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# NAFTA Chapter 11 as Supraconstitution

Stepan Wood and Stephen Clarkson\*

## I. Introduction

Legal scholars increasingly invoke constitutional concepts and terminology to make sense of the remarkable growth of transnational and international legal orders. They employ constitutional terminology in a bewildering variety of ways, often with little effort to clarify their analytical frameworks or acknowledge the normative presuppositions embedded in their analysis. The critical potential of constitutional analysis is frequently lost in methodological confusion and normative controversy. An effort at clarification is necessary if constitutional discourse is to realize its potential as a critique of power.

We propose a functional approach to international constitutional analysis, centred on the concept of a *supraconstitution*. A supraconstitution is a constitutional order arising at the international level, which at the same time transforms domestic legal orders by embedding an external constitution into national ones (Clarkson and Wood 2006, 98). Simultaneously international and domestic, it is a quintessentially transnational phenomenon. Supraconstitutionalization is not an “all or nothing” affair (Dunoff and Trachtman 2009b, 9) but a continuum of discourse and practice that is simultaneously domestic and transnational, and highly uneven across time, space and subject matter.

After setting out our analytical framework in Part 1, we apply it to the North American Free Trade Agreement (NAFTA)<sup>1</sup> in Part 2, concluding that NAFTA’s investment chapter superimposes a nascent supraconstitutional legal order on member states’ domestic constitutional orders. In Part 3 we highlight several reasons for concern about this emerging supraconstitution. Finally, in Part 4, we explain what supraconstitutional analysis offers as an instrument of critique that conventional analyses of transnational legal orders do not.

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<sup>1</sup> North American Free Trade Agreement (Canada-Mexico-United States), Dec. 17, 1992, Can. T.S. 1994, No. 2, 32 I.L.M. 289 (entered into force Jan. 1, 1994) (“NAFTA”).

## II. Supraconstitutionalization: A Framework for Analysis of Transnational Legal Orders

There is nothing novel about constitutional analysis of international law and organizations. Legal scholars have engaged sporadically in such analysis for many decades, from the United Nations Charter to the European Community, and from international human rights law to international trade and investment regimes (Verdross 1926; Lauterpacht 1950, 463; Ross 1950; Opsahl 1961; Jackson 1969, 1980; Stein 1981). It is only in the last decade, however, that such analyses have begun to occupy the mainstream of international legal scholarship (Fassbender 1998; Weiler 1999; De Búrca and Scott 2001; Joerges, Sand and Teubner 2004; Orrego Vicuña 2004; MacDonald and Johnston 2005; Cass 2005; Joerges and Petersmann 2006; Dunoff and Trachtman 2009a). In relation to Europe, the debate now centers on what kind of constitution the European Union ought to have, rather than whether it has one at all (Weiler and Wind 2003; Avbelj 2008).

Many of these commentators employ constitutional terminology in an optimistic way, portraying international constitutionalism as a contemporary manifestation of international law's mandate as the "gentle civilizer of nations" (Koskenniemi 2001). The end of the Cold War seemed to reinvigorate this project, inaugurating a burst of international institution-building, driven by renewed enthusiasm for international human rights, the rule of law, liberal-democratic reform and free market capitalism. This euphoric mood was not shared by many international legal scholars from the developing world, who saw the project of international constitutionalism as part of an imperial global state in the making (Chimni 2004). In any event the euphoria collapsed after September 11, 2001, when many international lawyers found themselves invoking international constitutionalism not as a triumphal project of international integration but as an anxious defence against the perceived threats to the international order posed by the Bush Doctrine of pre-emptive self-defence and the hostility toward international law and organizations that characterized the American-led global War on Terror. Constitutionalism was one language in which to challenge the legitimacy and legality of these developments.

Constitutionalism is not just an instrument of rule, invoked to bestow legitimacy upon the exercise of power. It also has a long history as a "*critique* of rule, as a vocabulary of rights, accountability and transparency" (Koskenniemi 2005, 17, emphasis in original). This critical potential is inhibited by the conceptual confusion that characterizes contemporary constitutional analysis of international law. Legal scholars apply constitutional concepts and terminology to international affairs in a bewildering variety of ways, often with little or no effort to clarify their analytical frameworks or acknowledge the normative presuppositions embedded in their analysis (Walker 2003, 39). An effort at clarification is therefore necessary.

We are not the first to make such an effort. Recent scholarship has brought us some distance toward analytical clarity (e.g. Kumm 2004, 2006; Schneiderman 2008, Dunoff & Trachtman 2009a). Like the editors of a recent major volume on international constitutionalization, we advocate a functional approach to the phenomenon (Dunoff & Trachtman 2009b). Also like them, we believe that clarity is best served by an analytical framework that is agnostic as to the

normative desirability of international constitutionalization (ibid., 4), at least in the initial stages of analysis. A functional analysis asks how we are governed, deferring to a later stage of inquiry the question of whether these governance arrangements ought to be promoted or resisted.

Unlike Dunoff and Trachtman, however, we do not consider the granting of *international law-making authority* to a centralized authority to be the hallmark of international constitutionalization. International constitutionalization is not so much about enabling or constraining the production of international law (ibid.) – as if states were not already floating in a sea of international law. It is more about the extent to which norms and institutions beyond the state transform domestic constitutional orders and constrain domestic law-making. It is this interaction between the international and the domestic that defines international constitutionalization.

A constitution is the ensemble of fundamental norms and institutions that perform certain basic functions in the establishment and organization of a given polity's legal order. Such functions include establishment of public institutions and political subdivisions, distribution of law-making authority among them, determination of objectives to guide the exercise of public authority, placement of constraints on their exercise, and judicial review of the exercise of public authority (Verdross, 1926; Snyder 2003, 56; Kumm 2006, 508).

We propose the term *supraconstitution* to refer to those international norms and institutions that form part of the assemblage of fundamental practices by which a national society is governed and from which domestic laws and policies – including constitutional norms – are not permitted to derogate (Clarkson and Wood 2009). Like constitutions generally, a supraconstitution can be analyzed in terms of general *principles* guiding the allocation and exercise of power, basic *rules* governing members' behaviour, and fundamental *rights* of community members vis-à-vis governing authorities. It can also be analyzed in terms of the *institutions* that perform – to varying degrees – legislative, executive, administrative, adjudicative, and enforcement functions. As fundamental elements of the legal order, these principles, rules, rights and institutions take precedence over ordinary political and legal decision-making, are harder to change than other norms and institutions, and are rooted in a particular system of core values (Wiener 2003; Bogdandy 2006, 231).

The term constitution is also used in a normative sense to denote the establishment of a legitimate, independent authority that structures a political process while legitimising it (Kumm 2006, 509). A community may have a constitution in the functional sense without having a constitution in the normative sense. What is considered necessary to establish a constitution in this normative sense depends on the variety of *constitutionalism* to which the observer subscribes. Constitutionalism refers to a normative position advocating *constitutionalization* (Trachtman 2006, 630), the historical process by which constitutions emerge, are consolidated, and expand to fill new domains (e.g. Cass 2001, 2005).

While there are many competing varieties of constitutionalism at play in contemporary debates about transnational constitutionalization (Avbelj 2008), all are rooted in liberal-democratic

political theory. As such, whether they are used to criticize or celebrate, they emphasize the constraint of public power, the rule of law, the protection of fundamental rights and freedoms, and legitimation via democratic deliberation. Debates about whether this or that supranational entity has a constitution in the normative sense are, in effect, debates about whether its fundamental norms, practices and institutions, and the procedures by which they are established, conform to the observers' preferred version of constitutionalism.

We do not shy away from this sort of normative inquiry. On the contrary, the principal attraction of our functional analysis is that it strips away some of the conceptual and ideological blinkers that prevent us from recognizing fully the fundamental arrangements by which societies are governed, and thus opens these arrangements to critical scrutiny. In Parts 2 and 3 we advance the normative claim that existing supraconstitutional norms and practices embodied in the emerging international investment arbitration regime are deeply inequitable and undemocratic. As we explain in Part 4, constitutional discourse, which has been almost entirely absent from public debates about this regime, provides a powerful instrument for its critique.

### **III. NAFTA Chapter 11 as Supraconstitution: Constraint, Primacy and Pre-Commitment**

Chapter 11 of NAFTA confers several important rights on investors – which for practical purposes means transnational corporations (TNCs) – from other NAFTA countries: national treatment (Article 1102), most favoured nation treatment (Article 1103), fair and equitable treatment in accordance with an international minimum standard (Article 1105), freedom from performance requirements (Article 1106),<sup>2</sup> and freedom from expropriation or measures “tantamount to expropriation” (Article 1110). Article 1110 provides that no NAFTA government “may directly or indirectly nationalize or expropriate an investment of an investor of another Party in its territory or take a measure tantamount to nationalization or expropriation of such an investment,” except for a public purpose, on a non-discriminatory basis, in accordance with due process of law and minimum standards of treatment, and on payment of compensation. “Investment” is defined broadly to include almost any form of business asset, actual or anticipated, tangible or intangible.<sup>3</sup>

NAFTA creates a system of international investment arbitration whereby aggrieved foreign investors may challenge host states' actions that allegedly interfere with their rights. These challenges to the exercise of public authority by sovereign states are heard by international arbitral panels that operate under rules designed for the settlement of international commercial

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<sup>2</sup> Article 1106 prohibits NAFTA governments from imposing performance requirements as a condition for the establishment, operation, management, conduct, or operation of foreign investments, such as export commitments, local sourcing, local employment, local research and development investments, or technology transfer. NAFTA, *supra* note **Error! Bookmark not defined.**, Art. 1106.

<sup>3</sup> *Ibid.*, Art. 1139.

disputes. Similar rights and remedies are found in hundreds of bilateral investment treaties (BITs). The resulting global web of investment rules creates powerful rights for transnational capital and a powerful new zone of adjudication to enforce them.

The international investment arbitration regime established by NAFTA and BITs has three features normally associated with a constitution: it is intended to constrain the exercise of public authority by government actors, it is effective and enforceable in host states' legal systems even in the face of contrary legislation, and it is difficult to change. We will address each of these features in turn.

#### A. NAFTA CONSTRAINS THE EXERCISE OF PUBLIC AUTHORITY

There is no doubt that the international investment arbitration regime embodied in NAFTA and BITs was intended to limit governments' exercise of public power by giving transnational capital enforceable protection against certain forms of state intervention in the economy, including protection against expropriation broadly analogous to that conferred by the Fifth Amendment to the US Constitution. Whether these treaties constrain the exercise of public authority in practice is more controversial. TNCs invoke them aggressively to inhibit public welfare regulation, with at least some effect. Even though governments have won most Chapter 11 decisions, arbitral panels have taken a broad view of what can count as measures "tantamount to expropriation," effectively restricting governments' ability to regulate TNCs' activities in what they see as the public interest.

Early Chapter 11 decisions stoked fears that NAFTA would limit governments' ability to regulate transnational capital in the interest of public health and welfare. The *Ethyl* case showed that investor arbitration claims can intimidate host governments into repealing legislation even before a decision is rendered on the merits of the claim. The case dealt with Ottawa's short-lived ban on imports of MMT, a highly toxic gasoline additive and suspected neurotoxin which had been used in Canada since 1976 to increase the octane rating of unleaded gasoline and reduce engine "knocking" (Michalos 2008, 72). Acting upon mounting public concern about its harmful effects on emission control systems and air pollution, the Canadian government put the ban in place even though the scientific evidence of these harms was mixed. The American manufacturer brought a Chapter 11 suit claiming that the ban violated NAFTA. After losing a bid to have the case dismissed on jurisdictional grounds, Canada settled the claim for US \$13 million and rescinded the ban. The concerns about MMT were ultimately vindicated, however, when most major oil companies in Canada voluntarily discontinued its use in 2004 even though a long-awaited independent review of the substance ordered by the Canadian government had not yet started (*ibid.*, 73). In its Chapter 11 claim, Ethyl challenged the routine activities of elected legislators, including the "mere introduction and debate about proposed legislation in properly constituted legislative bodies," as actions tantamount to expropriation (*ibid.*, 225). As Michalos (*ibid.*) comments, "It is difficult to imagine a more egregious attack on democracy and democratic process."

The *Metalclad* case demonstrated that foreign investors' rights can prevail over public regulation even where a company has an egregious record of flouting the host country's planning rules and pollution standards. The case dealt with a toxic waste dump near the Mexican city of Gaudalcazar.<sup>4</sup> In just over one year, the Mexican owner illegally dumped 20,000 tons of toxic waste on the site without treatment or containment. When the Mexican government shut down the facility in 1991, the company applied to the city for a permit to construct a hazardous waste landfill. The city refused, but the federal and state governments authorized the company to proceed, triggering a jurisdictional dispute among the three levels of government. Metalclad, an American waste disposal company, purchased the company in 1993 on condition that it obtain definitive permission to proceed with the project. It dropped this condition after federal officials, eager to secure the foreign investment, assured Metalclad that the company had all the authorization it needed to undertake the project. Metalclad started construction of the landfill without a municipal construction permit. After the federal government issued a further permit authorizing the final phase of construction, the city issued a stop work order. Metalclad applied for a municipal permit but ignored the stop work order, completing construction before the application was decided. After protesters disrupted the opening of the facility, the federal government and Metalclad reached an agreement under which Metalclad would operate the landfill for five years, clean up the existing contamination and increase the capacity of the dump tenfold. Ten days later the city rejected the application for a municipal permit on the grounds that it had been denied once before, the company had not just started but finished the project without a permit, there were environmental concerns about the facility, and many local residents opposed it. Shortly afterward, Metalclad initiated a Chapter 11 arbitration. While the arbitration was underway, the governor of the state declared an area of almost 200,000 hectares, including the dump site, an ecological preserve.

The tribunal ruled that the local, state and federal governments' conduct amounted to unfair and inequitable treatment and was tantamount to expropriation of Metalclad's investment. In its view, expropriation under NAFTA "includes not only open, deliberate and acknowledged takings of property, such as outright seizure or formal or obligatory transfer of title in favour of the host state, but also covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use or reasonably-to-be-expected benefit of property even if not necessarily to the obvious benefit of the host state."<sup>5</sup> Applying this standard, the tribunal held that the city's denial of a construction permit, its efforts to block the dump in the courts, and the federal government's failure to ensure a transparent and predictable framework amounted to indirect expropriation, effectively depriving Metalclad of the right to operate the landfill. It found the same to be true of the state's ecological decree. The tribunal awarded Metalclad US \$16.7 million as compensation.

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<sup>4</sup> The facts are drawn mainly from *United Mexican States v. Metalclad Corp.* (2001), 89 B.C.L.R. (3d) 359, *additional reasons* 95 B.C.L.R. (3d) 169 (British Columbia Supreme Court) [*Metalclad* (BCSC)].

<sup>5</sup> *Metalclad Corp. v. Mexico* (2000), 5 ICSID Rev. 230 at para. 103 (NAFTA Chapter 11 investor-state arbitration).

Mexico sought judicial review of the *Metalclad* award in British Columbia, because Vancouver had been designated as the place of arbitration (although the tribunal never met there). The court set aside the award in part, not because of its extraordinarily broad definition of expropriation, violated public policy, or took upon itself to interpret and apply Mexican constitutional and domestic law, but because the tribunal had exceeded the scope of the dispute submitted to it. The court ruled that the tribunal had gone beyond the scope of Chapter 11 by importing NAFTA's general transparency obligations into Articles 1105 and 1110. It therefore set aside the findings that Mexico had violated Article 1105 and that the events before the Ecological Decree amounted to an expropriation. As for the Ecological Decree, the court acknowledged that the tribunal's definition of expropriation was "extremely broad":

This definition is sufficiently broad to include a legitimate rezoning of property by a municipality or other zoning authority. However, the definition of expropriation is a question of law with which this Court is not entitled to interfere....<sup>6</sup>

As a result, the court held that there was no ground to set aside the tribunal's finding that the Decree was an act tantamount to expropriation. The court upheld the award to that extent, although it reduced the amount of damages somewhat.

In the *SD Myers* case, an American waste treatment company wished to export Polychlorinated Biphenyls (PCBs) from Canada to Ohio for treatment and disposal. PCBs are notorious carcinogens. Canada banned their export to the US, foiling *SD Myers*' plans. As a party to the Basel Convention on the transboundary movement of hazardous wastes,<sup>7</sup> Canada had an international legal obligation not to export hazardous wastes to non-parties, including the United States. *SD Myers* brought a Chapter 11 suit against Canada, and won. The tribunal held that the ban was a protectionist measure and had no legitimate environmental purpose. It ordered Canada to pay CAN \$6 million in compensation.<sup>8</sup> The Federal Court of Canada dismissed Canada's application for judicial review, remarking that the award was not contrary to public policy because it did not breach fundamental notions and principles of justice. The court also refused to interfere with the tribunal's characterization of the purpose of the ban because findings of fact or law cannot be judicially reviewed so long as they are within the scope of the submission to arbitration.<sup>9</sup>

The *Methanex* decision of 2005<sup>10</sup> quelled some of the worst fears about Chapter 11 investor rights running roughshod over host governments' authority to protect their citizens' health and welfare.

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<sup>6</sup> *Metalclad* (BCSC), *supra* note 4 at para. 99.

<sup>7</sup> Basel Convention on the Control of Transboundary Movements of Hazardous Wastes and Their Disposal, 22 March 1989, 1673 U.N.T.S. 126, 26 I.L.M. 657 (entered into force 5 May 1992).

<sup>8</sup> *S.D. Myers Inc. v. Canada* (partial award – merits) (13 November 2000) (NAFTA Chapter 11 investor-state arbitration).

<sup>9</sup> *Canada (A.G.) v. S.D. Myers Inc.*, 2004 FC 38 (T.D.) (*S.D. Myers* (F.C.T.D)).

<sup>10</sup> *Methanex Corp. v. U.S.* (final award) (3 August 2005) (NAFTA Chapter 11 investor-state arbitration).

The case concerned California's ban on the sale of gasoline containing the additive methyl tertiary-butyl ether (MTBE). Like MMT, MTBE was originally lauded as a solution to an environmental and public health problem. MMT had been introduced in the mid-1970s to replace lead as an octane enhancer. MTBE was introduced in the 1990s to reduce toxic automobile exhaust emissions. It is one of several ingredients, known as oxygenates, that can be used to boost the oxygen content of gasoline, promoting more complete combustion and reducing toxic air emissions. Gasoline containing these oxygenates is known as reformulated gasoline. MTBE was by far the most common oxygenate in reformulated gasoline used in the United States. Widespread use of reformulated gasoline had the beneficial effect of reducing emissions of various air pollutants including the known carcinogen benzene. This beneficial effect was short-lived, however, because MTBE and other oxygenates do not significantly reduce exhaust emissions from newer vehicles with advanced emissions control technology. Along with its diminishing beneficial effects, MTBE has a dark side. It is highly water-soluble, leading to a risk of widespread contamination of ground water via leaking underground storage tanks, and contamination of surface waters via discharges from motor boats. By the late 1990s, MTBE had been detected in several California drinking water systems. Contamination was found in both groundwater wells and surface reservoirs. A major study commissioned by the State of California found that the State's water resources were being placed at risk by the use of MTBE and that the cost of treatment of MTBE-contaminated drinking water supplies had the potential to be enormous.

As with MMT, the scientific evidence surrounding MTBE's health and environmental risks was controversial, and the California government chose to take precautionary action to limit the use of a potentially dangerous substance in the absence of full scientific certainty about the nature and degree of those risks. It based its conclusion that use of MTBE posed a significant risk to human health or the environment upon a statutorily-mandated, peer-reviewed, five-volume, sixty-author, 600-page University of California report and widespread public consultations. It required warning labels to be placed on gasoline pumps and later banned the sale of gasoline containing MTBE.

Methanex, a Canadian company, is the world's largest producer of methanol, which is a feedstock for MTBE. It launched a Chapter 11 claim, arguing that the measures were discriminatory, tantamount to expropriation, arbitrary, inequitable, and the product of an illicit conspiracy between California and one of Methanex's competitors. The panel rejected all of Methanex's claims. It ruled that "a non-discriminatory regulation for a public purpose, which is enacted in accordance with due process and, which affects ... a foreign investor or investment is not deemed expropriatory and compensable unless specific commitments had been given by the regulating government to the then putative foreign investor contemplating investment that the government would refrain from such regulation..."<sup>11</sup> No such assurances had been given to Methanex. On the contrary:

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<sup>11</sup> *Ibid.*, Part IV, Chapter D, p. 4.

Methanex entered a political economy in which it was widely known, if not notorious, that governmental environmental and health protection institutions at the federal and state level, operating under the vigilant eyes of the media, interested corporations, non-governmental organizations and a politically active electorate, continuously monitored the use and impact of chemical compounds and commonly prohibited or restricted the use of some of those compounds for environmental and/or health reasons.<sup>12</sup>

The tribunal found that California had acted carefully and reasonably with a view to protecting the environmental interests of Californians, not with the intent to harm foreign methanol producers:

Faced with widespread and potentially serious MTBE contamination of its water resources, California ordered a careful assessment of the problem and thereafter responded reasonably to independent findings that large volumes of the state's ground and surface water had become polluted by MTBE and that preventative measures were called for. The evidential record establishes no ill will towards Methanex or methanol....<sup>13</sup>

The tribunal did not stop there. It held that the ban on MTBE was not even covered by Chapter 11. Chapter 11 applies only to government measures "relating to" an investor or investment.<sup>14</sup> The tribunal concluded that the MTBE ban was not a measure "relating to" Methanex or its US investments:

Having concluded ... that no illicit pretext underlay California's conduct and that Methanex has failed to establish that the US measures were intended to harm foreign methanol producers (including Methanex) or benefit domestic ethanol producers (including ADM), it follows...that...the US measures do not "relate to" Methanex or its investments as required by Article 1101(1).<sup>15</sup>

The tribunal dismissed the case and ordered Methanex to pay the US government US \$4 million in attorneys' fees and other costs.

There is still room for concern in the wake of *Methanex* for several reasons. First, the *Methanex* decision is not binding on subsequent tribunals. While *Methanex* ruled that non-discriminatory regulation of general application does not amount to expropriation unless the regulating government gave the investor a commitment not to regulate, other Chapter 11 tribunals have held that Article 1110 "does cover nondiscriminatory regulation that might be said to fall within an

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<sup>12</sup> *Ibid.*, p. 5.

<sup>13</sup> *Ibid.*, Part IV, Chapter E, p. 9.

<sup>14</sup> NAFTA, *supra* note 1, Art. 1101(1).

<sup>15</sup> *Methanex*, *supra* note 10, Part IV, Chapter E, p. 10.

exercise of a state's so-called police powers.”<sup>16</sup> It is still up to each tribunal to characterize the intent and effect of regulatory measures, and several tribunals have held environmental and public health measures to be arbitrary, unfair, discriminatory, or protectionist.

Second, TNCs continue to use the threat of NAFTA litigation regularly to “chill” proposed regulation, from the Canadian government's “plain packaging” proposal for cigarettes in the early days of NAFTA, to its proposed ban on advertising “light” or “mild” cigarettes a few years ago. After introducing the latter proposal to much public fanfare, the Canadian government quietly abandoned it shortly after the Philip Morris Company threatened a Chapter 11 claim for regulatory expropriation of its trademarks. TNCs also continue to make frequent use of Chapter 11 to challenge existing public health and environmental regulations. For example:

- In 2008, Dow Agroscience launched a Chapter 11 claim challenging Quebec's ban on lawn care products containing the pesticide 2,4-D, one of the main ingredients in the notorious Agent Orange;
- In the same year another American company launched a Chapter 11 claim challenging Nova Scotia's refusal to approve a Cape Breton basalt quarry after an extensive environmental impact assessment concluded it would have significant adverse environmental effects; and
- In 2001, the US manufacturer of the widely banned pesticide lindane launched a Chapter 11 claim challenging Canada's decision to phase it out as an agricultural pesticide by 2004 due to its adverse effects on the health of ecosystems, wildlife and people. In 2008, lindane was proposed for addition to the list of outlawed chemicals under the Stockholm Convention on Persistent Organic Pollutants.<sup>17</sup>

Half of the fifty-odd Chapter 11 claims launched to date have challenged environmental or natural resource regulations. A further five attacked health-related measures.<sup>18</sup> Even if the success rate of Chapter 11 claims and the ratio of damages awarded to damages claimed remain low, the respondent governments still have to defend the claims, at a high cost to taxpayers.

Finally, while NAFTA in theory establishes uniform rules for the entire continent, it is evident that the brunt of Chapter 11's constraining power is felt by the continental periphery, not the

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<sup>16</sup> *Pope & Talbot Inc. v. Canada* (interim award) (26 June 2000) (NAFTA Chapter 11 investor-state arbitration), p. 32.

<sup>17</sup> Stockholm Convention on Persistent Organic Pollutants, 22 May 2001, 40 I.L.M. 532 (entered into force 17 May 2004).

<sup>18</sup> As of December 2008, a total of 55 Chapter 11 claims had been filed with the three NAFTA Parties, according to the NAFTA Parties' official Chapter 11 investor-state arbitration web pages. Of these, sufficient information was available to classify the subject matter of 48 of the claims. Insufficient information was available to classify seven claims. See Foreign Affairs and International Trade Canada, “Dispute Settlement: NAFTA – Chapter 11 – Investment,” <http://www.international.gc.ca/trade-agreements-accords-commerciaux/disp-diff/NAFTA.aspx?lang=en>; Mexico, Ministry of the Economy, “Dispute Settlement,” <http://www.economia.gob.mx/?P=5500>; and US Department of State, “NAFTA Investor-State Arbitrations,” <http://www.state.gov/s/l/c3439.htm>.

centre. The United States has not yet lost a Chapter 11 claim and had its laws or regulations declared to violate investor rights, whereas Canada and Mexico have lost two decisions each. Claims have been aimed mainly at Canada and Mexico (24 against Canada, 18 against Mexico and 13 against the US, as of December 31, 2008),<sup>19</sup> reflecting the reality that the United States is home to most of the TNCs benefited by Chapter 11.

All of this is not meant to suggest that investor rights provisions of NAFTA and BITs clamp an “iron cage” on host governments’ ability to regulate foreign investment. Some governments faced with adverse investment arbitration decisions, particularly in Latin America, have simply refused to pay or have negotiated settlements with victorious investors in which they have paid pennies on the dollar. Other governments have openly flouted investment rules, effectively daring investors to challenge their actions. Newfoundland premier Danny Williams recently nationalized an unprofitable pulp and paper mill after its American owner closed it. Even some governments in the periphery of the continental or global economy can, in practice, flout these emerging norms if they want to badly enough. But this may be costly: in the ruthless world of transnational investment, it may result in capital flight, bad credit ratings and expensive legal proceedings. Ultimately, if such governments want to attract and keep foreign investment, they must signal global capital markets that they take their investment obligations seriously.

In short, there is a substantial basis for critics’ concerns that Chapter 11 can undermine efforts to enact new laws and regulations in the public interest, in particular to protect the environment and human health, and that it can require governments to pay compensation to polluters for ceasing to pollute, even if their activities have an adverse impact on public health and welfare (Mann & Von Moltke 2001, 13). With its intrusive judicial institutions, NAFTA’s dynamic continental economic regime creates new levels of uncertainty for governments whose elected officials cannot be sure how measures they propose to implement might be judged by some future arbitral tribunal. As Been and Beauvais conclude,

The uncertainty over how far NAFTA can be pushed to provide protection for property owners, coupled with federal, state and local regulators’ unfamiliarity with NAFTA...and concerns about both the expense of defending against NAFTA claims and about their potential liability for compensation awards, at the very least make NAFTA a useful threat for those who oppose environmental and land use regulation.

## B. TRANSNATIONAL INVESTORS’ RIGHTS PREVAIL OVER ORDINARY LAW

The second remarkable feature of the investor rights in NAFTA and BITs is that they – or more precisely, the arbitral decisions applying them – are effective and enforceable in the host

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<sup>19</sup> The figure for the US includes more than one hundred individual claims launched by Canadian cattlemen over the closure of the US border to Canadian beef in the wake of a mad cow disease scare. These claims were consolidated into a single case and are treated as one case on the government Chapter 11 web pages cited in the previous note.

country's legal system without the need for, and indeed in spite of, government legislative action. By virtue of international treaties on enforcement of arbitral awards and ubiquitous international commercial arbitration statutes, investor-state arbitration awards are enforceable in domestic legal systems as if they were awards of a domestic court. Moreover, they are insulated against challenge in domestic courts. International investor rights thus take effect in national legal systems without the need for the intervening step of enacting or amending domestic legislation or constitutions. Indeed, since the whole point of many Chapter 11 claims is to invalidate existing legislative measures, they take effect despite conflicting legislative or constitutional provisions.

One of the hallmarks of a constitution is that it takes precedence over ordinary laws, regulations and government decisions. Applying this concept of constitutional primacy to international norms poses serious difficulties. In the European Union primacy is expressed most often in the doctrine of *direct effect* according to which Community legal norms become the law of each land, creating enforceable legal obligations not just between individuals and their governments, but among individuals themselves (Weiler 1999, 19). These norms may be invoked by individuals before national courts, and national courts must provide adequate remedies for their violation just as if they had been enacted by national legislatures.

Direct effect on its own does not distinguish supraconstitutional from ordinary international law. In some nation states international treaties are received automatically into the domestic legal order. Canadian law generally subscribes to the competing view that international treaties are not incorporated automatically but must be "received" via implementing legislation in order to take effect within the domestic legal system. Hundreds of international treaties have been received into Canadian federal and provincial law in this manner.

Supraconstitutional primacy refers to international norms taking effect in the domestic legal system in the absence of domestic legislation or even in the face of conflicting domestic legislation, not by virtue of it. Canadian reception of customary international law, which consists of customs rooted in widespread state practice and recognized as binding by states in their relations with each other, comes closer to what we mean because, in theory, it is received automatically into Canadian law as part of the common law.<sup>20</sup> But direct effect alone does not qualify a norm as supraconstitutional. Even in Europe where direct effect is widespread and presumptive, it is the combination of direct effect and the doctrine of *supremacy* that makes Community law supraconstitutional (Weiler 1999, 20).

The doctrine of supremacy holds that, within the Community's sphere of competence, any Community norm "trumps" conflicting national law whether enacted before or after the Community norm" (ibid., 20-21). The Community's own judicial organ, the European Court of Justice, has the authority to determine the Community's sphere of competence and hence the matters on which Community law is supreme (ibid., 21).

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<sup>20</sup> *R. v. Hape*, 2007 SCC 26.

Even if the reception of customary international law into domestic Canadian law is an example of direct effect, it is not an example of primacy. A norm of customary international law that is received as part of the common law would not prevail over conflicting domestic legislation, since legislation prevails over common law. Moreover, while legislation is presumed to be consistent with Canada's international legal obligations, it prevails over international law in the event of a conflict (van Ert 2002, 99-136; Kindred 2006, 19-21).

EU-style direct effect and supremacy represent the fullest expression of supraconstitutional primacy in the contemporary world and distinguish the European legal order from other supranational orders. Nevertheless, international norms and institutions may be supraconstitutional without reaching the European standard. Here we part company with those who insist that only Europe has a supraconstitution. But we do not go as far as others who see a supranational constitution in the UN Charter, basic principles of inter-sovereign relations, or international human rights law (Tomuschat 1999, Johnston 2005, MacDonald 2005, Fassbender 2005). In our logic, international norms and institutions are supraconstitutional if they establish constraints on the authority of governments that are legally binding, practically effective, and difficult to amend. Outside the EU, the leading candidates for this status are the rules of the international trade and investment regime.

Investor-state arbitral awards under NAFTA and BITs qualify for constitutional primacy because they are enforceable directly in almost any domestic legal system where the successful investor believes the losing government might have assets. They will be enforced even in the face of conflicting legislation, including the very laws or regulations that were declared to violate the investors' rights. Moreover, these awards are insulated from review by domestic courts. Courts in Canada, the US and many other countries have abandoned their traditional hostility to arbitration and embraced the enforcement of foreign arbitral awards. As the Ontario Court of Appeal put it, "predictability in the enforcement of dispute resolution provisions is an indispensable precondition to any international business transaction and facilitates and encourages the pursuit of freer trade on an international scale."<sup>21</sup>

Courts will review awards only on very narrow grounds, such as where the tribunal decided matters beyond the scope of the dispute, violated due process, or issued a decision inconsistent with the public policy of the reviewing jurisdiction. All these grounds are construed narrowly, with a strong presumption in favour of enforcing the award. The public policy ground, for example, is much more limited than it sounds. An award will be set aside on this basis only where its enforcement would violate the most basic norms of morality and justice in the legal system of the country where the award is invoked, such as where the award is tainted by fraud, bribery, corruption, perjury, breach of rules of natural justice, or failure of due process.<sup>22</sup> An

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<sup>21</sup> *Automatic Systems Inc. v. Bracknell Corp.*, 1994 CanLII 1871 (On. C.A.) at 13, 18 O.R. (3d) 257, 113 D.L.R. (4th) 449.

<sup>22</sup> *Corporacion Transnacional de Inversiones S.A. de C.V. v. STET International S.p.A.* (1999), 45 O.R. (3d) 183 (S.C.J.), *affirmed* (2000), 49 O.R. (3d) 414 (C.A.); *leave to appeal refused* (2001), [2000] S.C.C.A. No. 581, 271

award will not be considered contrary to public policy merely because it got the facts or law wrong, or is inconsistent with “public policy” understood in the ordinary sense of the political positions manifested in legislation, regulations, or judicial decisions.<sup>23</sup> As the Federal Court of Canada said when asked to review the *S.D. Myers* Chapter 11 award, “public policy does not refer to a political position, it refers to ‘fundamental notions and principles of justice’.”<sup>24</sup> Not surprisingly, public policy rarely succeeds as a ground to invalidate international arbitral awards.

### C. DIFFICULT TO CHANGE

Like constitutional norms, international investment rules are difficult to amend or repeal. They represent a form of precommitment strategy, an effort to bind future governments to particular core values, principles and rules. In theory, states may withdraw from these arrangements. Withdrawal from NAFTA or the World Trade Organization (WTO) is possible upon six months’ notice.<sup>25</sup> This prospect was mooted publicly by then-Senators Obama and Clinton in the 2008 race for the Democratic presidential nomination, although President Obama’s team quietly reassured the Canadian government that he did not really mean it.

Unlike NAFTA and the WTO, termination of BITs is typically permitted only after ten years, and their rules continue in force for a further ten to twenty years for investments made during the period of the BIT.

Even if possible in theory, exit is not a feasible option for Canada, let alone for economically weaker countries (Schneiderman 2000a, 771). Canada is not much more likely to want to incur the wrath of more powerful economic forces in the United States than developing countries are likely to want to incur the wrath of more powerful economic forces in Canada and other industrialized countries (cf. Unger 1998, 82-84). Moreover, the network of international trade and investment agreements is so extensive, entrenched and interwoven that fundamental renegotiation of its terms is not a feasible option for individual disgruntled governments. The international trade and investment regime subjects nation-states’ exercise of public regulatory authority to an unusual degree of external control (Van Harten and Loughlin 2006). The infeasibility of exit or renegotiation means that this external control is unlikely to relax in the short or even the medium term.

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N.R. 394 (note) (S.C.C.); *Waterside Ocean Navigation Co. v. International Navigation Ltd.*, 737 F.2d 150 at 152 (2nd Cir. 1998).

<sup>23</sup> *Quintette Coal Ltd. v. Nippon Steel Corp.* (1990), 50 B.C.L.R. (2d) 207 (C.A.); *leave to appeal refused* (1990), 50 B.C.L.R. (2d) xxviii (S.C.C.).

<sup>24</sup> *Canada (A.G.) v. S.D. Myers Inc.* (2004), 2004 FC 38 at para. 76 (T.D.).

<sup>25</sup> NAFTA, supra note **Error! Bookmark not defined.**, Article 2205; *Agreement Establishing the World Trade Organization*, 15 April 1994, reprinted in World Trade Organization, *The Legal Texts: The Results of the Uruguay Round of Multilateral Trade Negotiations* (Cambridge: Cambridge University Press, 2007), Article XV.

This is what champions of free trade meant when they described NAFTA as “locking in” neoconservatism – despite the fact that the neoconservative model was and is no closer to being accepted as a sustainable societal contract in Canada than it is elsewhere (Clark 1997). Even if political parties that reject this neoconservative model were to win power, they would find their hands tied by an internationally negotiated and domestically implemented supraconstitution to which their predecessors had committed them – unless they were willing to violate or withdraw from it and pay the resulting costs involved in their trading partners’ commercial or political retaliation.

Unlike domestic laws, the investor rights conferred by NAFTA and BITs cannot be amended unilaterally by any one state. As BITs with NAFTA-style investment rights proliferate, the difficulty of exit or renegotiation increases. From this perspective, the failure of the Multilateral Agreement on Investment can now be seen as a victory for neoconservative constitutionalism, since it would likely be harder to renegotiate the thousands of BITs that took its place than a single multilateral investment treaty. This resistance to change is an important part of what makes these rights supraconstitutional. As Schwartz and Bueckert (2006, 483) assert glibly, “[b]ecause it would be politically and economically difficult for Canada to withdraw from NAFTA, the treaty provisions have quasi-constitutional force.”

#### **IV. Reasons for Concern about the Emerging Supraconstitution**

Why should anyone care whether the investor rights and investment arbitration provisions of NAFTA and BITs have achieved *de facto* constitutional status in the legal orders of participating states? Because these investor protections are inconsistent with domestic constitutional and legal arrangements in at least some participating states, especially regarding takings of private property; they are enjoyed only by foreign investors, not by nationals; their meaning is determined by private adjudicators outside national democratic processes; their benefits and burdens are distributed very unevenly; and these emerging supraconstitutional norms have not been legitimated by a constitutive demos.

##### **A. INCONSISTENCY WITH NATIONAL LEGAL AND CONSTITUTIONAL NORMS**

The first reason for concern about these supraconstitutional norms is that the investor rights in NAFTA and BITs may contradict existing constitutional and legal norms in host countries. Take Canada as an example. NAFTA Chapter 11 provides substantially greater protection of private property rights than the Canadian constitution or legislation. Its rights for foreign investors are unprecedented in Canadian law and inconsistent with the treatment of private property in the Canadian constitution, which gives no protection against the taking of private property. Property rights were excluded deliberately from Canada’s *Charter of Rights and Freedoms* in 1982, because they would excessively enhance corporate power, which was thought to be adequately protected by the common law and ordinary legislation. Notwithstanding this deliberate

constitutional choice, just a few years later CUFTA introduced into Canada's legal system a guarantee of property rights for foreign investors modelled after the takings clause of the US Constitution.<sup>26</sup> Soon afterward, NAFTA reconfirmed these rights and extended them to Mexican investors. The effect of these provisions, as Been and Beauvais (2003, 143) conclude, is not merely to "internationalize" the US Takings Clause, but to "extend the scope of potential regulatory takings claims in significant respects." This was understood at the time neither (apparently) by the Canadian government nor (certainly) by the public.

It is true that the Canadian constitution protects some aspects of property rights, including security against unreasonable search and seizure, freedom to use one's property for expressive purposes, freedom to trade on the Sabbath, protection against racially-motivated confiscations such as those inflicted on Japanese Canadians in World War II, and protection of aboriginal property rights. But there is no constitutional protection against deprivation of private property, and no constitutional requirement for compensation in the event of a taking. The contrast between NAFTA and the Canadian constitution in this respect is stark.

On its face, NAFTA also goes well beyond the protection accorded to private property rights by ordinary Canadian law. Contrary to NAFTA Article 1110, common law rules of statutory interpretation provide that legislation may validly deprive citizens of property without compensation, provided that the statutory language clearly dictates this result.<sup>27</sup> In practice, provincial and federal expropriation laws provide for procedural due process and compensation, but there are exceptions and in any event these rules can be amended or repealed by the legislatures that enacted them. Canadian courts usually grant minimal compensation for expropriation, while NAFTA Article 1110 requires compensation to be prompt, fully realizable, freely transferable, and equivalent to fair market value immediately before the expropriation (Schwartz & Bueckert 2006). While human rights legislation such as the *Canadian Bill of Rights*<sup>28</sup> and some provincial statutes<sup>29</sup> contain provisions protecting private property rights, courts have generally interpreted them narrowly and been reluctant to apply them to invalidate laws. Finally, Canadian courts have shied away from the American notion of "regulatory takings" implicit in NAFTA's reference to measures "tantamount to expropriation."

This latter point is crucial to understanding NAFTA's significance for Canadian public law and policy. According to the US "regulatory takings" concept, government regulation that falls short of direct expropriation can nevertheless amount to an illegal taking. As Justice Oliver Wendell Holmes wrote in 1922, "while property may be regulated to a certain extent, if regulation goes too far it will be recognized as a taking."<sup>30</sup> In the United States the concept of regulatory takings

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<sup>26</sup> The Takings Clause provides that "nor shall private property be taken for public use, without just compensation." U.S. Const., amend. V.

<sup>27</sup> In other words, courts will not interpret a statute to take away property without compensation unless the statutory language clearly demands otherwise. *Manitoba Fisheries Ltd. v. R.* [1979] 1 S.C.R. 101.

<sup>28</sup> S.C. 1960, c. 44, s. 1, reprinted in R.S.C. 1985, App. III.

<sup>29</sup> E.g. *Alberta Bill of Rights*, R.S.A. 2000, c. A-14, s. 1.

<sup>30</sup> *Pennsylvania Coal Co. v. Mahon*, 260 U.S. 393, 415, 43 S.Ct. 158, 160 (1922).

has been invoked to challenge all kinds of regulation. Since the 1980s, “property-rights advocates have turned in increasing numbers to ‘takings’ arguments as a way to galvanize public support and roll back what they argue to be oppressive governmental interference with the rights of private property” (Underkuffler-Freund 1996, 162; see also Epstein 1985). They have won important victories in state and federal courts, and have succeeded in enacting ballot measures and statutes in several states requiring compensation for reductions in property value resulting from land-use regulation.

After decades of confusion, some clarity has finally emerged in the US Supreme Court’s regulatory takings jurisprudence (Kent 2008). Compensation may be required for either total or partial regulatory takings (Meltz 2007).<sup>31</sup> A total regulatory taking occurs when regulation deprives the owner of all economically beneficial uses of the property and renders the property economically idle. Thus, in the *Lucas* case, a local council in South Carolina designated a beachfront area as unavailable for development under a state statute for the protection of ecologically sensitive seacoast property, prohibiting the owner of affected beachfront lots from erecting any permanent structures on his land. The US Supreme Court held this to be a taking.<sup>32</sup>

When government action falls short of total deprivation of the property’s economic use or value, a partial regulatory taking may still be found if the impugned regulation is “functionally equivalent” to direct appropriation or ouster.<sup>33</sup> This will depend on the severity of the economic impact on the property owner, the degree of interference with the owner’s reasonable investment-backed expectations, and the character of the government action.<sup>34</sup> The intent of the Takings clause, according to the Court, is to prevent the government “from forcing some people alone to bear public burdens that, in all fairness and justice, should be borne by the public as a whole.”<sup>35</sup> Thus, requiring landowners to dedicate a public greenway over a portion of their property or allow public access to a privately owned beach as a condition for issuing a building permit, has been held a taking,<sup>36</sup> as has an interim ordinance prohibiting construction of any structures in a flood zone.<sup>37</sup> Even regulations that predate the plaintiff’s acquisition of title may

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<sup>31</sup> U.S. law also recognizes that a regulatory action that results in a permanent physical occupation of property is a taking *per se* (*Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419 (1982)), but we are more concerned here with public welfare regulation that restricts private property use without physically invading it.

<sup>32</sup> *Lucas v. South Carolina Coastal Council*, 112 S.Ct. 2886 (1992).

<sup>33</sup> *Lingle v. Chevron U.S.A. Inc.*, 544 U.S. 528, 539 (2005).

<sup>34</sup> *Penn Central Transportation Co. v. New York City*, 438 U.S. 104, 124 (1978).

<sup>35</sup> *Armstrong v. United States*, 364 U.S. 40, 49 (1960).

<sup>36</sup> *Nollan v. California Coastal Comm’n*, 483 U.S. 825 (1987); *Dolan v. City of Tigard*, 512 U.S. 374 (1994).

<sup>37</sup> *First English Evangelical Lutheran Church v. County of Los Angeles*, 482 U.S. 304 (1987).

qualify as takings.<sup>38</sup> In general, the purpose behind the regulations (environmental protection, public health, etc.) is not considered relevant.<sup>39</sup>

On the other hand, the US Supreme Court has dismissed many regulatory takings claims, including challenges to rent control regulation,<sup>40</sup> restrictions on surface mining of prime farmlands,<sup>41</sup> requirements to restore original slope contours after surface mining,<sup>42</sup> temporary land development moratoria,<sup>43</sup> and the use of historical landmark designation to prevent construction of a skyscraper atop an historic building.<sup>44</sup> The Court has recognized fairly wide scope for government regulation, holding that “[g]overnment hardly could go on if to some extent values incident to property could not be diminished without paying for every such change in the general law,”<sup>45</sup> and that deprivation of a property’s most profitable use is not, in itself, a taking.<sup>46</sup> As a result, regulatory takings claims remain a “difficult sell” in the United States (Meltz 2007, 371).

Nonetheless, they are an even harder sell in Canada. Two requirements must be met to make out a claim for a *de facto* taking requiring compensation in Canada: (1) an acquisition by the Crown of an interest in the property or flowing from it, and (2) deprivation of all reasonable uses of the property.<sup>47</sup> Not even a “total” taking of the kind found in *Lucas* would normally be considered a *de facto* expropriation in Canada. In circumstances similar to *Lucas*, the Nova Scotia Court of Appeal in *Mariner Real Estate* upheld a provincial government’s prohibition of development of beachfront lots.<sup>48</sup> The provincial government designated the plaintiffs’ beachfront lots in Kingsburg, Nova Scotia, as a beach under the *Beaches Act*.<sup>49</sup> Once designated, all development on such lands – from trails to fences to buildings – was prohibited unless authorized by the Minister. The plaintiffs applied for permission to build single family residences on their lots.

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<sup>38</sup> *Palazzolo v. Rhode Island*, 533 U.S. 606 (2001).

<sup>39</sup> In *Lingle*, the Court held that whether the government action substantially advances a legitimate state interest is not an appropriate consideration in regulatory takings cases. The focus, rather, is on the action’s impact on the private property. *Lingle*, *supra* note \_\_.

<sup>40</sup> *Ibid.*

<sup>41</sup> *Hodel v. Indiana*, 452 U.S. 314 (1981)

<sup>42</sup> *Hodel v. Virginia Surface Mining & Reclamation Ass’n*, 452 U.S. 264 (1981).

<sup>43</sup> *Tahoe-Sierra Preservation Council, Inc. v. Tahoe Regional Planning Agency*, 535 U.S. 302 (2002).

<sup>44</sup> *Penn Central*, *supra* note 34.

<sup>45</sup> *Pennsylvania Coal Co.*, *supra* note 30, 413.

<sup>46</sup> *Penn Central*, *supra* note 34, 125.

<sup>47</sup> *Canadian Pacific Railway v. Vancouver (City)*, 2006 SCC 5, [2006] 1 S.C.R. 227 at para 30.

<sup>48</sup> *Mariner Real Estate Ltd. v. Nova Scotia (A.G.)* (1999) 26 R.P.R. (3d) 37, 177 D.L.R. (4th) 696, 68 L.C.R. 1, 178 N.S.R. (2d) 294, 549 A.P.R. 294, [1999] N.S.J. No. 283 (C.A.).

<sup>49</sup> R.S.N.S. 1989, c. 32.

An environmental study commissioned by the government concluded that the houses should not be constructed due to the sensitive nature of the dune landforms and the likely damage to the houses themselves from the breakdown of the dune system. The provincial government refused the applications. The plaintiffs sued, claiming that their lands had, in effect, been expropriated and they were entitled to compensation under the provincial expropriation statute. The trial judge agreed, but the Court of Appeal reversed the decision.

The Court of Appeal concluded that “US constitutional law has, on this issue, taken a fundamentally different path than has Canadian law”.<sup>50</sup> It held that regulatory taking claims in Canada are constrained by two governing principles:

The first is that valid legislation ... or action taken lawfully with legislative authority may very significantly restrict an owner’s enjoyment of private land. The second is that the Courts may order compensation for such restriction only where authorized to do so by legislation. ... In short, the bundle of rights associated with ownership carries with it the possibility of stringent ... regulation.<sup>51</sup>

The question posed in US takings cases is therefore fundamentally different from that before a Canadian court. While deprivation of economically beneficial or productive use qualifies as a taking of land in the United States, it does not in Canada, even when the deprivation is drastic. The appropriate question, rather, is whether the effect of regulation is to eliminate “virtually all rights associated with ownership”.<sup>52</sup> This is a considerably higher threshold. The court held that “[p]reclusion of residential development ..., particularly on lands of this environmental sensitivity, is not, of itself, the extinguishment of virtually all rights associated with ownership.”<sup>53</sup> The plaintiffs had not shown that other traditional or reasonable uses were precluded, such as walking, camping, taking pictures, gardening, horseback riding, or grazing livestock. Nor had they shown that they were precluded from environmentally appropriate development other than houses built on standard concrete foundations. They therefore retained some of the normal rights and incidents of ownership, precluding a finding of *de facto* expropriation. In contrast, the fact that the plaintiff could still engage in camping on his beachfront property did not prevent the US Supreme Court from finding a taking in *Lucas*.

The *Mariner* case also highlighted a second major difference between American and Canadian takings law. Unlike the United States, where a plaintiff need not prove that the state acquires any interest in the land regulated, *de facto* expropriation will only be recognized in Canada if there is an acquisition of an interest in land by the Crown. The court in *Mariner* held that the development freeze and strict environmental regulation of beachfront property did not confer any interest in the land on the Province. Even if the measures enhanced the value of publicly owned

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<sup>50</sup> *Mariner Real Estate Ltd.*, *supra* note 48 at para. 101.

<sup>51</sup> *Ibid.* at paras. 38-39.

<sup>52</sup> *Ibid.* at paras. 5, 50 and 85.

<sup>53</sup> *Ibid.* at para. 85.

property (for example, the public portion of the beach), the court held that regulation enhancing the value of public property is not an acquisition of an interest in land.<sup>54</sup>

The *Mariner* case was endorsed recently by the Supreme Court of Canada in a decision that further underlined the contrast between Canadian and US regulatory takings law. The US Supreme Court has found regulatory takings where the government required private owners to grant public beach access or create a public greenway over a portion of their property as a condition for issuance of building permit.<sup>55</sup> By contrast, when the City of Vancouver amended its Official Plan to require an *entire* privately owned property – a discontinued Canadian Pacific Railways (CPR) rail corridor – to be used only as a public thoroughfare for transportation or greenways, the Supreme Court of Canada upheld this as valid regulatory action notwithstanding the fact that the effect of the by-law was to “freeze the redevelopment potential of the corridor and to confine CPR to uneconomic uses of the land.”<sup>56</sup> The court held that neither of the two requirements for a regulatory taking was satisfied. The Court rejected CPR’s argument that the City had in effect acquired a public park, concluding that the City “has gained nothing more than some assurance that the land will be used or developed in accordance with its vision, without even precluding the historical or current use of the land.”<sup>57</sup> Furthermore, the Court held that the by-law did not remove all reasonable uses of the land, noting that it did not prevent CPR from operating a railway on the land, maintaining the railway track, leasing the land for use in conformity with the by-law, or developing public/private partnerships. Finally, the Court held that even if the facts could support the inference of a *de facto* taking, that inference had been conclusively negated by a section in a provincial statute providing that the City was not liable to compensate landowners for loss as a result of by-law restrictions, and that property affected by a by-law was deemed not to have been “taken” by the City. As the Court said, the legislature has the power to alter the common law, and by providing that the effects of the by-law cannot amount to a taking, “it has rendered inapplicable the common law *de facto* taking remedy upon which CPR relies.”<sup>58</sup> This reinforces a crucial difference between takings law in Canada and the United States: Because protection against takings is not constitutionally entrenched in Canada, it can be modified or removed by legislation.

What does all of this tell us about NAFTA’s investor protections? The phrase “measure tantamount to nationalization or expropriation” is not defined in NAFTA, and there have only been a few tribunal decisions interpreting it (which we discussed above). But it is already clear that the rights incorporated into NAFTA – national treatment, most favoured nation treatment,

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<sup>54</sup> *Ibid.*, paras. 93-101 (distinguishing *British Columbia v. Tener*, [1985] 1 S.C.R. 533, in which the Crown’s prohibition of mining resulted in recovery of the mineral rights that had previously been granted to the plaintiff, and *Manitoba Fisheries Ltd. v. R.*, [1979] 1 S.C.R. 101, in which the legislation that deprived a company of its goodwill also conferred that goodwill upon a Crown corporation).

<sup>55</sup> *Nollan and Dolan*, *supra* note 36.

<sup>56</sup> *CPR*, *supra* note 47, para. 8.

<sup>57</sup> *Ibid.*, para. 33.

<sup>58</sup> *Ibid.*, para. 37.

protection against expropriation, no performance requirements, minimum international standard of treatment – are on their face inconsistent with the Canadian constitution and other Canadian laws. It is clear that they are much more closely aligned with American law than with either Canadian or – as we will see shortly – Mexican law (Starmer 2002). It is also clear that Chapter 11 “adopts wholesale” the rights that American TNCs had long demanded in their dealings abroad, and that the US government had advocated on their behalf (Afilalo 2001). The formula for compensation adopted in NAFTA – prompt, adequate (i.e., fair market value), effective, fully realizable and freely transferable – was the same one called for by the US government and industry in bilateral and multilateral fora, especially in relation to nationalizations by developing states in the Third World. The United States has long argued that this stringent compensation formula is the standard required by international law. Thus are NAFTA’s investor rights more in line with American legal norms than with those of the other continental trade partners.

We can go farther. Investors’ rights under Chapter 11 may be more expansive even than in American law. As Echeverria points out, the language of NAFTA Article 1110 is quite different from that of the US Takings Clause, and the rulings of NAFTA tribunals are essentially unreviewable in Canadian or US courts, “practically ensuring that the international law of takings will evolve along a separate and independent path from domestic takings law” (Echeverria 2006, 984). At the very least, the contrast between the Canadian and American law of takings, and the decades of confusion within US regulatory takings jurisprudence, indicate that the line between valid public welfare regulation and actions “tantamount to expropriation” can be drawn in very different places.

A discussion of NAFTA’s investor rights would be incomplete without considering their implications for NAFTA’s third partner, Mexico. If NAFTA Chapter 11 represents a “minimal shift” in US takings law and a “significant shift” for Canadian takings law, it represents a major departure from Mexico’s highly interventionist constitutional takings tradition (Starmer 2002, 428, 431). Experience in Mexico and some other Latin American countries that have signed Chapter 11-like investment treaties indicates that if investment treaties contradict domestic constitutional rules, so much the worse for the constitution. The modern constitutions of Mexico and other post-colonial countries were shaped substantially by those countries’ experiences with and reactions against transnational, especially American, capital. Like those of many other developing and less developed states, the Mexican constitution vested in the state a monopoly over certain key economic sectors along with authority to intervene in the market to steer economic development, redistribute wealth, and resist foreign influence. Article 27 of Mexico’s constitution contains a version of the famous “Calvo Clause,” traceable to the writings of nineteenth century Argentinian jurist, Carlos Calvo.<sup>59</sup> As Schneiderman explains:

Based on the dismal Latin American experience with interventionist international capital, Calvo argued that the countries of Latin America were entitled to the same degree of respect for their internal sovereignty as the United States of America and the countries of

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<sup>59</sup> Constitución Política de los Estados Unidos Mexicanos Ch. 1, Art. 27 (“Mex. Const.”).

Europe. Among Calvo's precepts is the proposition that states should be free, within reason, from interference in the conduct of their domestic policy (Schneiderman 2000b, 89).

This doctrine contained two basic principles: absolute equality of treatment of aliens and nationals and non-intervention by the home state in the event of a dispute between an alien investor and the host country (Starner 2002). Firstly, foreign investors who chose to establish themselves within the territory of the host state had no greater protection from state action (including expropriation) than nationals, were only entitled to pursue domestic remedies, and were prohibited from seeking diplomatic intervention by their home state, in some cases on pain of forfeiture of their property rights. Home states were prohibited against intervening, diplomatically or otherwise, to enforce their citizens' rights in the face of nationalization or expropriation of their property. The intent was for government action, including nationalization, to be judged by domestic standards in domestic courts, not by "international" standards dictated by the major capital exporting nations.

The Mexican constitution also establishes national sovereignty over and state ownership of natural resources, limits foreign ownership, authorizes expropriation of private property for public use (subject to payment of indemnity), and authorizes the regulation of private property and natural resources for the collective good, "to ensure a more equitable distribution of public wealth, to conserve them, to achieve the well-balanced development of the country and the improvement of the living conditions of the rural and urban population."<sup>60</sup> Such regulation does not give rise to a right to compensation even though it may drastically diminish the value of private property or eliminate almost all rights of ownership (Starner 2002, 414).

These constitutional provisions reflected a distinct Latin American brand of constitutionalism, which Cox called "state capitalism" (Cox 1996b). State capitalism emerged as an alternative to both Western capitalist imperialism and Soviet socialism. It emphasized state control of key economic sectors, intervention in the market to redistribute wealth, and insulation from external economic and political pressures. It was never accepted by the United States and the capital exporting states of Europe, although some of its principles were included in United Nations General Assembly resolutions associated with the proposed New International Economic Order in the 1970s. By the 1990s, state capitalism was in disfavour, pushed aside by its main post-Cold War rival, the neoconservative constitutionalism we described in Chapter 2. Developing countries in Latin America and elsewhere began to implement massive constitutional reforms to relinquish state control of the commanding heights of the economy, reduce or eliminate limits on foreign ownership and control, and roll back the state's central role in redistributing wealth and directing economic and social development.

In Mexico, some 30 constitutional provisions that gave expression to the Calvo Doctrine and the state-capitalist model of constitutionalism were amended in the lead-up to NAFTA. One of these

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<sup>60</sup> Ibid., quoted in Starner 2002: 414.

amendments precipitated the Zapatista armed uprising in Chiapas, by authorizing the redistribution of “underused” collective rural land to campesinos (Schneiderman 2000a, 766). While the Calvo Clause remained formally intact it was erased implicitly, at least as regards NAFTA parties, by a series of non-constitutional and legislative edicts (*ibid.*; Flores 2005). In effect, the Mexican constitution was made to submit to NAFTA’s discipline.

This phenomenon is not restricted to NAFTA. Governments in Latin America and elsewhere that once pursued a state-capitalist development path have increasingly become parties to BITs and regional free trade agreements that incorporate NAFTA-style investor rights. When such arrangements conflict with domestic constitutional arrangements, the latter have often been jettisoned. The Colombia-United Kingdom BIT of 1994 contained the usual provisions concerning national treatment, most favoured nation treatment, and prohibition against expropriations except for a public purpose and upon payment of prompt, adequate and effective compensation that is fully realizable and transferable. When the legislation implementing the BIT was presented to the Colombian Constitutional Court for certification, as required by the constitution, the Court held that the BIT violated the Colombian Constitution of 1991 in two ways. First, by guaranteeing compensation for expropriation, it contradicted a provision that authorized expropriation without compensation for reasons of equity. Second, by granting British investors preferential treatment that was not available to Colombian nationals, it violated the equality provisions of the constitution. The response of the Colombian government was to amend the constitution in 1999 to no longer permit expropriation without the payment of compensation. As Schneiderman concludes, “[h]ere is a clear instance of [neoconservative] constitutionalism disciplining a domestic constitutional text: Interference with private property and investment rights simply is beyond the bounds of acceptability” (Schneiderman 2000b, 106-108).

While some litigants have argued that NAFTA violates domestic constitutions, these arguments have not so far met with success in the domestic courts of the NAFTA parties.<sup>61</sup>

## B. ENJOYED ONLY BY FOREIGN INVESTORS

The second reason for concern about the rights conferred on foreign investors by NAFTA and BITs is that they are enjoyed only by foreign investors, not by nationals. This is not meant as a sop to nationalist or xenophobic sentiment; rather, it is meant simply to emphasize that these supraconstitutional norms favour transnational capital and discriminate against nationals. To

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<sup>61</sup> In Canada, for example, the Council of Canadians (a leading nationalist organization) launched a constitutional challenge against NAFTA Chapter 11 claiming (*inter alia*) that it violated Canadian constitutional rules giving the superior courts the mandate to interpret Canadian laws, but it was dismissed by the trial judge. *Council of Canadians v. Canada (A.-G.)*, Doc. No. 01-CV-208141 (Ont. Super. Ct. J., 8 July 2005), 2005 CanLII 28426; *aff’d* (2006), 277 D.L.R. (4<sup>th</sup>) 527 (Ont. C.A.), 149 C.R.R. (2d) 290.

return to the Canadian example, NAFTA investor rights are not available to Canadian investors in Canada. They are enjoyed only by American and (theoretically) Mexican investors. For practical purposes, this means transnational corporations. The more citizens' groups understood that foreign transnationals had been given rights to nullify domestic legislation that were not just beyond recourse in domestic courts, but were unavailable to Canadian enterprise, the more Chapter 11 and NAFTA as a whole were delegitimized. Moreover, these enhanced rights are not balanced by any corresponding obligations. The new justiciable empowerment accorded by trade agreements to transnational corporations subjects them to no balancing obligations enforced by continental-level institutions with the clout to regulate, tax, or monitor transnational business in the newly created continental market (Blank and Krajewski 1995). Chapter 11 expanded the scope of investment rights with no corresponding requirements on TNCs to promote the public interest by, for example, protecting the environment or public health. Some commentators suggest that the solution to the disparate treatment of foreign investors and nationals instituted by NAFTA and BITs is to extend similar rights and privileges to nationals. "Ideally," one article predicts hopefully, "better remedies for 'regulatory takings' under international law will pressure Canadian authorities to adopt a more generous compensatory approach for their own citizens" (Schwartz and Bueckert 2006, 485). The economic supraconstitution itself thus becomes a tool to advance a neoconservative project to transform domestic constitutions, laws and public policies.

### C. ADJUDICATION OF EXERCISES OF PUBLIC AUTHORITY OUTSIDE NATIONAL DEMOCRATIC PROCESSES

Chapter 11's investor-state dispute system represents an almost unprecedented privatization of public law adjudication (Dunberry 2001). Rather than challenging government action in domestic courts or before administrative tribunals, disgruntled investors may take the offending government to private international commercial arbitration where trade law experts will determine the validity of the government's exercise of public power. This is a most unusual way to challenge states' exercise of their public authority to regulate business. For example in one Chapter 11 case, *Metalclad*, the tribunal held that, as a matter of Mexican law, a municipal government had no constitutional authority to authorize or prohibit construction of a hazardous waste dump that had been authorized by the federal government – a judgment that hitherto only the Mexican courts had the power to make (*ibid.*).

International commercial arbitration developed as a means to resolve transnational business disputes between commercial parties. Its norms of confidentiality (according to which the existence, nature and outcome of disputes remain secret unless the parties agree otherwise) and party autonomy (according to which parties have complete freedom to choose the laws by which their disputes will be governed, the forum in which they will be decided and the judges who will adjudicate them) may facilitate transnational commerce, but they are deeply at odds with contemporary norms for challenging governments' exercises of public authority in democratic societies.

Public transparency and participation were the first casualties of Chapter 11. One of the most significant and hard-won developments in public administration in the past generation has been the establishment of the public's right to transparency of and participation in government decision-making. Previously, closed-door negotiations between government authorities and regulated industries were the norm for the development, implementation and enforcement of regulatory standards. Legislative hearings were unintelligible or inaccessible to many citizens and civil society organizations, and often not where the real business of government was conducted. The development of rules and regulations was secretive and mysterious except to governments and the affected industries. Only directly affected parties were entitled to receive notice of proposed administrative decisions or challenge government actions in court. Members of the public were mere supplicants before unanswerable bureaucracies (Sax 1971).

Now in Canada, the United States and many other countries, members of the public have enforceable legal rights to receive notice of, and comment on, a wide variety of proposed administrative rules and decisions, obtain information held by governments, and challenge government action and inaction in courts and administrative tribunals (eg. Richardson and Razzaque 2006). Not just industry but concerned citizens and public interest groups now have standing to challenge government decision-making. Courts and tribunals are more liberal in allowing public interest groups to intervene as *amicus curiae* (friends of the court) to make submissions on the validity of public law and policy. Increasingly, citizens themselves may go to court to enforce laws when governments fail to do so. And the proceedings before and decisions of these official courts and tribunals are almost always public. While behind-closed-doors government-industry bargaining still characterizes public policy-making on some issues in some places (this remains the norm for environmental regulation in Canada, Boyd 2003), the trend has been unmistakably toward increasing public transparency, accountability and participation.

Chapter 11 reversed this trend, going against twenty years of increased public participation, access to information, and access to justice in American public law, just at a time when Canadian governments and courts were finally taking similar steps themselves. As originally adopted, NAFTA envisaged that investor-state arbitrations would be conducted entirely in private. Arbitral decisions, and even the existence of suits, would be made public only at the discretion of the disputing parties. Tribunals could appoint experts to report on relevant matters only with the disputing parties' consent. The proceedings themselves would be held in secret. No one but the disputing parties and other NAFTA parties had a right to be present. In theory, tribunals could accept written (but not oral) *amicus curiae* submissions, but this was completely alien to commercial arbitration practice and unheard of in the early years of Chapter 11 disputes. Chapter 11 thus allowed disgruntled foreign investors to circumvent the transparency and accountability guarantees that trammelled their Canadian counterparts, and return to the good old days of one-on-one, closed-door bargaining with government over matters of public policy, with one crucial difference: even the adjudication of their disputes would take place in secret instead of in open court.

The NAFTA governments finally bowed to public pressure and modified this secretive process in 2001 so that the existence of suits is now published, most documents are made public except for confidential business information, and decisions are published.<sup>62</sup> Observers have been permitted to attend the rare hearing. In 2003, the NAFTA governments adopted procedures for the submission of *amicus curiae* briefs.<sup>63</sup> But there is still no central repository of information and documents, there are inconsistencies among the official websites maintained by the three governments, and it is up to each tribunal to decide whether to allow *amicus* briefs.<sup>64</sup> Despite these lingering problems, Chapter 11 arbitrations are more open now than NAFTA originally contemplated. As one Canadian environmental campaigner put it:

the three NAFTA governments have accepted the public interest arguments that lawsuits against our governments involving large sums of public money, which also concern public regulations and government decisions, may not be treated the same, procedurally, as truly private merely commercial disputes between corporate actors. (Swenarchuk 2003, 5)

The second casualty of NAFTA Chapter 11 was national democratic sovereignty. The meaning of the quasi-constitutional rights granted to foreign investors, and the validity of local, provincial and federal governments' exercises of their public authority to regulate business, are determined entirely outside national democratic institutions, with very limited oversight by domestic courts. Removing disputes from allegedly biased domestic courts and majoritarian politics was one of the central goals of international commercial arbitration from the start, and a long-standing objective of transnational capital.

Unlike most international law disputes, NAFTA investors are not required to exhaust local remedies before bringing an international claim. Their claims about the effects and validity of exercises of public legislative and regulatory authority need not be tested in the legislative, executive, or judicial institutions of the host country before being brought to a private arbitral panel for decision. When they consider themselves to have been subject to abuse in another NAFTA country, they can avoid having to make their case in domestic tribunals where the pleadings would be more transparent and the rulings subject to appeal before superior courts. Furthermore, unlike others who claim mistreatment at the hands of a foreign government, NAFTA investors are not required to convince their home government to espouse their case.

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<sup>62</sup> Free Trade Commission, Interpretation of Chapter 11 (31 July 2001), online: <http://www.state.gov/s/l/c3439.htm> (visited 4 January 2009).

<sup>63</sup> Free Trade Commission, "Statement of the Free Trade Commission on non-disputing party participation" (no date), online: <http://www.state.gov/s/l/c3439.htm> (visited 4 January 2009).

<sup>64</sup> For the Canadian website, see Foreign Affairs and International Trade Canada, "Dispute Settlement: NAFTA – Chapter 11 – Investment," <http://www.international.gc.ca/trade-agreements-accords-commerciaux/disp-diff/NAFTA.aspx?lang=en> (visited 4 January 2009); for Mexico, see Ministry of the Economy, "Dispute Settlement," <http://www.economia.gob.mx/?P=5500> (visited 4 January 2009); and for the United States, see U.S. Department of State, "NAFTA Investor-State Arbitrations," <http://www.state.gov/s/l/c3439.htm> (visited 4 January 2009).

They have standing to bring international claims themselves against the offending state. Since they need not wait for their government to initiate proceedings on their behalf, they gain the ability to short-circuit what may be lengthy diplomatic negotiations.

Furthermore, as we discussed earlier, investment arbitration awards are insulated from review by domestic courts. This may be appropriate for purely commercial disputes between private parties, but it is hard to see how it could be appropriate for arbitral awards deciding the legality of sovereign governments' exercises of public authority to regulate business. Yet investor-state arbitral awards are handled exactly the same as the arbitration of commercial disputes between private parties. This extraordinary deference to private transnational adjudication is not mandated by NAFTA itself. The rules constraining judicial review of international arbitral awards in domestic courts are found in domestic commercial arbitration statutes, most of which are based on the 1958 New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards<sup>65</sup> or the UNCITRAL Model Law on International Commercial Arbitration.<sup>66</sup> These UN instruments and implementing legislation were designed for arbitration of commercial disputes, not disputes about the validity of sovereign exercises of public authority. In its application for judicial review of the *Metalclad* award, Mexico argued that the courts should be less deferential toward Chapter 11 decisions than other foreign arbitral awards because the relationship between the investor and host state is regulatory, not commercial. The judge disagreed, holding that the relationship is one of "investing," and the applicable legislation defines this as a commercial relationship. The court therefore applied the same highly deferential approach used in relation to private commercial arbitration awards.<sup>67</sup>

The third casualty of NAFTA Chapter 11 was the rule of law. In international commercial arbitration, there is no doctrine of precedent or *stare decisis*, according to which courts are bound by prior decisions. This principle guarantees a minimum level of consistency and predictability in most legal systems. There is no such requirement in NAFTA Chapter 11 arbitrations. Furthermore, NAFTA Chapter 11 disputes are not decided by impartial judges. The parties each choose one arbitrator and the two party-appointed arbitrators choose a third arbitrator to preside over the panel. While the arbitrators are independent of the parties, the parties have an obvious incentive to pick an arbitrator they expect to be sympathetic to their position, based on nationality, past decisions, published writings, or other information. The parties pay the arbitrators for their services. Unlike a tenured, independent judiciary, the arbitrators lack security of tenure, have a commercial interest in repeat business, and are not precluded from engaging in activities incompatible with impartiality. Van Harten and Loughlin (2006, 147-148) summarize this disturbing situation as follows:

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<sup>65</sup> 10 June, 1958, 330 U.N.T.S. 38, 21 U.S.T. 2517, U.N. Doc. E/Conf. 26/9/Rev. 1 (1958).

<sup>66</sup> Adopted by the United Nations Commission on International Trade Law, 21 June 1985, U.N. Doc. A/40/17, Annex 1.

<sup>67</sup> *Metalclad* (BCSC), *supra* note 4.

Although able to determine the legality and cost of the exercise of public authority with limited supervision by domestic courts, arbitrators are not themselves members of a tenured judiciary. In most cases, arbitrators are practising lawyers or academics who compete for appointments in a market for adjudicative services. Unlike judges, arbitrators have a commercial interest to provide ‘an efficacious and economically valuable service for clients’, and are not barred from political or professional activities incompatible with their independence and impartiality. It is not uncommon for a prominent figure in investment arbitration simultaneously to be sitting as an arbitrator in one case, representing an investor or state in another, and generally advising other clients on investment law. Arbitrators are therefore more susceptible than judges to influence by concerns about their reputation and by the need to secure future business. Simply put, the business opportunities of arbitrators are tied to the popularity of investment arbitration: the greater the utility of investment arbitration to investors, the greater the number of claims will be filed, the greater the demand for arbitrators. Privately-appointed arbitrators are therefore more likely to favour the expansion of the scope and remedial power of investment arbitration, and will have commercial incentives to interpret the jurisdiction of investment tribunals expansively. No matter how well arbitrators do their job, an award will always be open to an apprehension of an institutional bias against the respondent state, given that expansive treaty interpretations and the heightened prospect of state liability promote investment arbitration as a commercial venture.

Beyond these structural impediments to impartiality, party-appointed arbitrators may come under direct pressure from appointing governments or investors to rule in their favour. One American appellate court judge who was appointed to a Chapter 11 tribunal reports being instructed by a US political official on the outcome the United States preferred in the case to protect NAFTA against political attack (Echeverria 2006, 984-985). As Echeverria concludes, “[f]or those of us who value the tradition of judicial independence, with NAFTA in place we're certainly not in Kansas any more, as Dorothy would say” (ibid., 985). In short, conflicts between investors’ interests and public regulation are judged by private arbitrators who are dependent on the parties for repeat business; who face structural incentives to interpret their jurisdiction broadly; whose professional expertise is focused on facilitating trade and investment rather than protecting public welfare; and whose decisions about the legality of the exercise of public authority are insulated from supervision by domestic courts.

#### D. UNEVEN DISTRIBUTION OF SUPRACONSTITUTIONAL BENEFITS AND BURDENS

The economic supraconstitution established by international trade and investment regimes is not globally uniform. It is a simultaneously domestic and international phenomenon. It represents the constitutional order of a nascent supranational or post-national political formation spanning multiple national boundaries, but it also reconstitutionalizes every participating state, in varying ways and degrees, by embedding an external constitution into its domestic one (Clarkson 2004). Because it acts upon and is embedded in national constitutional orders, it is experienced differently in different nation-states. In the North American context, the United States’

supraconstitution is not the same as Canada's or Mexico's. Not only does the supraconstitution vary from country to country, it is highly uneven across subject matters, achieving its strongest expression in the international trade and investment regime. Supranational protection of the rights of transnational capital far exceeds that of human rights or the environment. Supra-constitutionalization of trade and investment norms and institutions is proceeding without a corresponding supra-constitutionalization of social, environmental, cultural, or labour rights and norms. In short, both the emerging global supraconstitution and its North American variant are highly asymmetrical across actors, nation states and issue areas. They are characterized by severe imbalances between economic and social priorities, between the needs of capital and of people, between elites and masses, between hegemonic expansion and democratic self-determination, between the United States and its continental partners, and between the global North and South. These imbalances are the manifestations of a continuing, remarkably resilient and adaptive neoconservative project to remake the world. For globalization to be a progressive and legitimate process, these imbalances must be redressed.

#### E. THE SUPRACONSTITUTION'S LEGITIMATION DEFICIT

The insertion of authoritative new norms into the constitutional orders of capital-importing states has occurred without legitimation by, or even the genuine understanding of, affected publics. In the Canadian case, the imposition of constraints on the governing capacity not just of the federal, but also of provincial and municipal governments was the result of a negotiating process characterized by secrecy and non-transparency. It was achieved with a minimum of informed public debate. Moreover, from NAFTA Chapter 11 investor-state arbitrations to WTO Appellate Body rulings, these supraconstitutional norms and institutions operate largely insulated from domestic deliberation. This absence of a democratic context for a major shift in the parameters of the political order contrasts with the extensive engagement not just by the political parties, the media, and interest groups – the normal actors in a political process – but also of the highest court of the land from 1980 to 1982 during the campaign to repatriate the domestic Canadian constitution.

If the supraconstitution has been put in place and maintained without robust democratic legitimation *within* Canada, it goes without saying that this has also happened without *supranational* democratic legitimation. At this point in history no supranational *demos*, or *pouvoir constituant*, has emerged that is capable of generating and validating Canada's supraconstitution. If, as many scholars have observed, there is no such thing as a European *demos* that can act as the source of democratic legitimacy at the European level (e.g. Weiler 1999, 2003; De Wet 2006; Kumm 2004, 2006), there is *a fortiori* no such "We the People" be found in North America or at the global level. The only persons who can be seen as enjoying rights of citizenship at the North American level are investors of NAFTA member states. Even if NAFTA heralded the emergence of a continental capitalist class, or WTO a global one, this would hardly amount to a *demos* capable of legitimizing an international constitution. Not only does the international realm lack a *pouvoir constituant*, but "if such presented itself," as Koskeniemi (2005: 12) observes, "it would be empire, and the constitution it would enact

would not be one of an international but an imperial realm". We would argue that this is precisely what has happened with the neoconservative economic supraconstitution. The economic supraconstitution in which Canada and many other nations are increasingly embedded is the constitution of an empire which, while predominantly American in inspiration and location, is de-territorialized, with TNC head offices located in all capitalist countries including middle powers like Canada and, increasingly, developing economies such as South Korea, Taiwan and India.

Not only does Canada's supraconstitution lack a supraconstitutional demos, it lacks supranational institutions for democratic transparency and accountability that might make up for the lack of democratic supervision at the domestic level. There is no North American or global parliament. While there have been some moves toward transparency and participation in WTO dispute settlement processes, they remain less accessible and more secretive than domestic judicial proceedings. International investment arbitration under NAFTA and BITs are even more secretive and opaque. It is important at this juncture to observe that the absence of a supranational demos and of supranational institutions for democratic deliberation and oversight does not mean a supraconstitution cannot exist. On the contrary, a supraconstitution can be created and can effectively bind national constitutions and constrain domestic governments without a constitutive supranational demos and without supranational mechanisms for democratic accountability. The absence of these characteristics simply accentuates the democratic deficit at the heart of emerging supraconstitutional norms and institutions.

Normative additions to the Canadian legal order from NAFTA and the WTO have consequences. National treatment for investment spelled the end to a whole generation of industrial development policies centred round the targeting of subsidies to domestic corporations or sectors to improve their competitive performance in order to boost their exports. It also called into question the capacity of the Canadian state to continue to bolster its cultural industries through favouring domestic entities in the private sector. In this way, supraconstitutional norms have had direct impacts on the domestic legislative and administrative order without most of the public – and even much of the government apparatus – understanding how this had happened.

## **V. Why Supraconstitutional Analysis?**

Critics of constitutional analysis of international law might object that all of the above points can be made without resorting to constitutional terminology. They might argue that such terminology is at worst dangerous and at best a distraction from more important issues. We disagree.

Some critics of supraconstitutional analysis argue that the very language of constitutionalism may confer legitimacy on international regimes by presupposing democratic self-government, popular validation, the rule of law, and effective protection of individual human rights, the first two of which are completely absent and the latter two weak at the international level (e.g. Howse and

Nicolaidis 2001; Cass 2005). Invoking constitutional discourse “may be a rhetorical strategy designed to invest international law with the power and authority that domestic constitutional structures and norms possess” (Dunoff 2006, 649). Critics also point to the danger that constitutional language will demobilize opposition to undesirable international arrangements by making them appear natural, inevitable or immutable – endorsing the impression that “there is no alternative” to their neoconservative prescriptions, a claim advocated by Margaret Thatcher almost thirty years ago. To call international trade and investment rules supraconstitutional “might appear to establish economic globalization as an irreversible ‘fact,’ furnishing the convenient alibi to political and other global actors that there are no alternatives in sight” (Schneiderman 2008, 5). Constitutional discourse may have the intended or unintended effect of suppressing ambiguity and political contestation (Dunoff 2006).

Since it is still widely assumed that only the sovereign state can supply the exclusive, systematic and unified hierarchy of norms characteristic of a constitution, it is also thought that only within the boundaries of the national state can one find the single constituent power (the “We the People”) that a constitution presupposes and to which public authorities can be held accountable. As a result, to suggest the existence of a constitution at the international level strikes many not only as nonsensical, but dangerous, because it suggests that the democratic preconditions for constitution-making are present where they are not (e.g. Howse and Nicolaidis 2001). Furthermore, using constitutional language poses an insidious danger of conferring legitimacy on illegitimate actors and rules:

[C]onstitutionalism is not just about the history of legitimate self-government, but also about the history of *illegitimate* domination – of cloaking illegitimate regimes and the illegitimate acts of sometimes legitimate regimes with the inauthentic robes and mystifying aura of legitimate authority. (Walker 2003, 32, emphasis in original).

While these dangers are real, constitutional analysis does not necessarily reinforce the existing global status quo. Our use of constitutional terminology and our analytical framework are offered in this critical mode. We employ constitutional terminology precisely because of its power as a language of critique. By characterizing certain international norms and institutions as forming part of the basic ensemble of practices by which contemporary societies are governed, alongside national constitutions, we hope to alert readers to the fundamental significance of these arrangements and the serious normative issues they raise. Our intent is to challenge the choices embedded in NAFTA and other aspects of the institutional and normative architecture of neoconservative globalization, not to legitimize them. Constitutional concepts and terminology provide a powerful way to do this:

The discourse of constitutionalism is a powerful one and can equally rouse citizens into action as it can immobilize them. It has the advantage of assessing the new terrain of economic globalization from a perspective different from that in which it was conceived and so can engage critically with the dominant discourses of [neoconservatism] ....

Constitutionalism, in this way, performs a double role: both as descriptor and as normative guide to the current scene. (Schneiderman 2008, 5)

Constitutional analysis has three advantages not offered by alternative conceptual lenses. First, it enables frank and full identification of the fundamental norms and institutions by which national societies are governed in the contemporary era of international trade and investment liberalization, by putting on an equal analytical footing all of the basic rules, principles and procedures that constitute national legal orders without blind reference to their domestic or international character. Second, it enables critical appraisal of these arrangements in light of the same normative expectations that most observers apply to domestic constitutions. Contrary to the critics' charges summarized above, a constitutional lens enables us to question the legitimacy and immutability of supranational norms by alerting ourselves to their constitutive role and challenging their ideological underpinnings, democratic legitimacy and uneven effects.

Finally, a supraconstitutional perspective helps us to appreciate that the neoconservative project of the 1980s and 1990s is not dead. It would be a mistake to assume that neoconservatism has run its course. While it has suffered setbacks and undergone transformations, it has proven itself remarkably resilient, adapting to changing circumstances. It has crossed partisan lines and influenced the policies of social democratic and other centre-left governments. When thwarted domestically, it has turned to the international sphere where it has enjoyed unprecedented successes. It is "a shape-shifter, forever changing its name and switching identities" (Klein 2007, 17). From its home base in the World Bank Group, it has permeated the major organs of the United Nations, especially those concerned with economic and social development. Starting with its first unconfined field test in Pinochet's Chile in 1973, and continuing through post-Katrina New Orleans in 2005, it has exploited crises as opportunities for advancement (ibid.). The current global crisis is no exception. In the midst of a resurgence of state intervention and large scale *de facto* nationalizations, the global recession is being used as cover to advance some neoconservative governance projects that would have made Maggie Thatcher proud. In Canada and the United States, for example, governments used the crisis as an excuse to demand that the big automakers reduce their workers' wages to the level of their non-unionized competitors. The Canadian federal government also used the crisis as an excuse to introduce legislation dismantling environmental impact assessment regulations, while the Ontario government mooted a proposal to eliminate two regulations for every new one introduced – a deregulatory agenda that would make Ontario premier Mike Harris's neoconservative Red Tape Reduction program of the mid-1990s seem modest.

George W. Bush's neoconservatism was not his father's. It differed in important respects, including its proselytizing right-wing Christian zeal and breathtaking disregard for international law and human rights. In any case the most recent Bush administration has been replaced and important aspects of its political doctrine repudiated. Even before the change of administration, there were some positive changes at the margins of the international trade and investment regime. The American *Bipartisan Trade Promotion Authority Act of 2002*<sup>68</sup> required that new trade

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<sup>68</sup> *Bipartisan Trade Promotion Authority Act of 2002*, 19 U.S.C. §3801 (2002).

agreements not give foreign investors more substantive rights with respect to investment protections than American investors in the US. Ironically, this is a modest version of the Calvo Clause that American multinationals and governments had fought for decades to remove in Latin America. This legislation resulted in a change to the wording of some new American investment treaties. Canada made a similar change in its own bilateral investment treaty (BIT) negotiations. The 2006 Canada-Peru BIT is typical of the new language:

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.<sup>69</sup>

Some commentators have called for a similar amendment to NAFTA Chapter 11. Given President Obama's campaign statements, there may indeed be an appetite to reopen the continental trade and investment rule book. But simply inserting interpretive guidance on the meaning of expropriation would not change NAFTA's general thrust or its supraconstitutional effect. Nothing short of a fundamental renegotiation of the nascent continental governance regime would do the job, and there is no indication that this is in the offing.

## VI. Conclusion

In this paper we have argued that a supraconstitutional analysis provides a useful lens for making sense of the international investment regime and exposes several reasons to be concerned about this regime. The same analysis can be applied to international law and organizations generally, helping to make sense of some of the contemporary transformations of law and governance associated with globalization, especially the massive proliferation of international agreements and institutions having an influence over the daily lives of individuals, firms and governments. The paper focuses on NAFTA and BITs because in our view they present the strongest case for supraconstitutionalization outside the European Union. If the argument for the existence of a nascent global supraconstitution is not convincing in this context, it is unlikely to convince in others. If it does convince, then our attention should turn to what we can do to begin to right the perilous imbalance reflected in and perpetuated by contemporary supraconstitutional arrangements, a question that is beyond the scope of this paper.<sup>70</sup>

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<sup>69</sup> Agreement between Canada and the Republic of Peru for the Promotion and Protection of Investments (2006), Annex B.13(1), online: Foreign Affairs and International Trade Canada, [http://www.international.gc.ca/trade-agreements-accords-commerciaux/agr-acc/fipa-apie/fipa\\_list.aspx?lang=en](http://www.international.gc.ca/trade-agreements-accords-commerciaux/agr-acc/fipa-apie/fipa_list.aspx?lang=en) (visited 8 April 2009). Similar provisions are found in the current American and Canadian model BITs, which are used as the basis for new negotiations.

<sup>70</sup> See Clarkson & Wood 2009.

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