentioning that out of the 36 bilateral **Foreign Investor Protection Agreements (FIPAs)** that Canada has with other countries[19], there has been only one claim against Canada– by *Global Holdings Telecom*– under the Canada-Egypt agreement.[20] So one has to ask what it is about the NAFTA and US investors that targets Canada so frequently.

Trend in NAFTA Panel Decisions

The objective of this report is not to delve into the detailed rationale or jurisprudence in these decided NAFTA cases. However, some summary comments are warranted.

Of note is that a number panels that have affirmed **the right of governments to regulate for the public good** without offending NAFTA obligations:

- In *Chemtura Corporation*, the tribunal stated that non-discriminatory, science-based regulations aimed at safeguarding human health and the environment did not breach the fair and equitable treatment (FET) obligation or amount to indirect expropriation contrary to NAFTA obligations, such measures being valid exercises of the State's police powers.[21]

- In *Mesa Power*, the panel dismissed the US claim and found that regulations under Ontario's Green Energy Program were non-discriminatory and complied with NAFTA's FET obligation. Nothing in the NAFTA guaranteed investors against regulatory changes that were applied for the public good and on a scientifically sound and non-discriminatory basis.[22] Breaches of FET required evidence of **manifest**

[19] https://www.international.gc.ca/trade-commerce/trade-agreements-accords-commerciaux/agr-acc/index.aspx?lang=eng.

[20] The company claims $1.32 billion for alleged discriminatory treatment against its predecessor company Wind Mobile. http://www.international.gc.ca/trade-agreements-accords-commerciaux/topics-domaines/disp-diff/gth_sae.aspx?lang=eng.

[21] *Chemtura Corporation v. Canada*, Award, 2 August 2010, para. 266. http://www.international.gc.ca/trade-agreements-accords-commerciaux/assets/pdfs/disp-diff/chemtura-14.pdf.

[22] *Mesa Power Group LLC v. Canada* (PCA Case No. 2012-17), Award, 24 March 2016, paras. 502, 541 and 614. https://www.italaw.com/sites/default/files/case-documents/italaw7240.pdf.

arbitrariness, gross unfairness, discrimination and lack of transparency, leading to an outcome that offended judicial propriety. The Tribunal said, importantly, that,

> ". . . international law requires tribunals to give a good level of deference to the manner in which a state regulated its internal affairs."[23]

- In *Eli Lilly,* another important Canadian win, the panel dismissed the claim that Canadian court decisions, including by the Supreme Court of Canada, offended the NAFTA by invalidating certain patent applications by the company. Eli Lilly had argued that these decisions were arbitrary and discriminatory and hence contravened Canada's treaty obligations. Rejecting these arguments, among other points the panel said that it was **not an appellate body** in respect of decisions of national courts, to which NAFTA panels must accord considerable deference.[24]

In *Dow AgroSciences,* while not ending in a panel decision, the case was withdrawn by the US investor conceding the right of Quebec to regulate the use of 2,4-D.

The above brings home an important point. As governments seek to regulate in new areas of policy, including the environmental protection and public health arena, there is a likelihood of more investor claims coming to the fore.

Global Developments

Governments have concluded hundreds of investment promotion and protection treaties with ISDS provisions over the last 30 years. However, NAFTA was the first time fully-fledged ISDS provisions were incorporated into a preferential trade agreement.

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[23] *Ibid.,* paras. 502, 505.

[24] Kluwer Patent Blog: http://patentblog.kluweriplaw.com/2017/04/04/eli-lilly-v-canada-the-first-final-award-ever-on-patents-and-international-invest-ment-law/.

While the Trump administration wants these provisions removed, there are over forty bilateral investment treaties between the US and other countries that contain ISDS provisions (called bilateral investment treaties or "BITs" in US parlance).[25]

Canada also has dozens of such investment treaties, called Foreign Investment Promotion and Protection Agreements (FIPAs) in Canada's lexicon.[26] Canadian investors have collected billions of dollars in arbitration awards under these FIPAs, most recently the 2016 *Bear Creek Mining* award under the Canada-Peru investment agreement.[27]

In all, there are some 3,000 bilateral foreign investment protection treaties worldwide, many of which contain ISDS provisions.[28] So whether ISDS is removed from the NAFTA or whether NAFTA itself survives, there will remain a vast global network of bilateral investment treaties with ISDS provisions, including many to which the US is a party.

In other words, investor arbitrations will continue as a commercial fact of life under these investment treaties even it not in a Canada-US context.

Concluding Comments

For Canada, the record of investor-State arbitrations under the NAFTA is a mixed one. American investors have challenged many Canadian measures since 1994 and have succeeded in winning some **$58 million** in awarded compensation and over **$320 million** when agreed settlements are added. While this is a small fraction of the billions of dollars originally claimed, this is not an insignificant amount of money.

As this noted has also said, there are several pending cases against Canada and at least one concluded arbitration – *Clayton/Bilcon* – where compensation has yet to

[25] These are listed on the USTR web-site: https://ustr.gov/trade-agreements/bilateral-investment-treaties

[26] These are also listed on the Global Affairs Canada website: https://www.international.gc.ca/trade-commerce/trade-agreements-accords-commerciaux/agr-acc/index.aspx?lang=eng

[27] *Bear Creek Mining Corporation v. Republic of Peru*, ICSID Case No ARB/12/1: https://www.italaw.com/cases/2848.

[28] *World Investment Report 2017* (UNCTAD): http://unctad.org/en/pages/PublicationWebflyer.aspx?publicationid=1782

be awarded but where the claimant is seeking up to **$544 million**. Even if the claimant is partially successful, this could change the total of Canadian Chapter 11 payouts substantially.

In terms of gains and losses, Canada has succeeded in having US investor claims withdrawn, settled or dismissed in **twelve out of seventeen of these completed cases**. The overall win/loss balance in claims against Canada is in Canada's favour. However, Canadian investors have never succeeded in a NAFTA claim against the United States.

On substantive aspects, panel decisions are not entirely consistent but do seem to indicate a trend to accept **legitimate, non-discriminatory and scientifically-based State regulation** enacted for the public good as consistent with NAFTA obligations.

Whether this trend will be maintained in the NAFTA cases yet to be decided is the burning question.

Although American investors have achieved successes, the Trump administration has demanded removal of Chapter 11 completely, meaning any improvements along CETA lines is out of the question.

If the US withdraws from the NAFTA, **the Chapter 11 process will terminate**, including cases yet to be concluded.

As to the NAFTA re-negotiations themselves, the prospect of a mutually outcome among the three Parties is increasingly remote.

Even if the negotiations collapse and the US withdraws from the NAFTA, investor-State arbitrations **will still remain a fact of life** in global commerce.

The final comments is this. **Given that Canada has been the main target of US investor claims under the NAFTA and that more claims could result from increased Canadian government regulation in environmental, health and other public policy areas, it is not entirely clear why maintaining ISDS provisions in NAFTA is in the Canadian interest.**

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