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Jason L. Gudofsky

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Shedding Light on Article 1110 of the North American Free Trade Agreement (NAFTA) Concerning Expropriations: An Environmental Case Study

*Jason L. Gudofsky**

I. INTRODUCTION

“Their bark is bigger than their bite” is an apt way to describe the opponents to Chapter 11 of the *North American Free Trade Agreement*¹ (“NAFTA”) concerning investments. This is not to suggest, however, that the opponents to Chapter 11 have not had tremendous, almost unfathomable, success in making their views known to government, business, social groups and the public generally. Indeed, the opponents are generally credited for forcing the member countries of the Organization for Economic Cooperation and Development (“OECD”) to abandon their designs on creating a multilateral agreement on investments (“MAI”) which would have extended similar obligations on the treatment that OECD members would have had to accord to investors and investments from other OECD countries. Additionally, even the Government of Canada, a traditional proponent of investment agreements that aim at protecting foreign investors and investments in third countries, has bowed to political pressure and indicated its willingness to amend the scope of Chapter 11 of the NAFTA.

* Jason L. Gudofsky is an associate in the Toronto office of Stikeman Elliott where he practices principally in the areas of competition (anti-trust), international trade and regulatory laws. This paper was originally presented at a joint American Bar Association/Canadian Bar Association Conference “NAFTA Chapter 11 Investor-State Disputes: Litigating Against Sovereigns” held in Washington D.C. on February 1, 2000, and in Toronto, Ontario on March 6, 2000. The views expressed in the paper are the views of the author alone, and do not necessarily represent the views Stikeman Elliott.

¹North American Free Trade Agreement [hereinafter NAFTA], Dec. 17, 1992, Can. T.S. 1994 No.2 (entered into force January 1, 1994), *reprinted in* 32 I.L.M. 289 (1992).

Yet, for all of their bark, when the debate concerning Chapter 11 is considered, it becomes increasingly clear that the doomsday predictions are without substance or merit. This is not to suggest that Chapter 11 of the NAFTA is perfect and not in need of some minor revisions. However, to suggest that Chapter 11 of the NAFTA will prevent NAFTA Parties from implementing necessary environmental and social legislation, as many of the opponents to the Chapter typically do, is to exaggerate and misstate the possible application of the Chapter.

Chapter 11 of the NAFTA extends important safeguards to NAFTA investors and investments in order to ensure that they, and their investments, are treated in a fair, transparent and non-discriminatory manner in the territory of a host NAFTA Party—Canada, Mexico or the United States (a “Party” or, collectively, the “Parties”). By imposing the same obligations on all three Parties, the NAFTA ensures that NAFTA investors and investments will, at a minimum, be on a “level playing field” with all other investors, national or foreign, in the territory of a host Party.

While it is true that the NAFTA permits investors to initiate claims against, and seek monetary compensation from, a NAFTA Party, that is only true where a Party has violated one of its obligations, such as under Article 1102 (National Treatment) or Article 1103 (Most-Favoured-Nation Treatment), or has expropriated an investment under Article 1110. The simple act of initiating a claim is not tantamount to a Party being responsible to compensate an allegedly injured investor. A claim first must be substantiated. As discussed below, the existence of a compensable injury is far from obvious, and, in the context of Article 1110, certainly requires more than a mere interference with property or a mere reduction in the profitability of an investment. Notwithstanding the Ethyl claim, where the Government of Canada’s decision to compensate an injured investor was driven by a number of considerations, and certainly not exclusively the merits of the NAFTA claim,² as of October 1, 2000, only four decisions have been ren-

²The detractors to Chapter 11 of the NAFTA often point to the Government of Canada’s decision to settle Ethyl Corporation’s (“Ethyl”) claim as evidence that the NAFTA Parties will be severely constrained in their ability to pass necessary environmental legislation. The facts, however, do not support this conclusion. See M. Sforza & M. Vallianatos, *Briefing Paper: Ethyl Corporation vs. Government of Canada: Now Investors Can Use NAFTA to Challenge Environmental Safeguards*, PUBLIC CITIZEN, at <http://www.citizen.org/pctrade/harmonizationalert/NAFTA/ethyl.htm> (last visited Feb. 7, 2001).

Briefly, in 1997, Canada enacted the *Manganese-based Fuel Additives Act* (the “MFAA”) to ban the interprovincial and international sale of “certain manganese-based substances”, of which only methylcyclopentadieny manganese tricarbonyl (“MMT”), a gasoline octane enhancer, was enumerated as such a substance. While the MFAA imposed a ban on interprovincial and international trade in MMT, it did not ban its use in Canada, nor did it ban intraprovincial trade in MMT. The Government conceded that, at the time, it did not have scientific evidence to support the MFAA, but was generally satisfied with the evidence that the Canadian automobile manufacturers had accumulated as to MMT’s harmful effects. Furthermore, the Government of Canada was concerned that MMT was interfering with the

dered under NAFTA Chapter 11: *Robert Azinian, Kenneth Davitan & Ellen Baw v. The United Mexican States* (“*DESONA*”),³ *Waste Management Inc. v. The United Mexican States* (“*WMI*”),⁴ *Pope & Talbot v. The Government of Canada (interim award)* (“*Pope & Talbot*”),⁵ and *Metalclad Corporation*

emission control devices that the automobile manufacturers had been installing in automobiles in compliance with Canada’s emission standards. At the time, Ethyl, a Virginian-based manufacturer and distributor of MMT, was importing and processing MMT in Ontario, Canada, through a subsidiary corporation. Ethyl was the only supplier of MMT in Canada.

Two separate proceedings were initiated against the Government of Canada in respect to the MFAA. The first proceeding was initiated by the governments of Alberta, Saskatchewan, Québec and Nova Scotia pursuant to Chapter 15 of the *Agreement on Internal Trade* (the “*AIT*”) on the basis that, among other things, the MFAA did not serve a legitimate objective in that the Government of Canada had enacted the MFAA without scientific evidence and in an arbitrary and discriminatory manner. At around the same time, Ethyl initiated a claim under Chapter 11 of the NAFTA on the basis that, among other things, the MFAA violated the national treatment and expropriation provisions thereunder. The Government of Canada brought a preliminary objection to the proceedings on procedural grounds, arguing that the NAFTA tribunal was without jurisdiction because Ethyl’s claim was initiated prior to the law entering into force, and, therefore, had not crystallized into a “measure” for the purposes of Article 1101 of Chapter 11.

Prior to the NAFTA tribunal’s decision on the Government’s challenge to the jurisdiction of the tribunal, the panel constituted under the AIT found against the Government of Canada on the basis that, *inter alia*, while the Government had a reasonable basis for believing that MFAA would achieve a legitimate objective, the Government failed to establish that the legislation was not arbitrary. The AIT panel concluded that “[t]he evidence as to the impact of the MMT on the environment is, at best, inconclusive”. *Report of the Article 1704 Panel Concerning a Dispute Between Alberta and Canada Regarding the Manganese-based Fuel Additives Act*, File No.97/98 – 15 MMT – P058 at 2 (June 12, 1998). Shortly following the AIT panel’s decision, the NAFTA panel found against the Government of Canada on the Government’s procedural objections, thus allowing the case to proceed. The Government of Canada, having lost before the AIT Panel, decided to settle the case with Ethyl, for a reported Cdn \$20 million, rather than proceed with the case.

The Ethyl claim does not offer any insight to the application of Chapter 11 to an environmental-based claim. The Government of Canada did not have sufficient scientific evidence to support the impugned MFAA. Four provinces, as opposed to a U.S. investor, were successfully able to establish as much before an arbitral panel. Having lost before the AIT Panel, the Government decided not to continue with the case before the NAFTA tribunal. As such, the NAFTA tribunal never made any substantive conclusions regarding the merits of Ethyl’s claim. Furthermore, even if it had, the decision likely would have been tainted by the fact that the Government lacked suitable scientific evidence to support the MFAA. Accordingly, while the opponents to the NAFTA often point to the Government of Canada’s decision to compensate Ethyl as proof that Chapter 11 limits the ability of the Parties to implement environmental legislation, the facts do not support such a conclusion.

³Robert Azinian, Kenneth Davitan & Ellen Baw v. United Mexican States, 14 ICSID Rev.-FILJ 538 (1999)[hereinafter *DESONA*].

⁴Waste Management Inc. v. United Mexican States, ICSID Case No. ARB(AF)/98/2 (June 2, 2000).

⁵In the Matter of an Arbitration Under Chapter Eleven of the North American Free Trade Agreement Between Pope & Talbot and The Government of Canada (Arbitral Tribunal June 26, 2000) (interim award), at <http://www.poptal.com/newsinfo/newsinfo.htm>.

*v. The United Mexican States ("Metalclad").*⁶ In all four decisions, the NAFTA arbitral panels applied general principles of international law, with only the *Metalclad* case resulting in a finding in favour of the claimant investor. These cases indicate that NAFTA arbitral tribunals are not likely to open the floodgates to frivolous claims.

By focusing on the provision of Chapter 11 that has elicited the most fervent debate, namely Article 1110 concerning expropriations, this paper attempts to pick through the verbiage regarding, and shed light on, the meaning of Article 1110. To illustrate the discussion, the acquisition of MacMillan Bloedel Limited ("MB"), the then largest forest company in Canada, by Weyerhaeuser Company ("Weyerhaeuser") on November 1, 1999 to create a major global forest company (the "MB Acquisition") is examined.

Following the above introduction in Section I, the paper is organized as follows:

In Section II, a general overview of Chapter 11 of the NAFTA is provided. The discussion includes a description of the principal provisions of the Chapter, as well as a discussion of the law that governs the interpretation of the Chapter. This is followed by a general overview of expropriations under international law. This discussion is intended to provide a backdrop to the more detailed discussion concerning expropriations in the section that follows.

Section III, entitled "Article 1110 of the NAFTA on Expropriation," provides a detailed and comprehensive examination of the meaning of the terms "direct expropriation," "indirect expropriation" and "measures tantamount to an expropriation" under Article 1110 of the NAFTA. It will be seen that, contrary to the claims made by many of Chapter 11's detractors, there is an established body of law from which to draw principles and predicative tools for interpreting and understanding Chapter 11. Similar to many principles of law, whether domestic or international, expropriation law is not completely settled, or without its hazy areas. However, it is incorrect to suggest that there are no available precedents or predicative tools to assist in the interpretation of Chapter 11 of the NAFTA.

In Section IV, entitled "Article 1110 of the NAFTA and the Environment", the scope of Article 1110 of the NAFTA is examined in light of the ability of Parties to enact legislation in support of the environment. Specifically, the police powers exception under international law is discussed, both generally and with respect to the interpretation of Article 1110 of the NAFTA.

In Section V, entitled "Misconception and Confusion over the Application of Chapter 11 of the NAFTA," some of the pronouncements on and

⁶*Metalclad Corp. v. United Mexican States*, ICSID Case No. ARB(AF)/97/1 (Aug. 31, 2000) [hereinafter *Metalclad*].

criticisms of Chapter 11 of the NAFTA are set out. This will provide a context to understanding the nature of the concerns raised regarding the Chapter. The various claims that the Sierra Club of British Columbia (the "Sierra Club") made in opposition to the MB Acquisition are set out for illustration. In particular, the principal arguments raised by Ms. Jessica Clogg, a Canadian lawyer, in a legal opinion prepared for, and published over the Internet by, the Sierra Club (the "Sierra Opinion") in opposition to the MB Acquisition are outlined.

Next, in Chapter VI, entitled "Article 1110 of the NAFTA and the MacMillan Bloedel Transaction," the claims raised in the Sierra Opinion are evaluated with a view to developing a greater understanding of the possible application of Chapter 11 of the NAFTA to the ability of the NAFTA Parties to pass environmental and other social legislation.

Finally, general conclusions are offered in Section VII of the paper.

Ultimately, through a discussion of the international law of expropriation and, following that, the application of such legal principles to a practical, real world example (i.e., the MB Acquisition), this paper sheds light on the scope and application of Article 1110 of the NAFTA on the ability of the NAFTA Parties to adopt environmental measures.

II. OVERVIEW OF CHAPTER 11 OF THE NAFTA

A. NAFTA Chapter 11

Building upon the earlier bilateral free trade agreement between Canada and the United States, the NAFTA liberalizes trade and investment rules between its three signatory countries. The Parties have agreed to reduce and, in many cases, eliminate their tariff and non-tariff barriers to trilateral trade. Furthermore, through the NAFTA, the Parties have agreed to significant disciplines on how the nationals of other Parties are to be treated in a Party's territory, most notably in respect of services, telecommunications, intellectual property, government procurement and investments. It is this latter obligation, namely the one that pertains to investments, that is the subject matter of this paper.

Chapter 11 of the NAFTA extends significant protection to U.S., Mexican and Canadian investors, which includes natural persons, incorporated and unincorporated entities, and state enterprises, who own or control investments in the territory of another Party. Section "A" of Chapter 11 sets out the following conditions against which a NAFTA Party's actions may be measured:

NATIONAL TREATMENT: NAFTA Parties must treat NAFTA investors and investments as favourably as they treat their own domestic investors and investments "in like circumstances" (Article 1102);

MOST-FAVOURLED NATION TREATMENT: NAFTA Parties must treat NAFTA investors and investments as favourably as they treat non-NAFTA investors and investments "in like circumstances" (Article 1103);

MINIMUM STANDARD OF TREATMENT: NAFTA Parties must ensure that a minimum standard of treatment prescribed by international law, such as due process of law and natural justice, is provided to NAFTA investors (Article 1105);

PERFORMANCE REQUIREMENTS: NAFTA Parties must not impose or enforce certain specified performance requirements for the establishment, operation, management, conduct and operation of investments (Article 1106); and

EXPROPRIATION AND COMPENSATION: NAFTA Parties must not expropriate investments, either directly or indirectly, or through a measure tantamount to an expropriation, unless such expropriation is for a public purpose, is non-discriminatory, meets the prescribed international minimum standard of treatment, and is accompanied by compensation at the fair market value (Article 1110).

Perhaps the most innovative feature of the NAFTA is contained at Section "B" of Chapter 11 wherein NAFTA investors are provided the right to unilaterally initiate a claim against a host NAFTA Party where any of the above commitments in Section "A" of Chapter 11 are not met. The investor-State dispute settlement provisions may not be invoked to enforce any other provision of the NAFTA.⁷ Specifically, in DESONA, the Tribunal explained the scope of Section "B" as follows:

Arbitral jurisdiction under Section B is limited not only as to the persons who may invoke it (they must be nationals of a State signatory to NAFTA), but also to the subject matter: claims may not be submitted to investor-state arbitration under Chapter Eleven unless they are founded upon the violation of an obligation established in Section A.⁸

Articles 1115 to 1138 of the NAFTA set out rules for the negotiation and arbitration of disputes directly between investors and their host Party. At any time following the sixth month from when a NAFTA Party has violated one of its above-noted commitments (and advance written notice of the claim has been provided), but not more than three years from when the investor first acquired, or should have acquired, knowledge of the alleged breach, a NAFTA investor may submit a claim to either the International Centre for Settlement of Investment Disputes (the "ICSID"), under either the *Convention of the Settlement of Investment Disputes between States and Nationals of Other States* (the "Convention") or, where either the investor's home government or the Party is not a signatory to the Convention, to the

⁷The one exception is that an investor may invoke Section "B" to enforce an obligation under either Articles 1502(3)(a) or 1503(2), which covers conduct by state enterprises and monopolies while exercising a regulatory, administrative or other governmental function.

⁸DESONA, 14 ICSID Rev.-FILJ, at para. 82..

ICSID's Additional Facility Rules. Alternatively, a dispute can be referred to the United Nations Commission on International Trade Law (the "UNCITRAL").

It is the right of an investor to directly initiate a claim against a Party that has evoked the most attention by opponents to Chapter 11. The dispute settlement procedures allow private parties to do something that, to date, has never been provided for in a multilateral trade agreement: the ability to directly hold a State accountable for that State's conduct through a binding dispute settlement mechanism. The opponents to the NAFTA generally view this right as giving investors an unencumbered "stick" with which they can wield against NAFTA Parties in those cases where their host Party's legislation, programs or policies have an adverse impact on their investment in the territory of a Party. Conversely, for the supporters of Chapter 11, the dispute settlement provisions represent an important right which ensures that the Parties will abide by their commitments under Chapter 11 of the NAFTA, and, where their conduct violates Chapter 11, they can be held directly accountable.

B. The Applicable Law under the NAFTA

It is beyond reproach that, in order to evaluate the potential impact of Chapter 11 of the NAFTA on the ability of the Parties to regulate in favour of various "social" or "economic" measures, it is first necessary to delineate the scope of the Chapter. Many of its key terms, however, are not defined. The terms "treatment no less favourable" and "like circumstances" in Articles 1102 and 1103, for example, are not specifically defined by the NAFTA, nor are the terms "expropriation," "nationalization" or "measures tantamount to" in Article 1110 defined. Accordingly, in order to assess and evaluate Chapter 11 of the NAFTA, it is first necessary to understand its key terms. Unfortunately, as will be discussed below in the context of the MB Acquisition, many commentators on Chapter 11 either do not examine, or choose to ignore, the interpretative tools necessary to understand and evaluate Chapter 11. In this section, these interpretative tools are briefly examined. This introduction to the law of the NAFTA is also necessary in order to understand the more comprehensive discussion below regarding the meaning of expropriation in international law.

The law which applies to Chapter 11 of the NAFTA is set out under Article 1131 as follows:

1. A Tribunal established under this Section shall decide the issues in dispute in accordance with this Agreement and applicable rules of international law.
2. An interpretation by the Commission of a provision of this Agreement shall be binding on a Tribunal under this Section (emphasis added).

Chapter 11 must be interpreted, therefore, in accordance with the following three sources of law: (a) any previous interpretations by the Free Trade Commission (the "Commission"); (b) the terms of the NAFTA itself; and (c) general principles of public international law.

While the NAFTA directs an arbitral tribunal to consider previous interpretations by the Commission, to date, no such interpretations have been issued.⁹ Accordingly, for now, this interpretative tool does not assist in shedding light on Chapter 11.

Next, it is not insignificant that Article 1131 provides that a Tribunal shall be guided by the NAFTA as a whole, rather than being restricted to only the terms of Chapter 11 or, more restrictively, to only Article 1110 itself.¹⁰ Of particular importance to forest conservation and environmental measures, which is the particular subject matter considered in the case study at Sections V and VI below, are both the Preamble to the NAFTA and the *North American Agreement on Environmental Co-operation* (the "*Environmental Side Agreement*").¹¹ The Preamble provides that, among other things, the Parties are resolved to:

UNDERTAKE each of the preceding in a manner consistent with environmental protection and conservation;

...

PROMOTE sustainable development;

...

STRENGTHEN the development and enforcement of environmental laws and regulations;¹²

The Preamble to the *Environmental Side Agreement* both confirms and provides further breadth to each Party's right to regulate in furtherance of

⁹Some commentators have suggested that the Parties can exclude matters pertaining to the environment through a Commission interpretation, such as, for example, to exclude matters pertaining to the environment from the definition of a "measure".

¹⁰For example, in other parts of the NAFTA the Parties have restricted the interpretation of a provision to either a single paragraph, to a single Article, or to a Chapter. See NAFTA, *supra* note 1, Arts. 1134, 10:7, 110:8, and 1213.1. Furthermore, had the Parties intended to limit the application of Article 1110 to general principles of international law only, they would not have needed to include Article 1131:1, as Article 102:1 already provides that the NAFTA shall be interpreted in accordance with applicable rules of international law. See *id.* Art. 102:1. Accordingly, when interpreting Article 1110, reference must not only be to general principles of international law and to past interpretations by the Commission, but also to the terms of the NAFTA more generally.

¹¹Article 1114 further confirms each Party's right to regulate in support of the environment. See NAFTA, *supra* note 1, Art. 1114.

¹²Article 31(1) of the *Vienna Convention on the Law of Treaties* provides that a treaty "shall be interpreted in good faith in accordance with the ordinary meaning to be given to the terms of the treaty in their context and in the light of its object and purpose." The "context" is further defined to include, among other things, "its preamble". As the NAFTA constitutes a treaty, as stated at para. 80 of DESONA, the Preamble to the NAFTA could be consulted for guidance by a tribunal pursuant to Section B of Chapter 11 of the NAFTA. See *Vienna Convention on the Law of Treaties*, May 23, 1969, UN Doc A/CONF. 39/27, reprinted in 8 I.L.M. 679 (1969). Canada is a Party to the *Vienna Convention*, having acceded to the *Convention* on October 14, 1970. See *id.*

the environment.¹³ Article 3 of the *Environmental Side Agreement* explicitly provides that each Party has the right “to establish its own levels of domestic environmental protection and environmental development policies and priorities, to adopt or modify accordingly its environmental laws and regulations,” as well as imposing a duty to “ensure that its laws and regulations provide for high levels of environmental protection.”

The NAFTA, therefore, directs the Parties to legislate in support of the environment and sustainable development. While the exact weight that a tribunal appointed under the NAFTA would place on these provisions is not yet known, a tribunal would, at the very least, be informed by them. In *Metalclad*, for example, the NAFTA arbitral tribunal referred to NAFTA's Preamble as evidence that the Chapter was designed to encourage investments and that the Parties are committed to ensuring transparency in their laws and administrative procedures.¹⁴ As described in Section IV below, the Preamble and the *Environmental Side Agreement* may give both weight and breadth to the application of the police power defense when interpreting Article 1110 of the NAFTA.

Finally, Article 1131 provides that the NAFTA shall be interpreted in accordance with general principles of international law. Generally speaking, the relevant sources of international law are encompassed in Article 38 of the *Statute of the International Court of Justice* (the “*Statute of the ICJ*”) as follows:

38(1) The Court, whose function is to decide in accordance with international law such disputes as are submitted to it, shall apply:

(a) international conventions, whether general or particular, establishing rules expressly recognized by the contesting states;

(b) international custom, as evidence of a general practice accepted as law;

(c) the general principles of law recognized by civilized nations;

(d) subject to the provisions of Article 59, judicial decisions and teachings of the most highly qualified publicists of the various nations, as subsidiary means for the determination of rules of law.¹⁵

Any discussion as to the scope and meaning of Chapter 11 of the NAFTA, and Article 1110 more narrowly, must be considered in accordance with above described interpretative tools and sources of law. In the

¹³ Article 2201 provides that the Annexes constitute an integral part of the NAFTA.

¹⁴ *Metalclad Corp. v. United Mexican States*, ICSID Case No. ARB(AF)/97/1 para. 71 (Aug. 31, 2000).

¹⁵ While stated with respect to the ICJ, these sources “are generally regarded as reflecting a complete statement of the sources of international law.” IAN BROWNLIE, *PRINCIPLES OF INTERNATIONAL LAW* 3 (4th ed. 1990).

Sections that follow, the international law of expropriation is considered with a view to shedding light on the scope and application of Chapter 11 of the NAFTA. This discussion will then be applied to the MB Acquisition.

C. The Law of Expropriation

As noted, while the NAFTA Parties agreed to extend a number of substantive safeguards to NAFTA investors and investments under Chapter 11, this paper focuses on Article 1110 concerning expropriations only. While Section "III" provides a detailed examination of the international law of expropriation, immediately below is a general overview of expropriation law.

It is now widely accepted that every State has a right to expropriate and nationalize private property situated within its territory, regardless of whether the subject property is owned by a national or by an alien. International law, however, is only concerned with the latter.

A right to expropriate property is essentially a manifestation of the principle of territorial sovereignty and, to some extent, has its roots in utilitarian concepts of ownership. The primary concern of international law is to ensure that property owned by aliens is only taken when it advances public utility, is non-discriminatory and is accompanied by adequate compensation.¹⁶ However, this merely states a legal conclusion. It does not shed light on or ultimately settle when a measure gives right to a concomitant obligation on a State to compensate injured foreign nationals. As well, it does not describe the inherent limitations on the manner by which States may exercise their sovereign power over property. To this end, James Hyde notes that:

It is generally recognized as a matter of law that a state has the power to control and use its natural resources and therefore to acquire property within its jurisdiction. It would be an over-simplification to assert this principle can stand alone, without considering the treaties as well as international agreements or other form of estoppel which may qualify the exercise of that power.¹⁷

An expropriation generally refers to a small-scale taking or deprivation.¹⁸ It is usually directed at the property of a particular owner but may, in some instances, extend to a group of properties. An expropriation is often described by reference to a certain class or type of measure. Alternatively, it may be described by the effect which the impugned measure has on a

¹⁶ See B.A. WORTLEY, *EXPROPRIATION IN PUBLIC INTERNATIONAL LAW* 23 (1959); Timothy B. Hansen, *The Legal Effect Given Stabilization Clauses in Economic Development Agreements*, 28 VA. J. INT'L L. 1015, 1026 (1988); G.C. Christie, *What Constitutes a Taking of Property under International Law*, 1962 BRITISH Y.B. INT'L L. 307; WAYNE MAPP, *THE UNITED-STATES CLAIMS TRIBUNAL: THE FIRST TEN YEARS 1981-1991* 163 (1993).

¹⁷ James N. Hyde, *Permanent Sovereignty Over Natural Wealth and Resources*, 50 AM. J. INT'L L. 854, 862 (1956).

¹⁸ See Lianlian Lin and John R. Allison, *An Analysis of Expropriation and Nationalization Risk in China*, 19 YALE J. INT'L L. 135, 139 (1994).

property owner. This problem of reference pervades the entire expropriation issue and likely explains why much of the intellectual and judicial discourse on the subject is confused.¹⁹

In establishing an expropriation, the issue essentially boils down to whether it requires that a State actually take or acquire something, or whether it is sufficient to substantiate a claim on the basis that a property owner has suffered a loss. The distinction is important in determining the scope and meaning of the legal term "expropriation." If the definition of expropriation is restricted to instances where a State actually acquires title, then, while simplifying the legal inquiry, the scope of the matter is very limited. However, where the focus is on the loss suffered by a property owner, then the scope is wider; it would capture both a direct taking and an interference with the use and enjoyment of property. Although discussed at greater length *infra*, it is important to be aware of the varying scope which attaches to the term expropriation. In the context of the NAFTA, the wider the scope, the greater is the protection given to NAFTA investors.

Although gradual in its acceptance, international law has now generally adopted a wide definition of an expropriation. It includes both a taking and a deprivation of property. Referring to the impact of a taking on a property owner, Wortley explains that:

There are, indeed, many different methods of expropriation, but, so far as the dispossessed owner is concerned, they all deprive him of making his claims *within the jurisdiction of the expropriating State*. They do not necessarily rid the "owner" of his conviction that he is the owner, and that he should be enti-

¹⁹This problem is made worse because highly specific and descriptive language is often used in a manner which confuses the nature of an expropriation. In some instances an expropriation is referred to as a "taking", in others as an "acquisition", while still in others as a "deprivation". Furthermore, the actual act of taking has been described variously as "creeping", "de facto", "disguised" and "constructive". As a result of this confusion in the terminology, Weston recommends that the term "welfare deprivation" be used since, according to him, it removes the normative elements which is the subject matter of the police power and instead examines the actual effect of an action or inaction on a property holder. Accordingly, Weston argues that in Burns H. Weston, *'Constructive Takings' Under International Law: A Modest Foray Into The Problem of 'Creeping Expropriation'*, 16 VA. J. INT'L L. 103, 111 (1975-1976):

loose talk looms ominously over any attempt to deal forthrightly with the "constructive taking" problem; however, not simply because of the potentially curable ambiguities that evolve from the unabated, indiscriminate use of expressions like "taking" and "exercise of the power of eminent domain" (or their complementary but equally equivocal opposites, "regulation" and "exercise of the police power"). The basic point is that such words and phrases, with all their normative overtones, tend more often to describe a result than to define the process by which the result is reached. Without facilitating discrimination between fact and legal consequence, they assume the answer to the principal question that is at issue in the first place - the compensation question - and, in so doing, divert attention from the many variables that can and do bear critically upon it.

For the purposes of this paper, though not trying to contribute to the overall confusion, the above terms are used interchangeably.

bled, if not to secure his reinstatement as owner, then at least to claim some compensation for this disappointment.²⁰

Although a broad definition of an expropriation does not legally preclude a State from taking or affecting property, because it is accompanied by a related obligation to provide compensation, it can, theoretically, impact on the types of policies which a government adopts. For the purposes of this paper, it is sufficient to conclude that an expropriation refers to either a taking or deprivation of property by a State, directly or indirectly, as against the interests of a single or small group of property owners. The degree of interference or deprivation necessary for a measure to constitute an expropriation, however, is discussed below.

While an expropriation refers to the deprivation of an individual property or small number of properties, a nationalization generally refers to a large-scale "impersonal taking of the economic structure in full or in part for the nation's benefit . . ."²¹ A nationalization generally arises from some form of social, political or economic reform or upheaval. Furthermore, it tends to apply broadly and cover an entire industry or large geographic area. This said, as a practical matter, there is not much difference between both types of takings. Wortley provides that a nationalization differs from an expropriation in its "scope rather than in its juridical nature." For the purposes of this paper, only expropriations are specifically considered.

III. ARTICLE 1110 OF THE NAFTA ON EXPROPRIATION

Article 1110(I) of the NAFTA provides that no Party may "directly" or "indirectly" nationalize or expropriate an investment, or take any "measure tantamount to" a nationalization or expropriation of an investment,²² of an investor of another Party, unless it is for a public purpose,²³ is non-discriminatory,²⁴ complies with the requirements for minimum international standards of treatment in Article 1105 and due process of law,²⁵ and is accompanied by compensation.²⁶ While the Parties are free to expropriate

²⁰ WORTLEY, *supra* note 16, at 4 (emphasis in original).

²¹ Nicholas R. Doman, *Postwar Nationalization for Foreign Property in Europe*, 48 COLUM. L. REV. 1125 (1948). As well, Wortley, *supra* note 16, at 36, provides that:

The word 'nationalization' is not a term of art, but it usually signifies expropriation in pursuance of some national political programme intended to create out of existing enterprises, or to strengthen, a nationally controlled industry. Nationalization differs in its scope and extent rather than in its juridical nature from other types of expropriation.

²² For the purposes for this discussion, the words "investment", as defined under Article 1139 of the NAFTA, and "property" are used interchangeably.

²³ NAFTA, *supra* note 1, Art. 1110:1 (a).

²⁴ *Id.* Art. 1110:1(b).

²⁵ *Id.* Art. 1110:1(c).

²⁶ *Id.* Art. 1110:1(d). The NAFTA requires that compensation be paid at full market value. For all intents and purposes, the NAFTA adopts the Hull Formula of "prompt, adequate and effective" compensation.

NAFTA investments, they may only do so in accordance with the above requirements.

In the subsections that follow, the meaning of the terms “direct expropriation,” “indirect expropriation,” and “measures tantamount to” an expropriation under Article 1110 of the NAFTA are considered. The analysis is fundamental because it sheds light on the dividing line between a mere interference with an investment, which is not covered under Article 1110 of the NAFTA, and an expropriation, which is covered under the Article.

A. Direct Expropriation

A direct expropriation is generally not difficult to detect. It involves a formal decree or measure directing a single property owner (or a group of owners) to relinquish both title and possession over its (or their) property. Examples may include a government taking an entire parcel of land in order to establish a park, a road or a nature reserve. A direct expropriation is generally obvious since it requires that title be permanently relinquished to a host State.²⁷

The primary debate over direct expropriations, outside of the debate over standards of compensation generally, involves situations where a State removes only part of a subject property or where there are consequential losses arising from a direct expropriation. The case law, though mostly concerned with interferences rather than direct takings, seems to indicate that in some instances a partial taking is sufficient for establishing a compensatory injury.²⁸ By way of example, in the early 1980s, the Federal Government of Canada recommended a 25% hold-back on gas permits under the *National Energy Program* (“NEP”). Olmstead *et al.* argued that the Canadian Government would be liable to foreign permit holders for the loss

²⁷ See HENRY J. STEINER, DETLEV F. VAGTS AND HAROLD HONGJU KOH, *TRANSNATIONAL LEGAL PROBLEMS – MATERIALS AND TEXT* 450 (4th ed. 1994).

²⁸ The *Upton Case* provides a good example of a compensable injury being founded on the basis of a partial taking. In that case, the Venezuelan Government had requisitioned the Claimant’s property, including a boat and steel lighter, in order to help in its defence against warring rebels. When the Venezuelan government returned the property to the Claimant, it was severely damaged. The Commission awarded the Claimant \$3,000 of the \$3,500 requested on the basis that it had not been entirely destroyed since it retained some value. Presumably, the Commission was willing to find that most but not all of the Claimant’s interest in the launch had been taken by the Venezuelan Government. See *Upton Case, in VENEZUELAN ARBITRATIONS OF 1903* 172 (prepared by Jackson H. Ralston, 1904). As well, in *Houston Contracting*, despite the fact that the Iranian government had exercised its control over the Claimant’s entire equipment, the Iran-United States Claims Tribunal only awarded damages for the amount actually used by the Revolutionary Guard. *Houston Contracting Company v. Nat’l Oil Co.*, 20 Iran-U.S. Cl. Trib. Rep. 3 (1988).

of partial rights on the basis that such loss amounted to an expropriation over that part of the interest removed.²⁹

While taking most of an owner's property is likely sufficient to establish an expropriation, there must be more than a *de minimis* effect on the property. To this end, Herz notes that:

If, however, a measure indirectly interferes with property, e.g., by diminishing its value through certain acts, or by burdening the whole of the property of an individual with pecuniary obligations (taxation), the question of *degree* becomes important. If it remains within certain usual limits, such interference is deemed not to be an expropriation of part or the whole of the property; but if it exceeds certain limits it is said to constitute partial expropriation.³⁰

The other main contentious issue concerning the definition of a direct expropriation involves a situation where a State, by taking one property, unintentionally expropriates another. The *Case Concerning Certain German Interests in Polish Upper Silesia*³¹ provides an apt illustration of this point.

In that case, the Polish Government, upon assuming control over certain German territory, enacted legislation whereby it purported to expropriate a German nitrate factory owned by *Oberschlesische Stickstoffwerke A.-G.* ("Oberschlesische") at Chorzow, in Upper Silesia. The actual patents, licenses, machinery and equipment were owned and operated by a separate German company, *Bayrische Stickstoffwerke A.-G.* ("Bayrische"). Germany claimed that by taking over the nitrate factory Poland had expropriated both companies. Poland countered that it only intended to expropriate the proprietary interests of *Oberschlesische* and not those of *Bayrische*. The Permanent Court of International Justice found against the Polish Government, because, irrespective of its intentions, it had, in fact, expropriated the interests of both companies.³² Poland was thus held liable to compensate both German companies.

A similar finding was reached in the *Norwegian Shipowners' Claims* where a Tribunal found that the United States government had expropriated the Claimants' contractual rights and physical property in certain ships, de-

²⁹ Cecil J. Olmstead, Edward J. Krauland and Diane F. Orentlicher, *Expropriation in the Energy Industry: Canada's Crown Share Provision as a Violation of International Law*, 29 MCGILL L.J. 439 (1984).

³⁰ John Herz, *Expropriation of Foreign Property*, 35 AM. J. INT'L. L. 243 (1941). Similarly, Wayne Mapp noted that while there is little argument that a direct taking amounts to a compensable injury, the only question is at what point this occurs. MAPP, *supra* note 16, at 151.

³¹ *Case Concerning Certain German Interests in Polish Upper Silesia*, 1926 P.C.I.J. (ser. A) No. 7 (May 25)[hereinafter *Polish Silesia*].

³² It should be kept in mind that this case was raised and decided pursuant to Head III of the Geneva Convention and, to a lesser extent, the Treaty of Versailles. However, in light of the fact that the case has been cited by numerous authors and in numerous judicial decisions, it likely now reflects international law.

spite the United States' contention that it had only intended on taking the latter.³³ These cases appear to support the proposition that a taking may be found even where a government does not purport to expropriate a particular parcel of property.

The existence of a direct taking is fairly obvious. Unless a State denies liability, for example, where property is taken under a treaty or pursuant to its police powers,³⁴ the debate concerning direct takings generally revolves around compensation.³⁵ Hence, it is sufficient to note that a direct taking refers to a situation where a property holder is forced to relinquish title in his or her property.³⁶

B. Indirect Expropriation

The difference between a direct expropriation and an indirect one is that, unlike in the case of the former, the latter generally does not result in a property owner relinquishing title to his or her property. Although some jurists argue that an expropriation should be limited to instances where property is formally taken, both case law and jurists overwhelmingly acknowledge that a taking may occur absent a direct incursion on title.³⁷

³³Norwegian Shipowners' Claims (Norway v. U.S.) 1 R.I.A.A. 307 (1922). Although this case, like *Polish Upper Silesia*, has been cited by many jurists and in numerous decisions, it should be kept in mind that the United States had already admitted liability. The only issue for the arbitral tribunal was assessing compensation. As well, the United States, upset with the amount of compensation awarded, attached a note providing that it did not view the decision as setting precedent. The case, however, has been cited with approval on many occasions, particularly as it pertains to whether a State must "intend" to expropriate property in order for liability to attach.

³⁴See discussion *infra* p. 46.

³⁵This paper does not explore the international standard of compensation. Paragraph 2 of Article 1110 of the NAFTA, however, states that compensation "shall be equivalent to the fair market value of the expropriated investment immediately before the expropriation took place, and shall not reflect any change in value occurring because the intended expropriation had become known earlier." NAFTA, *supra* note 1, art. 1110:2. As of October 1, 2000, *Metalclad*, is the only NAFTA Chapter 11 case in which the appropriate standard of compensation is considered. *Metalclad Corp. v. United Mexican States*, ICSID Case No. ARB(AF)/97/1 (Aug. 31, 2000).

³⁶It is not necessarily true that the title vests in the State, since, theoretically, the State can transfer title to a third person, depending on the circumstances.

³⁷For example, in *Computer Sciences Corp. v. Gov't of the Islamic Republic of Iran*, the Iran-United States Claims Tribunal found in favour of the Claimant despite the fact that there had not been a formal decree to expropriate the Claimant's property. 10 Iran-U.S. Cl. Trib. Rep. 269 (1987). Similarly, in *Dames and Moore v. Islamic Republic of Iran*, the Tribunal noted that "[t]he unilateral taking of possession of property and the denial of its use to the rightful owners may amount to an expropriation even without a formal decree regarding title to the property." 4 Iran-U.S. Cl. Trib. Rep. 212, 213 (1985).

In *Tippets, Abbott, McCarthy, Stratton v. TAMS-AFFA*, the Tribunal held that "[a] deprivation or taking of property may occur under international law through interference by a state in the use of that property or with the enjoyment of its benefits, even where legal title to

Notionally, the requirement to compensate property owners for losses arising through an indirect expropriation imposes a much greater limitation on the ability of a government to regulate and adopt other measures that, directly or indirectly, interfere with property rights. Unlike in the case of a direct expropriation, an indirect expropriation does not result in a formal loss of title or dispossession of property by its owner. An indirect expropriation often occurs in instances where a government does not "intend" to take property.³⁸ Typically, an indirect expropriation occurs where a government is trying to regulate, provide order, protect the environment or advance some other social, health or economic objective. However, at least when measured against the effect that an impugned measure has on a property owner, the impact of an indirect expropriation on a property owner is the same as is a direct expropriation; in both cases, a property owner loses most or all of the benefits of the use and/or enjoyment of his or her property. Considered in this manner, the impact of a direct and an indirect expropriation is effectively the same and, therefore, should give rise to identical rights in law.

There is a general misunderstanding of the meaning of the term "indirect" in the context of an expropriation. Reference to "indirect," or for that matter "direct," merely describes the manner by which the injury occurs. It does not alter the fact that ultimately, there must be an expropriation. Considered as such, from the perspective of an investor, there is no practical difference between a direct and an indirect expropriation.

An indirect expropriation, therefore, describes a situation where an alien property holder has suffered a significant loss over the use and/or enjoyment of his or her property.³⁹ Wallace provides that an indirect expropriation may derive through a host of measures which on their surface appear legitimate⁴⁰ but in effect are expropriatory.⁴¹ The difficulty is in

the property is not affected." 6 Iran-U.S. Cl. Trib. Rep. 219, 225 (1984) [hereinafter *Tippets*]; see also *Reza Said Malek v. Gov't of the Islamic Republic of Iran*, 28 Iran-U.S. Cl. Trib. Rep. 246, 286 (1996); *Benvenuti et Bonfant v. People's Republic of the Congo*, 21 I.L.M. 740 (1982).

³⁸Notwithstanding *Polish Upper Silesia* and the *Norwegian Shipowners' Claims* examined above, a direct taking generally occurs where a government intends on acquiring property.

³⁹Sandrino explains the essence of an indirect, or creeping, expropriation in the following manner. Gloria L. Sandrino, *The NAFTA Investment Chapter and Foreign Direct Investment in Mexico: A Third World Perspective*, 27 VAND. J. TRANSNAT'L L. 259, 317 n.276 (1994):

measures whereby the government increasingly imposes restrictions and controls, such as, excessive and repetitive tax regulatory measures, on the foreign investment enterprise so as to make it difficult to continue in business at a profit ... It is the cumulative effect of the measures which then has a de facto confiscatory effect in that their combined effect results in depriving the investor of ownership, control, or substantial benefits over his enterprise, even when each such measure taken separately does not have this effect.

⁴⁰"Legitimate" here does not refer to valid but rather whether it invokes a duty to compensate a property owner.

determining the demarcation between a compensable and a non-compensable injury. Weston noted that such a distinction, in what he termed the “expropriation-regulation” dilemma, has been lacking among legal scholars:

[F]ailure of international law scholars and practitioners to provide anything remotely approaching a systematic appraisal of the many ways in which aliens, not the targets of “confiscation”, “expropriation”, “nationalization”, or “requisition” *stricto sensu*, can be and have been effectively deprived, in whole or in part, of the “use and enjoyment” of their foreign-based wealth by the exercise of so-called police powers.⁴²

The following subsections attempt to illustrate some of the methods by which an indirect expropriation may (or may not) arise.

1. Government Interference with Peaceful Use and Enjoyment of Property: Effects-Based Test

Some jurists argue that an effects-based test is sufficient for determining whether a governmental measure or interference amounts to an expropriation. Under this approach, the inquiry rests entirely on the effect that a governmental measure has on property owned or controlled by an alien. Rosalyn Higgins adopted this approach as a suitable means for establishing an indirect expropriation, as follows:

[T]here seems to be a tendency to define “taking” in terms not of the amount or quality of interference with those rights normally associated with property, but in terms of whether the methods were unlawful and whether compensation was paid. This is, with the greatest respect, to confuse the question of a definition with the question of a legal justification.⁴³

This method requires a tribunal to establish a line between when a government’s measure goes “too far” and imposes too great an interference

⁴¹Wallace provides the following list of possible techniques (some of these will be explored further in this subsection):

unreasonable taxation; discriminatory legislation and administrative decrees; certain cases of zoning; the granting, in certain cases, of a monopoly by a government; prolonged ‘temporary seizure’; unreasonable price ceilings which are not allowed to keep pace with inflationary trends; the rendering useless of property by the expropriation of other property so intimately connected with the first that it ceases to have any further value or function; the forced sale of alien property at a price which falls far short of the actual value of the property or of its real worth had its use not been interfered with by the state; the setting of local wages at prohibitively high rates; the appointment of custodians, managers or inspectors who substantially impair the free use by the alien of his premises and facilities; the appointment of a receiver to liquidate a commercial enterprise or other property; unreasonable contract renegotiation or discriminatory contract termination; prohibition of gainful activity previously lawfully engaged in; and any other means of such unreasonable interference with the property rights of the alien owner that he is effectively deprived of the use and beneficial enjoyment of his holdings.

CYNTHIA DAY WALLACE, *LEGAL CONTROLS OF THE MULTINATIONAL ENTERPRISE* 277 (1983)

⁴²Weston, *supra* note 19, at 106.

⁴³Rosalyn Higgins, *The Taking of Property by the State: Recent Developments in International Law*, III RECUEIL DES COURS 263, 328 (U.N. Collection of Courses, 1982).

with the use and enjoyment of property.⁴⁴ Of course, the line is passed when all property rights are formally taken, the more difficult question is determining whether, in the circumstances of a particular case, there has been a sufficient deprivation of the use and enjoyment of property to amount to a compensable injury.⁴⁵ This sub-subsection examines when and how much interference is necessary in order to find that a deprivation of the use or enjoyment of property amounts to an (indirect) expropriation.

The first step in determining whether a measure has an expropriatory effect is to examine whether the interference is reasonable. According to the Iran-U.S. Claims Tribunal,⁴⁶ for example, "a taking of property may oc-

⁴⁴ For example, in *American Bell Int'l Inc. v. Islamic Republic of Iran*, the Claimant U.S. Corporation was not only denied access to its bank account but was also forced to transfer its funds to the Telecommunications Company of Iran (the two companies had been involved in a joint project). In finding for the Claimant, the Tribunal noted that "where, as here, both the purpose and effect of the acts are totally to deprive one of funds without one's voluntarily given consent, the finding of a compensable taking under any applicable law - international or domestic - is inevitable, unless there is clear justification for the seizure." 12 Iran-U.S. Cl. Trib. Rep. 170, 214 (1988).

⁴⁵ Although referring to takings under the Fifth Amendment of the U.S. Constitution, Cormack notes that an important distinction exists between a deprivation of possession and a deprivation of use:

A choice, in eminent domain cases, between the concepts which have been discussed involves important consequences. Under the physical concept it is necessary, in order that compensation to the condemnee be required, that he be deprived of the possession of land or some other tangible physical object. Under the mental concept, it is only necessary that there be interference with some of the legal relations which, from the standpoint of this concept, constitute his property.

Joseph M. Cormack, *Legal Concepts in Cases of Eminent Domain*, XLI YALE L.J. 221, 224 (1932)

This distinction is no longer particularly relevant. Although in both *Mariposa Development Co. v. U. S. -Panama Claims Commission* and *Mavis Daley v. Islamic Republic of Iran*, the adjudicators looked for an actual loss of possession. The former case, however, is somewhat dated and the latter one is anomalous in light of a plethora of contrary decisions by the Iran-U.S. Claims Tribunal. The case law consistently demonstrates that a taking may be substantiated whether or not alien retains title and/or the interference is on less than the entire property. A deprivation of use (*i.e.*, the "mental concept") can refer to either the marketability and value of property or to the right to exercise effective "control, use and benefit" over property. This sub-subsection is concerned with cases where compensation was awarded despite the fact that a claimant retained title and/or possession of his/her property. See *Mariposa Development Co. v. U.S. -Panama Claims Commission*, 7 I.L.R. 255, 257 (1933); *Mavis Daley v. Islamic Republic of Iran*, 18 Iran-U.S. Cl. Trib. Rep. 232 (1988)

⁴⁶ As provided at paragraph 38(1) of the *Statute of the ICJ*, a tribunal may have reference to judicial decisions in determining a rule of law. For example, in *Metalclad*, the NAFTA arbitral tribunal had reference to *Biloune, et. al. v. Ghana Investment Centre et. al.*, in characterizing the Mexican Government's actions as expropriatory for the purposes of Article 1110 of the NAFTA. *Metalclad Corp. v. United Mexican States*, ICSID Case No. ARB(AF)/97/1 para. 108 (Aug. 31, 2000); *Biloune, et. al. v. Ghana Investment Centre et. al.*, 95 I.L.R. 183 (1993). In the same manner, therefore, the Iran-U.S. Claims Tribunal's decisions may inform the law of expropriation. By way of background, the Iran-U.S. Claims Tribunal was established after the Government of Iran seized U.S. hostages at the U.S. embassy in Tehran and, in retaliation, the U.S. Government seized Iranian assets located in the

cur by virtue of *unreasonable* interference in the use of that property . . . ”⁴⁷
The inquiry rests on determining what constitutes a reasonable interference. For example, in *Malek*, after finding against the Claimant, the Tribunal noted that:

Although the Claimant’s above evidence suggest that the Iranian Authorities were parking their cars on the Wooden Land during the relevant jurisdictional period, the Tribunal does not believe that such activity implies sufficient interference to be deemed a taking. It probably amounts to trespassing or, at most, the initial steps in a series of events which ultimately may have ripened into a more or less irreversible deprivation of the Wooden Land. The physical alteration of that property by the construction of roads and buildings, on the other hand, would entail a degree of interference that is more than sufficient to find a taking. The Claimant’s evidence, however, is unclear on the question of whether this alteration occurred during the relevant jurisdictional period.⁴⁸

The above statement raises the following question: what constitutes “enough”? In other words, although the Tribunal discussed what it considered to be “more than” and “less than” sufficient, the Tribunal did not clarify the exact level or degree of interference that shifts a measure from being reasonable to unreasonable.

United States. To resolve the dispute, the two governments agreed to establish a tribunal to adjudicate losses arising out of, *inter alia*, the Iranian Revolution. The Iran-U.S. Claims Tribunal was struck pursuant to the *Declaration of the Government of the Democratic and Popular Republic of Algeria Concerning the Settlement of Claims by the Government of the United States of America and the Government of the Islamic Republic of Iran* (January 19, 1981) (the “Declaration”). According to the Declaration, the Tribunal can consider claims arising out of numerous matters, including expropriations and “other measures affecting property rights”. DECLARATION OF THE GOVERNMENT OF THE DEMOCRATIC AND POPULAR REPUBLIC OF ALGERIA CONCERNING THE SETTLEMENT OF CLAIMS BY THE GOVERNMENT OF THE UNITED STATES OF AMERICA AND THE GOVERNMENT OF THE ISLAMIC REPUBLIC OF IRAN, Jan. 19, 1981, Art. III(2), *reprinted in* 1 Iran-U.S. C.T.R. 9, 10 (1983). Since its inception, the Iran-U.S. Claims Tribunal has considered hundreds of cases under international law and in accordance with the Declaration. While the Iran-U.S. Claims Tribunal may serve as a good source of case law, a word of caution is necessary. Because the Declaration uses the phrase “other measures affecting property”, it extends beyond the scope of Article 1110 of the NAFTA. This caution was expressed by the NAFTA arbitral tribunal in *Pope & Talbot*, where the NAFTA arbitral tribunal refused to rely on the decisions of the Iran-U.S. Claims Tribunal to extend the scope of Article 1110 through the word “tantamount” used in that Article. See *Pope & Talbot*, *supra* note 5, at para. 104. That said, the Iran-U.S. Claims Tribunal’s decisions are informative to the extent that they set out general principles of international law or help to explain how certain measures may be characterized as an expropriation. For example, in *Metalclad*, the NAFTA arbitral tribunal cited a decision of the Iran-U.S. Claims Tribunal in determining the applicable standard of compensation at international law. *Metalclad*, ICSID Case No. ARB(AF)/97/1 at para. 122.

⁴⁷ *Ataollah Golpira v. Gov’t of the Islamic Republic of Iran*, 2 Iran-U.S. Cl. Trib. Rep. 171, 176-177 (1984) (emphasis added).

⁴⁸ *Reza Said Malek v. Gov’t of the Islamic Republic of Iran*, 28 Iran-U.S. Cl. Trib. Rep. 246, 290 (1996) (emphasis added).

That said, it appears that a mere hindrance or restriction on the use of property will not constitute an expropriation. Presumably, this gives a government a considerable amount of leeway when, for example, implementing conservation measures. On the other hand, a substantial interference, particularly one which will exist for a significant period of time, will likely be sufficient to constitute an expropriation.⁴⁹

In addition to, or in lieu of, a reasonableness-based test, the Iran-United States Tribunal, beginning with *ITT Industries*,⁵⁰ also adopted an ephemeral test for determining the existence of a taking. In both *ITT Industries* and *TAMS-AFFA* the Tribunal held that:

[W]hile assumption of control over property by a government does not automatically and immediately justify a conclusion that the property has been taken by the government, thus requiring compensation under international law, such a conclusion is warranted whenever events demonstrate that the owner was deprived of fundamental rights of ownership and it appears that this deprivation is not merely ephemeral.⁵¹

The Tribunal recognized that a taking may be found even where legal title is not disturbed.⁵² Accordingly, under this test posited by the Tribunal, a taking may be substantiated where its effect on a property owner is more than ephemeral.

In *Pope & Talbot*, the NAFTA arbitral tribunal adopted a substantiality test similar to the one consistently applied by the Iran-U.S. Claims Tribunal. That case arose out of Canada's implementation of the *Softwood Lumber Agreement* between the Governments of Canada and the United States (the "SLA"). Under the SLA, Canada agreed to limit exports to the U.S. of

⁴⁹That a taking will be found where a government's interference is permanent and substantial is consistent with the Tribunal's earlier decisions in both *Harza Eng'g Co v. Gov't of the Islamic Republic of Iran* and in *Dames and Moore*. *Harza Eng'g Co v. Gov't of the Islamic Republic of Iran*, 1 Iran-U.S. Cl. Trib. Rep. 499 (1983) [hereinafter *Harza*]; *Dames & Moore v. The Islamic Republic of Iran*, 4 Iran-U.S. Cl. Trib. Rep. 212, 213 (1985). Once again, however, there is no bright line test as to when a measure becomes unreasonable. For example, in *Harza*, the Tribunal did not find that the measures taken by the Iranian Government were unreasonable since, although onerous, they were necessary for ensuring that only authorized bank withdrawals were made. See generally *Harza*, 1 Iran-U.S. Cl. Trib. Rep. Although the requirements imposed by the Respondent on the Claimant withdrawing its money were fairly onerous, the Tribunal determined that it did not amount to a taking because it was not sufficiently unreasonable. On the other hand, in *Dames and Moore*, the Tribunal found that the Government's decision to deny the Claimant access to its stored equipment was "so complete that it must be deemed unreasonable." *Dames & Moore*, 4 Iran-U.S. Cl. Trib. Rep. at 223. While title remained vested in the Claimant, the Tribunal found that a taking had occurred since the Claimant had been effectively separated from and denied rights to his property.

⁵⁰*ITT Industries v. The Islamic Republic of Iran*, 2 Iran-U.S. Cl. Trib. Rep. 348 (1983).

⁵¹*Id.* at 351-352; *Tippets, Abbett, McCarthy, Stratton v. TAMS-AFFA*, 6 Iran-U.S. Cl. Trib. Rep. 219, 225-26 (1984).

⁵²See *Tippets*, 6 Iran-U.S. Cl. Trib. Rep. at 225; *Starrett Hous. Corp. v. Gov't of the Islamic Republic of Iran*, 4 Iran-U.S. Cl. Trib. Rep. 122, 154 (1983).

softwood lumber first manufactured in the provinces of British Columbia, Alberta, Ontario and Québec through the adoption of a scheme that effectively operated as a tariff-rate-quota (i.e., imposing progressively higher fees on the export of softwood lumber over certain prescribed levels). Canada implemented this scheme through its *Export and Import Permits Act* (Canada) under which it placed softwood lumber from the four enumerated provinces on Canada's Export Control List. The Claimant, Pope & Talbot, Inc., a Delaware company, complained that its investments, Pope & Talbot Ltd. and (later) Harmac Pacific Inc., both British Columbia companies, had been expropriated, effectively on the basis that its investments had "suffered injury to its business operations, its expansion and management, and its overall profitability."⁵³ The Government of Canada denied that there had been an expropriation, pointing to the fact that, among other things, the Claimant's mills, profits and shares were not seized, it continued to export a considerable amount of lumber to the U.S., it remained profitable, it retained ownership of its investments, the price of lumber went up (i.e., as a result of the decreased supply required under the SLA), and the SLA helped prevent a broader trade war with the U.S. On the basis of these facts, the NAFTA arbitral tribunal was of the view that Canada's Export Control Regime was not sufficiently onerous to amount to an expropriation. Specifically, the Tribunal stated that the impugned measure was not "substantial enough to be characterized as an expropriation under international law."⁵⁴ Further, the Tribunal noted that "the test is whether that interference is sufficiently restrictive to support a conclusion that the property has been 'taken' from the owner."⁵⁵

The key consideration, therefore, is determining what constitutes "ephemeral" or "substantial."⁵⁶ Subject to the police powers exception dis-

⁵³Pope & Talbot, *supra* note 5, at para. 86. In addition to Article 1110, the Claimant also raised the following Articles: 1102, 1103, 1105 and 1106. The interim award dealt with the Claimant's arguments under Articles 1106 and 1110.

⁵⁴*Id.* at para. 96.

⁵⁵*Id.* at para. 102.

⁵⁶In *Metalclad*, for example, the NAFTA arbitral tribunal was clearly of the view that the Government of Mexico, through the actions of the local government, had gone too far, effectively ending the Claimant Investor's opportunity to operate its hazardous waste landfill in La Pedrera (the Guadalcázar region), Mexico. *Metalclad Corp. v. United Mexican States*, ICSID Case No. ARB(AF)/97/1 (Aug. 31, 2000). In that case, the Claimant had received numerous federal permits to construct and operate a landfill, as well as assurances that it did not need any approvals from the local government for that purpose. Independent studies by the Autonomous University of SLP and the Mexican Federal Attorney's Office for the Protection of the Environment both indicated that, although certain improvements were necessary, provided that the appropriate engineering requirements were made, the site was geographically suitable for a landfill. Nonetheless, the local government was opposed to the landfill and was determined to shut it down. In particular, the local government complained that the Claimant failed to apply for and receive the necessary construction permit, notwithstanding that the federal government had assured the Claimant that this was not necessary.

cussed *infra*, an expropriation would seemingly occur where a measure results in either a substantial, total or effective loss of an alien's property right(s). On the other hand, where a measure, such as a forest conservation plan or zoning by-law, merely acts as a hindrance, but is otherwise reasonable, an expropriation is not likely to be found. In this respect, Herz provided that:

If, however, a measure indirectly interferes with property, e.g., by diminishing its value through certain acts, or by burdening the whole of the property of an individual with pecuniary obligations (taxation), the question of degree becomes important. It remains within certain usual limits, such interference is deemed not to be expropriation of part or the whole property; but if it exceeds certain limits it is said to constitute partial expropriation.⁵⁷

Ultimately, the problem rests in identifying, and then defining, the gray area between a taking and a non-compensable injury. The case law of the Iran-U.S. Claims Tribunal suggests that a case-by-case analysis is the most appropriate method. While doctrinally this is an unsatisfying answer, particularly for the opponents of Chapter 11 of the NAFTA who want predict-

The Claimant made numerous attempts to settle the issue, even entering into an agreement – the “Convenio” – with two independent, governmental sub-agencies whereby Metalclad agreed to, among other things, carry out an environmental audit and perform any remediation considered necessary (the audit revealed certain deficiencies, which Metalclad was going to ameliorate as per the Convenio), designate 34 hectares of its property as a buffer zone for the conservation of endemic species, contribute money towards social works in Guadalupe, provide a discount for the treatment and final disposition of hazardous waste generated in SLP, provide one day per week of free medical advice to the inhabitants of Guadalupe, employ manual labourers from within Guadalupe and give preference to the inhabitants of Guadalupe for technical training. The local government refused to participate in the negotiation of the Convenio. Instead, it remained steadfast in its opposition to the landfill, continuing to justify its non-support on the fact that the Claimant had failed to receive the necessary construction permits (although the Claimant pointed out that there was no evidence that the local government had ever required or issued a municipal construction permit for another project in Guadalupe, or even that there was an administrative process for doing so). All the while, the federal government of Mexico remained supportive of the landfill, continuing to issue permits to Metalclad. Finally, nearly three years after the dispute arose, the Governor (local government) issued an Ecological Decree declaring the subject area a Natural Area for the protection of rare cactus. The Ecological Decree ended any opportunity for Metalclad to operate its landfill. On the basis of these facts, the NAFTA arbitral tribunal was of the view that the local government had gone too far in that it effectively denied the Claimant from operating any part of its investment. The NAFTA tribunal was satisfied that the expropriation occurred prior to the pronouncement of the Ecological Decree. The decision is certainly consistent with the case law of the Iran-U.S. Claims Tribunal in that the local government's interference with the Claimant's investment was more than ephemeral by effectively preventing the Claimant from using and enjoying its investment. The NAFTA arbitral tribunal did not even consider the police powers defense, presumably because it was satisfied that the local government's conduct was not aimed at protecting the local environment or the health and welfare of the local community (*i.e.*, as a result of favourable findings by independent studies and the Claimant's obligations under the Convenio). See generally Metalclad, ICSID Case No. ARB(AF)/97/1.

⁵⁷HERZ, *supra* note 30, at 251.

ability regarding the scope and application of the Chapter, it nevertheless represents the fact that an effects-based test does not exist in a vacuum.⁵⁸ Rather, it serves as a helpful tool for a tribunal or panel faced with a claimant who has suffered a loss but retains title in and possession of his or her property.

2. Is an Intention to Expropriate Determinative?

As a preliminary matter, it is necessary to determine whether, in order to establish a compensable injury, a State must first, directly or indirectly, “intend” to expropriate property.

It is a well settled principle of international law that a State is not required to evince an intention to expropriate property in order for a tribunal to find the existence of an expropriation.⁵⁹ There are a number of practical reasons militating against a tribunal undergoing such an examination.

⁵⁸ Although the effects-based test is helpful, it is not alone sufficient for considering expropriations. For example, it does not provide any guidance for measuring the requisite level of interference necessary for establishing a taking. It leaves open questions such as whether the degree of effect should be measured as a percentage of one’s total property or on a minimum quantity basis. Alternatively, it may be possible to sever negatively impacted property so that a measure only be considered in respect of that portion of an adversely impacted parcel. Weston also notes that an effects-based test suffers from an inherent inequity because it requires property owners who are negatively affected by a government’s measure which falls below an imaginary line to suffer an injury for the benefit of society, while property owners whose injury is above an imaginary line receive compensation equal to their total loss. Weston questions why some property owners are expected to personally suffer a loss while the same demand is not made on others. See Weston, *supra* note 19, at 119. In addition to these inherent inequities, it also runs the risk of encouraging inefficient measures by government planners. For example, planners may become overly concerned with the effect that a measure has on others rather than being concerned with its particular merits. Furthermore, barring other considerations, provided that a measure does not go “too far”, there would be little economic incentive to create a prudent or efficient program. Finally, it does not incorporate the police power exception. While helpful, an effects-based test certainly does not represent a complete approach for determining when a measure amounts to a taking.

⁵⁹ As noted, in both *Polish Upper Silesia* and *Norwegian Shipowners’ Claims*, liability was predicated on the effect of the Respondent’s actions on the Claimant’s property, and not whether the Respondent intended to expropriate the subject property in its entirety. Case Concerning Certain German Interests in Polish Upper Silesia, 1926 P.C.I.J. (ser. A) No. 7.; *Norwegian Shipowners’ Claims* (Norway v. U.S.) 1 R.I.A.A. 307 (1922). Christie states, for example, that:

The Norwegian Claims and the German Interests in Polish Upper Silesia cases show that a State may expropriate property, where it interferes with it, even though the State expressly disclaims any such intention. More important, the two cases taken together illustrate that even though a State may not purport to interfere with rights to property, it may, by its actions, render those rights so useless that it will be deemed to have expropriated them.

Christie, *supra* note 16, at 311

Similarly, except in a few limited cases, such as *Harza and Sea-Land Service, Inc. v. The Islamic Republic of Iran*, the Iran-U.S. Claims Tribunal has overwhelmingly rejected an intentions-based test. *Harza Eng’g Cov. Gov’t of the Islamic of Republic of Iran*, 1 Iran-U.S.

To begin, it is extremely difficult and complex, if not impossible, for a tribunal to enter into an examination of whether a particular law, policy or program was, in fact, intended to expropriate a property owner's interests in his or her property.⁶⁰ Sir John Fischer Williams, who argued that expropriations only provide a limited right to compensation, argued against tribunals investigating into a government's underlying motives, as follows:

The motives of individuals are often difficult enough to determine by legal inquiry, but such an inquiry is surely both impracticable and impertinent in the case of a state . . . It is surely fantastic to suppose that states would expressly or implicitly consent, or that there now exists any international law requiring them, to submit to such an inquisition as to domestic legislation passed by their own legislatures and to agree that its validity is to depend on a foreign estimate of the motives of statesmen, of legislatures, or of peoples.⁶¹

Additionally, it would be an affront to the principle of State sovereignty if, in the course of legislating, a State had to justify the intended effects of its measures. In any event, how could it be substantiated? As well, even if it could be substantiated, there is no equitable reason why a property owner should be treated differently on the basis of whether his or her host government intended to take his or her property since the effect is the same.⁶² An intentions-based test, therefore, is not appropriate for determining the existence of a taking.

3. *Does a Public Purpose Exonerate a Government from Liability?*

The next possible test for determining the existence of an expropriation, or more pointedly, a compensable injury, is determining whether there is a public purpose for the regulatory measure. Under this test, regardless of the effect that a particular measure had on an investment, a State could absolve itself from liability on the basis that a particular offending measure

Cl. Trib. Rep. 499 (1983); *Sea-Land Service, Inc. v. The Islamic Republic of Iran*, 6 Iran-U.S. Cl. Trib. Rep. 149 (1986). The seminal opinion in this regard was Panel Member Aldrich's statement in *Tippets*, where he provided that "[t]he intent of the government is less important than the effects of the measures on the owner, and the form of the measure of control or interference is less important than the reality of their impact." 6 Iran-U.S. Cl. Trib. Rep. 219, 225-26 (1984).

This statement has been cited with approval in *ITT Industries v. The Islamic Republic of Iran*, 2 Iran-U.S. Cl. Trib. Rep. 225-226 (1983); *Phillips Petroleum Co. Iran v. Islamic Republic of Iran*, 21 Iran-U.S. Cl. Trib. Rep. 79, 115 (1990); *Sedco Inc. v. Nat'l Iranian Oil Co.*, 84 I.L.R. 483, 513 (Iran-U.S. Cl. Trib. 1985).

⁶⁰ See WESTON, *supra* note 19, at 115.

⁶¹ Sir John Filscher Williams, *International Law and the Property of Aliens*, 1928 BRIT. Y.B. INT'L L. 1, 26.

⁶² On this point, Herz asserts, *supra* note 30, at 248, that:

In either case, whenever the criteria of expropriation are present, the act amounts to real expropriation. Here, too, it is only the result which counts, and a state whose acts result in taking away foreign property may find itself involved even when acting *bona fide* and without any intention of depriving anybody of his rights.

was implemented for a public purpose. The difference in this example from the one posited in the previous subsection is that in the former, compensation derives from the existence of a requisite intention which resulted in a particular effect, whereas in this case compensation is linked to the purpose of an expropriatory measure. For the reasons set out immediately below, international law does not recognize a public purpose test as changing the description of whether a measure constitutes an expropriation *per se*.

Conceptually, a public purpose exception would provide a State with an almost infinite right to legislate without fear of any corresponding liability. Viewed on its own, this may appear to be an appropriate method to determine the existence of an expropriation. Depending on one's view of property and government, however, it is a problematic solution to the takings issue (not to mention also being contrary to international law). If a State was entitled to expropriate property without having to consider possible resulting liabilities, not only would it be a supremely unfair result for property owners, but it would remove an important "check and balance" on government power. States would be free to ignore the actual costs of their measures.⁶³ This would not be desirable from either an economics or equity perspective.⁶⁴

Wortley raises the following additional problem with a public purpose exception: "The distinction between indirect loss resulting from reasonable and general restrictions imposed in the social interest, and an indirect loss amounting to a mere smoke-screen for the taking of an asset, is a real one."⁶⁵

It would be far too easy for a government to justify its incursion on private property as being for a public purpose. In essence, it would destroy the actual, underlying tenets of private property rights. As well, such a definition would be functionally irrelevant since, by definition, a government always legislates or regulates in furtherance of a public purpose. A test based entirely on public purpose, therefore, would not be practical.

While a straight public purpose test for determining the existence of an expropriation, and thus a compensable injury, must be rejected, it is important not to confuse a public purpose exception from the police power or noxious use⁶⁶ exception.

⁶³In other words, it allows governments to treat as free what otherwise has a market value (*i.e.*, a person's property). Hence, the true costs of a measure, from a welfare perspective, are lost.

⁶⁴In *Agins v. City of Tiburon*, for example, the United States Supreme Court noted that "[t]he determination that governmental action constitutes a taking is, in essence, a determination that the public at large, rather than a single owner, must bear the burden of an exercise of state power in the public interest." 447 U.S. 255, 260 (1980)

⁶⁵WORTLEY, *supra* note 16, at 51.

⁶⁶This latter term is generally restricted to the municipal law *fora*.

Although the exact nature and scope of the police power exception is discussed *infra*, briefly, the *Restatement Third of the Law*⁶⁷ provides that “[a] state is not responsible for loss of property or for other economic injury that is due to bona fide general taxation, regulation, forfeiture for crime, or other action of the kind that is commonly accepted as within the police power of states . . .” International law recognizes that certain interferences by a government on property rights will not entail a right to compensation. The main difficulty with establishing a public purpose exception, and thus the prime reason for the police power exception, is the tremendous breadth traditionally given to the former term.⁶⁸ Although any measure in furtherance of a public purpose is seemingly important, the police power exception acts as a necessary limitation on a State’s right to encroach upon private property rights without the fear of having to compensate adversely impacted property owners.⁶⁹

In *Pope & Talbot*, for example, the NAFTA arbitral tribunal rejected Canada’s assertion that because the measure in question (i.e., an export control) was enacted through regulation and was not otherwise discriminatory, it could not amount to an expropriation on the basis that it was a valid exercise of its powers.⁷⁰ Citing the *Third Restatement of the Law* favourably, NAFTA Tribunal rejected Canada’s argument as going “too far,” noting that if regulatory measures were excluded from the scope of Article 1110 “much creeping expropriation could be conducted by regulation, and a blanket exception for regulatory measures would create a gaping loophole in international protections against expropriation.”⁷¹

The existence of a valid public purpose, therefore, is not a sufficient excuse for failing to compensate an alien property owner.⁷² Instead, tribu-

⁶⁷RESTATEMENT (THIRD) OF THE LAW: THE FOREIGN RELATIONS LAW OF THE UNITED STATES §712g (1987).

⁶⁸This should not be interpreted as implying that the determination of whether a measure falls under the police power exception is clear or certain.

Again it is very difficult to draw a sharp line of demarcation between the exercise of the right of eminent domain and that of police power, especially since states have more and more abandoned the *laissez-faire* conception of their functions and become “welfare” state interfering daily in all imaginable realms of private activities by all imaginable measures and procedures. It may be often difficult to ascertain whether such interference is one which is necessary to protect the public against a direct danger threatening its safety or one which refers to public utility only.

Herz, *supra* note 30, at 252.

Notwithstanding this difficulty, he later concludes “in spite of difficulties of demarcation, the distinction between measures of police and expropriation for public utility is one of positive international law, recognized by state practice as well as by almost unanimous opinion of theorists.” *Id.*

⁶⁹However, even here compensation may be required if, in Justice Holmes’ words, the measure “goes too far.”

⁷⁰*Pope & Talbot*, *supra* note 5, at para.99.

⁷¹*Id.*

⁷²For example, in the *De Garmendia Case*, the Government of Venezuela destroyed the Claimant’s wooden building so that space could be left open to view the port. *De Garmen-*

nals have treated the existence of a public purpose as a condition precedent for establishing a lawful expropriation, rather than as an excusing condition. In *Amoco International Finance Corporation*, the Iran-U.S. Tribunal explained this principle stating that “[s]uch a property shall not be taken except for a public purpose,” the Treaty implies that an expropriation which is justified by a public purpose may be lawful, which is precisely the rule of customary international law.⁷³

The above conclusion is confirmed by Article 1110(I)(a) of the NAFTA which provides that an expropriation or nationalization for which compensation is owed, must be for a public purpose. Thus, under Article 1110 of the *NAFTA*, a public purpose objective is a necessary requirement for any expropriation in the same manner as is non-discriminatory treatment and the payment of compensation. A public purpose test, therefore, is a necessary condition rather than as an excusing factor. A public purpose test alone does not reveal the existence of an expropriation.

4. *Form of a Measure*

The next possible point of inquiry as to whether a measure constitutes an expropriation is to consider the form of the measure. In this sense, it

dia Case, VENEZUELAN ARBITRATIONS OF 1903 10, 13 (1903). Despite the Venezuelan government’s plea that action was “necessary as an act of public utility”, Commissioner Bainbridge awarded damages to the Claimant. Similarly, in *Phelps Dodge Corp.*, the Iran-U.S. Claims Tribunal found that while the particular law and actions taken by the Iranian Government may very well have been premised on legitimate objectives, namely the protection of workers, the Government was nevertheless liable to the Claimant Phelps Dodge Corp., 10 Iran-U.S. Cl. Trib. Rep. 121, 130 (1986).

The Tribunal fully understands the reasons why the Respondent felt compelled to protect its interests through this transfer of management, and the Tribunal understands the financial, economic and social concerns that inspired the law pursuant to which it was enacted, but those reasons and concerns cannot relieve the Respondent of the obligation to compensate Phelps Dodge for its loss.

Id.

Finally, in *United States v. Republic of Panama (De Sabla case)*, the Government of Panama, in the course of establishing a comprehensive land program, transferred some private land holdings which it considered *balδιο* to other private citizens. *United States v. Republic of Panama (De Sabla case)*, reprinted in 28 AMER. J. INT’L L. 602, 611-612 (1933). As a result of these measures, the Claimant lost 1,362 hectares of its land to outright grants and another 1,818 hectares of land to the Government’s issuance of temporary licence. Once again, despite the Government’s plea that the measures were necessary, the Commission held that:

It is axiomatic that acts of a government in depriving an alien of his property without compensation impose international responsibility . . . As the public statements of its high officials show, it was endeavoring throughout this period to bring order out of a chaotic system of public land administration. In such a period of development and readjustment, it is perhaps inevitable that unfortunate situations like the present one should arise. It is no extreme measure to hold, as this Commission does, that if the process of working out the system results in the loss of private property of aliens, such loss should be compensated.

Id.

⁷³ *Amoco Int’l Fin. Corp. v. Gov’t of the Islamic Republic of Iran*, 15 Iran-U.S. Cl. Trib. Rep. 189, 223 (1987).

may be possible to define an expropriation on the basis of how a loss occurs, rather than the mere fact that there has been a loss of use or enjoyment of property.

There certainly is not universal acceptance of this approach. For example, Friedman, rejecting this as a means by which to determine the existence of an expropriation, stated that:

International law does not prescribe in an imperative manner the particular form which a measure of expropriation must assume. For an international judge, it is immaterial whether the measure in question is the consequence of a law or a decree. In the eyes of the international judge, laws, decrees or judicial decisions are mere facts, which he must appraise in an independent capacity.⁷⁴

Notwithstanding Friedman's explanation above, an examination of both case law and authoritative writings demonstrates that the form of an impugned measure often plays a role in revealing the existence of a taking. Tribunals have been more likely to find a taking in certain circumstances than in others.⁷⁵ In this sense, while the form of a measure is not, in and of itself, determinative of a taking, it is a predicative tool. In the subsections that follow, various forms of measures are considered with a view to determining the likelihood that, if implemented, they would be considered expropriatory if they significantly deprived a property owner the use or enjoyment of his or her property. In particular, the following types of measures are considered: legislative and regulatory measures, land control and conservation measures, government-appointed managers and directors, tax measures, and currency-related regulations.

The treatment given to these measures by previous panels, although not binding, may help predict how a panel struck under the NAFTA would view a similar measure. This can then be related back to the more narrow issue of the impact of Chapter 11 of the NAFTA on the ability of the NAFTA Parties to enact environmental and forest conservation measures.

(a) General Legislative and Regulatory Measures

A State has a fundamental right to legislate for its own benefit. Through legislation a State can establish, *inter alia*, its monetary and fiscal regime, its programs and policies concerning health, welfare and the environment, and its criminal justice system. While the power to legislate and

⁷⁴S. FRIEDMAN, *EXPROPRIATION IN INTERNATIONAL LAW*, 136 (1953).

⁷⁵For example, the OECD Draft Convention on the Protection of Foreign Property, (adopted by the OECD Council on 12 October, 1967), provides that the following may lead to an inference of a taking: "excessive or arbitrary taxation; prohibition of dividend distribution coupled with compulsory loans; imposition of administrators; prohibition of dismissal of staff; refusal of access to raw materials or of essential export or import licences." OECD Draft Convention on the Protection of Foreign Property, *reprinted in* 2 INT'L LAW. 331, 338 (1967). Presumably, a list such as this one could not be created unless there was some consistency in the manner by which tribunals viewed certain measures over others.

regulate is inherently internal and municipal, States exist in a large global community and, in that capacity, their laws, programs and conduct are held up against, and are subject to, international law and legal requirements. In the *Norwegian Loans* case, Sir Lauterpacht provided the following remarks in *obiter* concerning Norway's contention that the International Court of Justice was not competent to consider its national regulations:

National legislation—including currency legislation—may be contrary, in its intention or effects, to the international obligations of the State. The question of conformity of national legislation with international law is a matter of international law. The notion that if a matter is governed by national law it is for that reason at the same time outside the sphere of international law is both novel and, if accepted, subversive of international law. It is not enough for a State to bring a matter under the protective umbrella of its legislation, possibly of a predatory character, in order to shelter it effectively from any control by international law.⁷⁶

Accordingly, the fact that a State implements a domestic regulation in accordance with its constitutional powers does not negate its review pursuant to international law. Indeed, in the context of the NAFTA, the tribunal in *DESONA* clearly held that a Party's (in that case, Mexico's) laws and legislative system must be consistent with general principles of international law.⁷⁷ Similarly, as noted, in *Pope & Talbot*, the NAFTA arbitral tribunal explicitly acknowledged that regulatory measures may be covered under Article 1110 of the NAFTA.

Legislation and regulatory measures can result in a taking either through a single formal measure, or through a number of discreet measures which, when aggregated, have the same practical effect as does the single formal measure. In terms of a formal taking, it occurs when an acquired or vested right is expunged.⁷⁸ For example, a direct taking can occur through legislation which either cancels or is contrary to a right granted under a

⁷⁶Case of Certain Norwegian Loans (France v. Norway), 1957 I.C.J. 9, 37 (separate opinion of Judge Lauterpacht). Norway argued that, on the basis of reciprocity, it could invoke France's reservation to the jurisdiction of the Court whereby under the *French Declaration of Acceptance* the Court was precluded from considering "matters which are essentially within the national jurisdiction, as understood by the Government of the French Republic." *Id.* Sir Lauterpacht's comments have since been cited with approval on a number of occasions. See F.A. MANN, *THE LEGAL ASPECT OF MONEY* 468 (1992); Kenneth S. Carlston, *Concession Agreements and Nationalization*, 52 *AMER. J. INT'L L.* 260, 275 (1958); *Mobil Oil Iran Inc., v. Gov't of the Islamic Republic of Iran*, 16 *Iran-U.S. Cl. Trib. Rep.* 3, 25 (1987).

⁷⁷Robert Azinian, Kenneth Davitan & Ellen Baw v. United Mexican States, 14 *ICSID Rev.-FILJ* para. 97 (1999); see also NAFTA, *supra* note 1, art. 1105.

⁷⁸The Canadian Federal Government has employed this method on a number of occasions. For example, Canada's former *National Energy Program (NEP)* has already been mentioned in this regard. Another example is Bill C-22, *Pearson International Airport Agreements Act*, which expunged various long-term lease agreements to re-develop two terminals at Toronto's Lester B. Pearson Airport.

concession or license to a private individual or company. Gillian White asserts that "the effect of the nationalisation measure on the concession is to bring it to an end before the agreed date and to transfer the right of carrying on the particular activity from the concessionaire to the nationalising State."⁷⁹ Such measures can be particularly severe to a concessionaire or licensee who has devoted a considerable amount of time and resources to developing the infrastructure necessary in order to gain the benefits under its expropriated concession.⁸⁰ For this reason, legislation purporting to directly expropriate proprietary interests has generally been held by international tribunals and courts as invoking State responsibility.

A separate and, possibly, more contentious issue arises where a legislative or regulatory measure has a significant impact on the ability of property holders to use or enjoy their property. On the one hand, a government cannot be held hostage every time that its measures have a negative economic impact on foreign owners' property, while on the other hand, the impact that legislation can have on property owners can be just as severe in effect as is a formal taking.

Borrowing from both the reasonableness and effects-based tests described above, international law recognizes that a deprivation of rights and use of property may result in a taking.⁸¹ This is precisely the nature of the

⁷⁹ GILLIAN WHITE, NATIONALIZATION OF FOREIGN PROPERTY 162 (1961). While it is true that many nationalizations have been inspired by governments attempting to take over and operate their foreign-held concessions (e.g., the numerous nationalization programs undertaken by a number of Arab States during the 1960s and 1970s concerning foreign-held oil concessions), there also have been instances where governments have expropriated rights by offering the rights held concessionaires, in whole or in part, to third parties. For example, in *In the Matter of the Arbitration Between Valentine Petroleum & Chemical Corp. and Agency for Int'l Dev.*, an arbitral tribunal, pursuant to an OPIC Contract of Guaranty, found that the Government of Haiti had expropriated the Claimant's interests by annulling the Claimant's ten year oil exploration permit in favour of a third party. In the Matter of the Arbitration Between Valentine Petroleum & Chemical Corp. and Agency for Int'l Dev., 9 I.L.M. 889 (1970). Similarly, in *Saudi Arabia v. Arabian American Oil Co. (ARAMCO)*, an arbitral tribunal found that a taking had occurred on the basis that part of the Claimant's concessionary rights had been annulled in favour of a third party transportation company. 27 I.L.R. 117 (Arbit. Trib. 1958). In both cases, compensation was awarded to the injured alien concessionaire.

⁸⁰ See Vance R. Koven, *Expropriation and the "Jurisprudence" of OPIC*, 22 Harv. Int'l L.J. 269, 294 (1981); see also *Shufeldt Claim (Guatemala v. U.S.)*, 2 R.I.A.A. 1079, 1095 (1930), (where the Arbitrator placed considerable weight on the fact that the concessionaire had invested a significant amount of money on the good faith of the Guatemalan Government).

⁸¹ In *Starrett Hous. Corp.*, where, despite the Respondent's contention that certain measures were necessary for, *inter alia*, safeguarding purchasers and protecting workers against being laid-off work, the Tribunal found that the Claimant had lost "effective use, control and benefits" of its property and was, therefore, entitled to compensation. *Starrett Hous. Corp. v. Gov't of the Islamic Republic of Iran*, 4 Iran-U.S. Cl. Trib. Rep. 122, 144 (1983). Similarly, in *Sedco, Inc. v. Nat'l Iranian Oil Co.*, the Tribunal held that legislation purporting to be in

claim successfully made by the Claimant in *Metalclad*. In *Metalclad*, for example, while the Claimant retained title in its property, the denial of a construction permit by the local government resulted in the Claimant effectively losing all benefits of ownership since it could not operate a landfill, notwithstanding that it had been given the necessary permits for that purpose from the federal government of Mexico.

Finally, while legislative measures may, if sufficiently severe, result in an expropriation, a compensable injury generally does not arise until the host government actually exercises its authority under such legislation. For example, where a government merely passes a law that could, if exercised, have an expropriatory effect, until the power is actually exercised, it generally is not considered to amount to a compensable injury. The fact that a venerable cloud hovers over property does not, in and of itself, establish a taking. There must be some definitive evidence to establish that the deprivation has crystallized.

In *Mariposa Development*, for example, the Commission noted that:

Practical common sense indicates that the mere passage of an act under which private property may later be expropriated without compensation by judicial or executive action should not at once create an international claim on behalf of every alien property holder in the country . . . claims should arise only when actual confiscation follows.⁸²

The reasoning in *Mariposa Development* has been followed in a number of cases before the Iran-U.S. Claims Tribunal.⁸³

In *Malek*, for example, the Tribunal held that the mere fact that legislation applies prospectively to effect property rights does not in itself amount to an expropriation. Rather, there must be some evidence that a government has begun to exercise its rights:

It follows from the language of the provision [Article 989] that the Article is not self-executing but that a procedure for the sale of the real estate must be set in motion under the supervision of the local Public Prosecutor, The Claimant, however, has not submitted any evidence purporting to prove that this procedure was ever implemented in relation to the Farmland between 5 November 1980 and 19 January 1981.⁸⁴

The mere enactment of legislation that may or may not at some future date lead to an expropriation will not be enough to substantiate a claim. Only where the rights or powers under the impugned legislation are exer-

respect of insolvency measures was in fact expropriatory. *Sedco, Inc. v. Nat'l Iranian Oil Co.*, 10 Iran-U.S. Cl. Trib. Rep. 180 (1986) (interlocutory award).

⁸²*Mariposa Development Co. v. U. S. -Panama Claims Commission*, 7. I.L.R. 255, 257 (1933).

⁸³*See, e.g.*, *The Mavrommatis Jerusalem Concessions Case* (Greek Republic v. Great Britain), 1925 P.C.I.J. (ser.A) No. 5 (Mar. 26).

⁸⁴*Reza Said Malek v. Gov't of the Islamic Republic of Iran*, 28 Iran-U.S. Cl. Trib. Rep. 246, 267 (1996).

cised will it generally be evaluated as to whether it amounts to a compensable injury on the basis of an expropriation.

(b) Land Control and Conservation Measures

A second way that governments can impose controls or restrictions on the use of property is through zoning and land-use planning measures. According to Professor Eric Todd, "[b]y the imposition, removal or alteration of land use controls a public authority may dramatically increase, or decrease, the value of land by changing the permitted uses which may be made of it."⁸⁵ For example, a government may designate, or zone, a particular region for a particular use, such as industrial, commercial, residential or agricultural. Through zoning measures and the like, governments can direct how land will be used, and, relatedly, how it will not be used. Generally speaking, while land-use and zoning measures can have a tremendous impact on the value of property, governments are, for the most part, not responsible for compensating those property owners who are impacted by such measures. In this respect, (former) Canadian Supreme Court Justice Estey noted that "[o]rdinarily, in this country, the United States and the United Kingdom, compensation does not follow zoning either up or down."⁸⁶ This inherently recognizes that certain costs naturally accompany ownership rights. Unfortunately, there are very few international law cases which have considered zoning and land-use planning issues.⁸⁷ As a result, it is difficult to derive common principles under international law.

⁸⁵ERIC C.E. TODD, *THE LAW OF EXPROPRIATION AND COMPENSATION IN CANADA* 22 (1992).

⁸⁶*The Queen (B.C.) v. Tener*, 1 S.C.R. 533, 557 (1985). However, tracing the historical roots of the relationship between zoning and police powers, Hippler provides that:

Zoning had rapidly developed as a tool for municipalities to restrict and control urban growth. It was clear that the power to zone was desirable, if not necessary, to regulate the interrelationship of property interests in urban communities. As an exercise of police power, however, zoning had little justification in terms of judicial precedent. Specifically, zoning went well beyond previously sanctioned police power prohibitions of nuisances. Indeed, its function was to prevent situations which could result in future nuisances. In addition, zoning often involved significant diminution in value of private property when it allowed only a residential or other use of limited profitability.

Thomas A. Hippler, *Re-examining 100 Years of Supreme Court Regulatory Taking Doctrine: The Principles of "Noxious Use," "Average Reciprocity of Advantage," and "Bundle of Rights" from Mugler to Keystone Bituminous Coal*, 14 B.C. ENVTL. AFF. L. REV. 653, 688 (1986).

⁸⁷One international law case which directly involves a conservation measure is *In the Matter of Arbitration between Int'l Bank and Overseas Private Inv. Corp.* 11 I.L.M. 1216 (1972). In that case, the impugned measure was a forest conservation measure enacted by the Government of the Dominican Republic. The Claimant, a lumber mill operator, alleged that as a result of the conservation measures it was forced to cease production which, according to the Claimant, amounted to an expropriation. The Tribunal disagreed, instead finding for the Respondent Government.

On the surface, the case appears to establish the proposition that a government may establish a conservation measure free from the threat of expropriation. Upon closer review, however, the case will likely not stand up to future judicial consideration for the following

The best example of how international law may treat future land-use and zoning regulations, and a limited one at that, involves two cases decided by the European Court of Human Rights ("European Court").⁸⁸

The first case, *Sporrong and Lonnroth*, involved two separate claims which arose pursuant to legislation enacted by the Stockholm City Council as part of its attempt to redevelop the Lower Norrmalm district.⁸⁹ The Plaintiffs claimed that the legislation, which created certain expropriation permits and use restrictions over an extended period of time, had such a

reasons: the case was determined pursuant to an Overseas Private Investment Corporation insurance contract; the legislation did not bar the cutting of almacigo timber which was the only type used by the Claimant; the Claimant's operation was losing a substantial amount of money prior to the enactment of the conservation measures; and the Government did everything in its power to accommodate the Claimant's special needs. Finally, the Tribunal noted that even valid environmental legislation may go too far and amount to an expropriation. In the end, *Int'l Bank* does not provide much guidance.

⁸⁸Both cases were raised pursuant to Article 1 of the First Protocol of the European Convention on Human Rights which provides that:

Every natural or legal person is entitled to the peaceful enjoyment of his possessions. No one shall be deprived of his possessions except in the public interest and subject to the conditions provided for by law and by general principles of international law.

The preceding provisions shall not, however, in any way impair the right of a State to enforce such laws as it deems necessary to control the use of property in accordance with the general interest or to secure the payment of taxes or other contributions or penalties.

First Protocol to the Convention for the Protection of Human Rights and Fundamental Freedoms, *reprinted in* EUROPEAN CONVENTION ON HUMAN RIGHTS: COLLECTED TEXTS 40 (Council of Europe 1994).

The precedential value of cases heard by the European Court is questionable. On the one hand, Rudolf Dolzer and the majority opinion in *Foremost Tehran, Inc. v. Gov't of the Islamic Republic of Iran*, refer favourably to the European Court's decision in the *Sporrong and Lonnroth* case, discussed *infra*. See Rudolf Dolzer, *Indirect Expropriation of Alien Property*, 1 ICSID REVIEW: FOREIGN INVESTMENT L. J. 41, 46 (1986); *Foremost Tehran, Inc. v. Gov't of the Islamic Republic of Iran*, 10 Iran-U.S. Cl. Trib. Rep. 228, 251 (1986). On the other hand, Justice Holtzmann, dissenting in *Foremost Tehran*, argued against conferring any weight to the decisions of the European Court. *Foremost Tehran*, 10 Iran U.S. Cl. Trib. Rep. at 267

⁸⁹*Sporrong and Lonnroth Case*, 68 I.L.R. 86 (Eur. Ct. H.R. 1982). The legislation at issue here created expropriation permits, which allowed the Council to name areas susceptible to future expropriation, as well as general measures allowing the legislature to prohibit construction and property improvements in certain named areas. The legislation did not, however, restrict an owner's right to sell, mortgage or let its property. The first claim was raised by the *Sporrong* estate. On 31 July 1956, an expropriation permit was issued against the estate property. It was subsequently renewed three times, eventually expiring on 3 May 1979. As well, between July 1954 and July 1979, the City Council imposed a prohibition against any construction on property within the zone. The permits and prohibition were issued in order that the City could construct a viaduct. The second claim was raised by Ms. Lonnroth whose property was subject to both an expropriation permit and construction prohibition for eight and twelve years, respectively. While the first Plaintiff never attempted to sell its property, Ms. Lonnroth complained that the legislation had deterred a potential purchaser and resulted in her being unable to secure a loan by using the property's mortgages as collateral. *Id.*

negative impact on their use and enjoyment of their property that it gave rise to a compensable injury on the basis that it amounted to an expropriation. Ten votes to nine, the European Court agreed with the Plaintiffs. Adopting an effects-based test,⁹⁰ the Court explained that while the legislation did not formally expropriate the Plaintiffs' property, it ultimately had the same effect. While the property owners were permitted to sell, mortgage and let their property, the Court explained that the impugned measure:

[N]evertheless in practice significantly reduced the possibility of its exercise.

They also affected the very substance of ownership in that they recognised before the event that any expropriation would be lawful and authorised the City of Stockholm to expropriate whenever it found it expedient to do so. The applicants' right of property thus became precarious and defeasible.⁹¹

Although not stating so directly, it would appear that the European Court's decision was influenced by both the length of time which the legislation applied, as well as the nature of the restrictions.⁹²

On its own, the decision in *Sporrong and Lonnroth* may shed light on whether a zoning measure can amount to an expropriation. However, its value in establishing a precedent is questionable as a result of the European Court's contrary decision in *James and Others*.⁹³ In *James and Others*, the European Court was asked to determine whether legislation requiring certain property owners to let or sell their property at prices below market value constituted an expropriation.⁹⁴ As a result of the legislation, the Plaintiff was forced to sell eighty of its approximately two thousand homes, resulting in losses totalling over two million pounds. This time, and in marked contrast to its decision in *Sporrong and Lonnroth*, the Court found against the Claimant on the basis that the legislation did not have an expropriatory effect. In the end, the European Court held that the legislation represented a valid incursion on private property rights.

⁹⁰In other words, the Court explained its role as follows: In absence of a formal expropriation, that is to say a transfer of ownership, the Court considers that it must look behind the appearances and investigate the realities of the situation complained of. *See id.* at 106.

⁹¹*See id.* at 105.

⁹²This reasoning is seemingly at odds with the decisions in both *Mariposa*, and *Malek*, where the courts held that legislation which acts prospectively does not amount to an expropriation until the restrictions under it are actually executed. *Mariposa Development Co. v. U. S. -Panama Claims Commission*, 7 I.L.R. 255, 257 (1933); *Reza Said Malek v. Gov't of the Islamic Republic of Iran*, 28 Iran-U.S. Cl. Trib. Rep. 246, 286 (1996)

⁹³In *Re James and Others*, 75 I.L.R. 396 (Eur. Ct. H. R. 1986).

⁹⁴In this case, the United Kingdom Parliament passed legislation, the Leasehold Reform Act, which was intended to create opportunities for private citizens to purchase property. The traditional long-term leasing practices had been such that lessors were often required, as a condition of obtaining a lease, to construct a building or a home on their leased property. Upon termination of the lease period, both the land and the improvements would revert back. According to the legislation, long-term lessors could either opt for a twenty-five year lease extension or purchase their rented property. In either case, the rental or selling rate was set equal to the value of the land without any buildings or improvements. *See id.*

It is difficult to evoke common principles from either case. While it is clear that a zoning measure may amount to an expropriation where it goes "too far," the demarcation line remains uncertain.

Finally, it also should be noted that an expropriation may exist in less obvious settings. For example, in *Seismograph Service Corporation*,⁹⁵ the Iran-U.S. Claims Tribunal found in favor of the Claimant after the Iranian government had failed to issue it the necessary permits for re-exporting its equipment from Iran.⁹⁶ Similarly, in *Petrolane*, the Tribunal held that:

Based on the foregoing, the Tribunal finds that by preventing the Claimant from exporting its Service Plant, NIOC deprived the Claimant of the effective use, benefit and control of the equipment listed on the April and June RTEs in breach of contract, as well as constituting an expropriation . . .⁹⁷

The Iranian Government was thus held responsible for failing to provide the necessary approvals despite the fact there was no evidence of any official policy or plan to expropriate the Claimant's property. Rather, the Tribunal held the Government liable on the basis of the effect of its omission on the Claimant.

(c) Government Appointed Managers and Directors

The next measure examined pertains to a situation where a host government assumes control, directly or indirectly, over a corporation, entity or proprietary right. Traditionally, this occurs in situations where a government attempts to limit or remove foreign ownership or involvement in or from a particular sector of the economy. Alternatively, it can refer to instances where a government takes over a company on the brink of bankruptcy or where it is violating the terms of its license or permit requirements. For example, in the context of environmental legislation, it may, depending on the terms of the empowering legislation, include a situation where a forest or mining company is acting in a manner that is (grossly) contrary to the terms of its license or permit.

The simple act of a government appointing a manager, liquidator or official to assume temporary control over a company is generally not sufficient for establishing an expropriation.⁹⁸ Rather, something more

⁹⁵ *Seismograph Serv. Corp. v. Nat'l Iranian Oil Co.*, 22 Iran-U.S. Cl. Trib. Rep. 3 (1988).

⁹⁶ The Tribunal restricted its finding to include only the equipment which the Claimant took positive steps to re-export. See *Houston Contracting Company v. Nat'l Oil Co.*, 20 Iran-U.S. Cl. Trib. Rep. 3 (1988), where a similar decision was rendered by the Tribunal earlier in 1988.

⁹⁷ *Petrolane, Inc. v. Gov't of the Islamic Republic of Iran*, 27 Iran-U.S. Cl. Trib. Rep. 64, 96 (1991).

⁹⁸ See *Case Concerning Elettronica Sicula S.p.A. (ELSI) (U.S. v. Italy)*, 1989 I.C.J. 15 (July 20); *Eastman Kodak Co. v. Gov't of the Islamic Republic of Iran*, 17 Iran-U.S. Cl. Trib. Rep. 153 (1987); *Motorola, Inc. v. Iran Nat'l Airlines Corp.*, 19 Iran-U.S. Cl. Trib. Rep. 73 (1988). In the latter case, the Iran-U.S. Claims Tribunal found against the Claimant despite the fact that the Claimant's manager was arrested and the Government's appointed

substantial, such as failing to treat an alien as a rightful owner, is required. In this respect, Weston provides that:

Once again, then, one is left to conclude that the "State administration" of private wealth is by itself to be regarded not as a compensable event but as a temporary custodial action not amounting to a "constructive taking." Only when such measures are determined to be truly non-custodial in character, or, alternatively, when they are determined to be part of an ultimately definitive disposition—such as would transfer title or otherwise conclusively deprive an owner of the yield therefrom—is the appointment and subsequent functioning of a State administrator regarded as the equivalent of a "direct taking."⁹⁹

Generally, a tribunal or arbitral panel will look to see whether a claimant has been denied the benefits of ownership. Such benefits include the power to designate directors, be involved in major decisions (including the purchase or sale of substantial levels of equipment or inventory), receive dividends which are provided to shareholders within the same class, and make major planning and executive decisions (including whether to merge or acquire new companies or dissolve existing ones).¹⁰⁰ A mere temporary restriction on some of these rights likely will not result in a compensable injury. Rather, only where a measure is permanent or where its effect is particularly incursive or draconian will a tribunal find the existence of an expropriation.

(d) Confiscatory Taxation

International law is generally indifferent towards how a state taxes its residents, such as, for example, an income tax, consumption tax, or a manufacturing tax, or how a State spends its tax revenues. By virtue of an alien's decision to reside in a particular country, the alien is generally deemed to accept the fiscal measures and legislative system of its host state, provided, of course, that such measures or system otherwise does not violate minimum standards of treatment under international law. For the most part, therefore, aliens must accept their tax obligations in the same manner as do the nationals of their host State.

In *Brewer, Moller & Co. Case*, for example, a German national company which was residing in Venezuela was ordered to pay the taxes that it

manager, Mr. Tahanha, was elevated from temporary to general manager. The Tribunal, however, found against an expropriation since Mr. Tahanha had invited the Claimant to participate in the management of the company. Judge Brower, dissenting, complained that the majority "could not have constructed a purer fairy tale out of plain facts." See *Motorola, Inc. v. Iran Nat'l Airlines Corp.*, 19 Iran-U.S. Cl. Trib. Rep. at 95.

⁹⁹WESTON, *supra* note 19, at 165.

¹⁰⁰In *Phelps Dodge Corp.*, the Iran-U.S. Claims Tribunal further noted that where a government assumes control over property or a right owned by a private individual, the government owes a fiduciary responsibility to that individual. *Phelps Dodge Corp.*, 10 Iran-U.S. Cl. Trib. Rep. 121 (1986).

owed its host State notwithstanding its objections otherwise.¹⁰¹ The foreigner was deemed to have assumed the everyday costs and risks associated with entry into a foreign jurisdiction.¹⁰²

Municipal taxation measures are not, however, free from international legal disciplines. Albrecht notes that just like with anything else, taxation laws must be held up to international legal standards when an alien locates to a foreign State.¹⁰³ The issue for this paper is whether taxes that are so onerous and effectively deprive a property owner of the use or enjoyment of his or her property could amount to an expropriation, thus giving rise to state responsibility.

An onerous taxation rate can have the same practical effect on a property owner as does any expropriatory measure. In order to pay a tax, for example, a property owner may be forced to relinquish a substantial portion of his or her property. Yet, tribunals and courts generally have not viewed taxation in this manner. Wortley notes that the hesitancy against finding a taxation measure to be expropriatory results from the fact that:

A State is presumed to exist for the common good, and therefore, as the object of taxation is to meet the expenses of the State in peace and war, taxation may be presumed to be a lawful act of sovereignty when it takes place in respect of property within the sovereign's territory.¹⁰⁴

In *Kugele*, the claimant, a former owner of a brewery, alleged that because of increasingly high license fees his business was rendered unprofitable and, as a result, he was forced to exit the market.¹⁰⁵ Although not formally pled, the claimant alleged that Poland's taxation measures amounted to an indirect expropriation. President Kaeckenbeeck of the Upper Silesian Arbitral Tribunal, finding in favour of the Respondent Government, viewed the matter differently:

The increase of the license fees was not itself capable of taking away or impairing the rights of the plaintiff . . . The increase of the tax cannot be regarded as a taking away or impairment of the right to engage in a trade, for such taxation presupposes the engaging in the trade. It is true that taxation may render the trade less remunerative or altogether unremunerative. However, there is an essential difference between the maintenance of a certain rate of profit in an undertaking and the legal and factual possibility of continuing the undertaking.

¹⁰¹ See Brewer, Moller & Co. Case (Ger. v. Ven.), 10 R.I.A.A. 423 (1903).

¹⁰² Roland R. Foulke properly notes that "[i]t seems clear that if he goes to a state, lives therein and reaps the benefit of that state's political organization, he should be called on to pay the same share of the expense of running that organization as other persons who are within the state." ROLAND R. FOULKE, TREATISE ON INTERNATIONAL LAW, VOL. II, 24 (1920).

¹⁰³ See A. R. Albrecht, *The Taxation of Aliens Under International Law*, 1952 BRIT. Y.B. INT'L L. 145.

¹⁰⁴ WORTLEY, *supra* note 16, at 46.

¹⁰⁵ *Kugele v. Poland (Germany v. Poland)*, 6 Ann. Dig. 69 (Upper Silesian Arbit. Trib. 1932).

The trader may feel compelled to close his business because of the new tax . . . But this does not mean that he has lost the right to engage in the trade. For had he paid the tax, he would be entitled to go on with his business.¹⁰⁶

However, despite the fact that *Kugele* has been cited with approval on a number of occasions,¹⁰⁷ this must be treated circumspectly. It appears that the arbitral tribunal neglected to consider whether the claimant's rights were merely naked and, by the time the government's fees were imposed, no longer subsisting. The case report is scanty in this regard.

The extreme deference given to taxation measures is likely attributable to the fact that it is often confused with the police power exception.¹⁰⁸ Tribunals have commonly held that taxation measures, because they are necessary to the functioning of a State, are (virtually) beyond inquiry. In so doing, tribunals have relied upon the police power nature of such measures in order to absolve a State from liability. As a result, taxation measures have been mostly shielded from expropriation claims.

Additionally, some jurists have argued that a tax measure can only constitute an expropriation where applied in a discriminatory manner. For example, Friedman asserts that "[i]t is, in fact, very widely admitted that a diplomatic claim 'would be inadmissible in respect of the imposition and collection of a tax affecting nationals and foreigners indiscriminately.'" ¹⁰⁹

¹⁰⁶ *Id.* at 69.

¹⁰⁷ For example, Judge Lagregren cited it with approval in *Sedco Inc., v. Nat'l Iranian Oil Co.*, while in the *Oscar Chinn Case (United Kingdom v. Belgium)*, the Permanent Court of International Justice employed similar reasoning. *Sedco Inc., v. Nat'l Iranian Oil Co.*, 84 I.L.R. 483, 513 (Iran-U.S. Claims Tribunal 1985); *Oscar Chinn Case (United Kingdom v. Belgium)*, 1934 P.C.I.J. (ser. A/B) No. 63 (Dec. 12). Furthermore, it was noted with (seeming) approval by the American Law Institute's influential Third Restatement of the Law. Third Restatement of the Law, *supra* note 67, at 211 (Reporters' Notes). However, in paragraph 712, the Restatement holds that a tax measure may be a taking where either it is "confiscatory, or that prevents, unreasonably interferes with, or unduly delays, effective enjoyment of an alien's property or its removal from the state's territory . . . [or where it is] discriminatory." *See id.*

¹⁰⁸ Fachiri offers an alternative reason. According to him, a tax measure should be treated separately from an expropriation because:

Generally speaking, taxation is distinguishable from expropriation amongst other things in this, that the latter is in substance retroactive in its results, whereas the former is not. If the Government seizes my land, or may savings in the bank, it deprives me, once for all, of pre-existing property, without the possibility of my making good the loss. On the other hand, an income tax, death duties, even a capital levy are prospective in operation, and provided that the rate is not too high, can be balanced by saving and insurance (emphasis added).

Alexander P. Fachiri, *International Law and the Property of Aliens*, 1929 BRIT. Y.B. INT'L. L. 32, 54 [hereinafter Fachiri].

However, since the discussion here is restricted to instances where the rate "is [not] too high", the above statement, other than possibly explaining why the interference necessary for finding a tax measure expropriatory should be more obvious than with other measures, is not very helpful.

¹⁰⁹ FRIEDMAN, *supra* note 74, at 2.

It is unclear, however, why a discrimination requirement should be imposed on taxation measures.¹¹⁰ There is no legitimate reason to adopt a discrimination requirement on taxation measures (or currency regulations) when it is not required for other forms of expropriation.¹¹¹

In light of the earlier discussion on public purpose, intentions, and effects, there is no legitimate reason why an excessively onerous taxation measure should not be deemed a compensable injury.¹¹² The initial inquiry should concern whether a measure is reasonable and whether its adverse impact is more than ephemeral. This is not, however, how tribunals and panels have traditionally approached taxation measures. Instead, the police power exception, as well as the requirement of discriminatory treatment, has been infused into the determination of liability and, as a result, taxation measures have been virtually excluded from the scope of expropriations.

(e) Currency-Related Measures

If abused, currency-related measures, including inflation, deflation, transfer and/or exchange restrictions and monetary policies can have an ex-

¹¹⁰ Another reason against importing a discrimination requirement is that it essentially eliminates lawful expropriations and nationalizations and only recognizes unlawful ones. It will be remembered that a condition to having a lawful expropriation is that it be applied in a non-discriminatory manner. Hence, if a condition of finding a tax measure expropriatory is that it be applied in a discriminatory manner it also necessitates a finding of unlawfulness. This in turn has serious repercussions on an offending State. In both *The Case Concerning the Factory at Chorzow (Germany v. Poland)* and *INA Corporation v. The Islamic Republic of Iran*, referring to the deplorable nature of a State acting unlawfully, damages were assessed at the standard of restitution. The Case Concerning the Factory at Chorzow (Germany v. Poland), 1928 P.C.I.J. (ser. A) No. 13; *INA Corp. v. The Islamic Republic of Iran*, 8 Iran-U.S. Cl. Trib. Rep. 373 (1985). Accordingly, Judge Lagregren, in *INA Corporation*, found that:

It is generally accepted that some types of expropriation are inherently unlawful - among these one can cite cases in which foreign assets are taken on a discriminatory basis or for something other than a public purpose. Here it is well settled that the measure of compensation out to be such as to approximate as closely as possible in monetary terms the principle of *restitutio in integrum*.

INA Corp., 8 Iran-U.S. Cl. Trib. Rep., at 385.

¹¹¹ Albrecht, also rejects the notion that a discrimination requirement should be demanded for takings arising through taxation measures. See Albrecht, *supra* note 103, at 172-173. Accordingly, he provides that where a measure effects a taking, the type of measure under which it occurs is irrelevant:

According to the doctrine of the sovereign right of taxation, and in the absence of special treaty provisions, there would seem to be no basis in international law for objections to the exercise by a state of its right to tax where there is no discrimination against aliens. As a general rule, this must be admitted. Nevertheless, an exception must be made in the case of confiscatory taxation, for it is a rule of international law that confiscation, or expropriation without compensation, is illegal. There is little difference in the practical effect of confiscation and confiscatory taxation. Surely, then, confiscation in the guise of taxation cannot be permitted when confiscation itself is prohibited.

Id.

¹¹² Indeed, Article 2103:6 of the NAFTA explicitly recognizes that a tax measure may be expropriatory, although that Article creates procedural limitations on the ability to initiate a claim on that basis under Chapter 11 of the NAFTA. See NAFTA, *supra* note 1, art. 2103:6.

propriatory effect on foreign property holders. However, like with taxation, tribunals have accorded extreme deference to these types of policies. Once again, except in obvious situations, and likely only where it is applied in a discriminatory manner, aliens are faced with a difficult task where trying to establish a State delinquency on the basis of a currency regulation.

According to general principles of international law, every State has the sovereign right to establish and regulate its currency.¹¹³ In most circumstances a State may determine without the scrutiny of the community of nations whether, for example, to counter inflation, support its currency or place limitations on exchange and foreign transfers.¹¹⁴ While currency regulation is a municipal and internal matter, like with taxation, it enters into the realm of international law when an alien enters into commercial relations with a foreign State.¹¹⁵ This may occur, for example, where an alien places money in a foreign bank, retains foreign currency or in any other manner which places an alien in the position of a creditor to a foreign State. Furthermore, an alien is not required to actually reside in the debtor State for that State to owe it an obligation pursuant to international law.

Most expropriatory measures involving currency policies have occurred in the so-called lesser-income countries.¹¹⁶ Generally speaking, currency-related claims arise out of situations where a country is attempting to reorder and take control of its economy.¹¹⁷ Except for certain comments

¹¹³ See Case Concerning the Payment of Various Serbian Loans Issued in France (France v. Kingdom of the Serbs, Croats and Slovenes), 1929 P.C.I.J. (ser. A) Nos. 20/21.

¹¹⁴ Dr. Mann, *supra* note 76, at 461, provides that:

Money, like tariffs or taxation or the admission of aliens, is one of these matters which *prima facie* must be considered as falling essentially within the domestic jurisdiction of States . . . Customary international law does not normally fetter the municipal legislator's discretion in these matters or characterize his measures as an international wrong for which he could be held responsible, just as it leaves him the freedom to decide whether he wishes to introduce a particular type of tax and whether he levies tax at a particular rate.

¹¹⁵ Case of Certain Norwegian Loans (France v. Norway), 1957 I.C.J. 9, 37 (separate opinion of Judge Lauterpacht).

¹¹⁶ For example, in a peculiar twist, Rosenn chronicled how the extreme inflationary period between the early-1950s to the mid-1960s in Brazil and Argentina allowed both States to expropriate compensation awards gained through earlier expropriation proceedings. By the time the Governments paid their compensation, particularly because the rate of inflation exceeded interest rates given on such awards, the actual money a property owner received for its taken property was nominal. Rosenn noted that the monetary policies of both countries "operated confiscatorily, and thus have severely strained the confidence of property owners and investors in the promises of both governments to protect private investment." Keith S. Rosenn, *Expropriation, Inflation and Development*, 1972 Wis. L. Rev. 845, 847 (1972).

¹¹⁷ At the same time, it must not be lost that a State can manipulate its monetary policy in such a way as to extract a supreme advantage over its creditors. For example, it can support a program of devaluation in order to erase its debt. However, for an alien, the difficulty is in substantiating his or her claim. Even if a purely effects-based test were applied, an alien would still be faced with a difficult challenge in establishing both a loss of property and that his or her loss was attributable to its host State. See EDWIN BORCHARD, STATE INSOLVENCY

made in dissent, which are discussed below, the case law has overwhelmingly sided with respondent host States where an expropriation claim is made on the basis of a currency policy.

The first hurdle to meet in establishing an expropriation claim arising from a currency measure is in demonstrating a loss of property. It is difficult to conceptualize this form of taking. The problem lies in that there is often not an accompanying direct loss. The losses are notional, and may only apply for a temporary period. Furthermore, currency legislation is often applied in a very broad and general fashion. While the creditor of a host state may very well receive the face value of his or her investment as at the date of maturity, in actuality, the real value of his or her payment will have severely declined.

Alternatively, a State may adopt a currency conversion regulation which provides that aliens may not redeem their investments, or, if they can redeem them, that the amount be reduced by a specified rate. For example, in *Eisner*,¹¹⁸ a U.S. national alleged that her property was "taken" when, following the liberation of Germany after the Second World War, the American Military Commander in Berlin ordered that German Reichmarks be converted into a "new" currency. Because the conversion rates were not applied equally (e.g., residents of Germany received a better rate than did aliens), the plaintiff asserted that such actions were expropriatory. In finding against the plaintiff, the United States Court of Claims noted that when dealing with currency conversion it is very difficult to even know whether there has been a loss of real value.¹¹⁹ Similarly, in *French*, despite the fact that the claimant was not permitted to redeem his certificates worth US\$150,000 outside of Cuba, the New York Court of Appeals found that the fact that "it is still his or his assignee's to enforce or attempt to enforce . . ." demonstrates that it has not been taken.¹²⁰ Hence, when raising an ex-

AND FOREIGN BONDHOLDERS - GENERAL PRINCIPLES vol. 1 136 (1951), who noted that currency regulations can be used in an expropriatory manner. On the other hand, Wortley notes that "when devaluation is a genuine defensive measure to counterbalance a disastrous fall in prices, it is not abusive." Wortley, *supra* note 16, at 48.

¹¹⁸ *Eisner v. United States*, 1954 I.L.R. 476 (U.S. Ct. of Claims, 1954).

¹¹⁹ A similar finding was reached in the *Adam's Case* where, though the facts were slightly different, the Commissioners did not even consider the Claimant's case to be a valid one. *Adam's Case* (Great Britain v. United States), in 3 HISTORY AND DIGEST, MOORE ARBITRATIONS 3066, 3067 (1898).

¹²⁰ *French v. Banco Nacional de Cuba*, 66 I.L.R. 6, 16 (N.Y. 1968). Essentially, the Court adopted a direct physical invasion test whereby, as long as a property owner retains title, even if it means that a property owner merely has the right to "burn" his or her property (*i.e.*, left valueless), then no action may be raised. In light of the very nature of an indirect expropriation, this type of reasoning is not likely to be followed. Instead, the following minority opinion of Keating J. is more reflective of the present state of international law:

There is sufficient authority in international law for the proposition that a taking of property can occur without first depriving the owner of legal title if the foreigner is effectively deprived of all benefit of the property . . . Moreover, simply because Decision No. 346 was initially necessitated by

propriation claim on the basis of fiscal policies or currency measures, a claimant faces an initial formidable barrier in having to substantiate a loss.

Assuming that a loss can be established, as described above, the next hurdle is to demonstrate that such loss is attributable to the debtor-State. In *French*, Fuld C.J. asserted that:

This is not an era, surely, in which there is anything novel or internationally reprehensible about even the most stringent regulation of national currencies and the flow of foreign exchange. Such practices have been followed, as the exigencies of international economics have required—and despite resulting losses to individuals—by capitalist countries and communist countries alike, by the United States and its allies as well as by those with whom or country has had profound differences. They are practices which are not even of recent origin but which have been recognized as a normal measure of government-for hundreds of years, if not, indeed, as long-as currency has been used as the medium of international exchange.¹²¹

As well, in the *Furst Claim*, the United States Foreign Claims Commission held that a State cannot be held liable for fluctuations in its currency when attempting to bring order “in time of financial stress.”¹²²

Thus, similar to taxation and other fiscal measures, international tribunals are not likely to consider currency measures as amounting to an expropriation.

C. Measures Tantamount to an Expropriation

In addition to including direct and indirect expropriations, both of which already have been canvassed above, Article 1110 imposes obligations on Parties for their “measures [which are] tantamount to” an expropriation and nationalization. The specific elements for establishing a

Cuba’s need to protect its foreign exchange, it does not follow that it remains valid under international law permanently.

Id. at 42.

Although stated in relation to the U.S.’s Fifth Amendment, similar reasoning to the above was adopted by the U.S. Court of Appeals, Second Circuit, in *Sardino v. Federal Reserve Bank of New York*, where eventually finding for the U.S. Government on the basis of the police powers exception, the Court rejected the Respondent Government’s contention that no taking had occurred. 361 F.2d 106, 110 (2d Cir. 1966). The plaintiff was denied the transfer of its money out of the U.S., because “it has merely placed a temporary barrier to its transfer outside the United States . . . [the plaintiff may] . . . use the account to pay customs duties, taxes or fees owing to the United States, a state, or any instrumentality of either.” *Id.* The Court, in response to the above argument, noted that “we find it hard to say there is no deprivation when a man is prevented both from obtaining his property and from realizing any benefit from it for a period of indefinite duration which may outrun his life.” *Id.* at 111. However, these cases effectively demonstrate the hesitancy which tribunals have had with finding the existence of an expropriation out of a currency measure.

¹²¹ French, 66 I.L.R. at 19.

¹²² *Furst Claim*, 42 I.L.R. 153, 154 (U.S. Foreign Cl. Comm’n, 1960).

“measure tantamount to” a nationalization or expropriation are not specified in the NAFTA. Appleton, for example, provides that:

The NAFTA does not include any definition of what constitutes an act tantamount to expropriation. This is an area which is certain to receive attention from future NAFTA dispute settlement panels as acts which are not considered to constitute expropriation by the host state, but which impair the benefits of NAFTA investors, may be subject to this NAFTA obligation.¹²³

Although the phrase has not been judicially considered, phrases similar to it have been included in other bilateral investment treaties (“BITs”). For example, Article III of the United States’ prototype investment treaty provides that: “Investments shall not be expropriated or nationalized either directly or indirectly through measures tantamount to expropriation or nationalization.”¹²⁴

Similarly, in a BIT between Saint Lucia and the Federal Republic of Germany, the Parties agreed that:

Investments by nationals or companies of either Contracting Party shall not be expropriated, nationalized or subjected to any other measure the effects of which would be tantamount to expropriation or nationalization in the territory of the other Contracting Party . . .¹²⁵

As well, even Canada has implemented similar wording (arguably even broader) in previous legislation to implement the 1988 *Canada-US Free Trade Agreement*. Article 1605 of the *Canada-United States Free Trade Agreement Implementation Act* provided that:

Neither Party shall directly or indirectly nationalize or expropriate an investment in its territory by an investor of the other Party or take *any measure or series of measures tantamount to an expropriation* of an investment . . .” (emphasis added).¹²⁶

Although the phrase “measures tantamount to” is not defined by the NAFTA, in *Pope & Talbot* the NAFTA arbitral tribunal interpreted it to effectively be the same as an indirect expropriation. This interpretation is consistent with how some jurists have interpreted the phrase. For example, Sandrino explained that:

Article 1110 of the NAFTA Investment Chapter provides for the protection of foreign investments against nationalization, expropriation, and other forms of

¹²³ BARRY APPLETON, *NAVIGATING NAFTA – A CONCISE USER’S GUIDE TO THE NORTH AMERICAN FREE TRADE AGREEMENT* 86 (1994).

¹²⁴ *United States Prototype Treaty Concerning the Reciprocal Encouragement and Protection of Investments* (1984 revised text), reprinted in UNITED NATIONS CENTRE ON TRANSNATIONAL CORPORATIONS, *BILATERAL INVESTMENT TREATIES*, ANNEX V (1988).

¹²⁵ *Article 4, Treaty Between Saint Lucia and the Federal Republic of Germany Concerning the Encouragement and Reciprocal Protection of Investments of 16 March 1985*, reprinted in UNITED NATIONS CENTRE ON TRANSNATIONAL CORPORATIONS, *BILATERAL INVESTMENT TREATIES*, ANNEX 11 (1988).

¹²⁶ *United States-Canada Free Trade Agreement Implementation Act of 1988*, Pub. L. No. 100-449, 102 Stat. 1851 (1988).

interference that are “tantamount to nationalization or expropriation.” The Article covers direct, indirect and “creeping expropriation.”¹²⁷

As well, in *Metalclad*, the U.S. Government explained that the phrase “tantamount to expropriation” was not intended to create a new category of expropriation, but that it effectively has the same meaning as an indirect expropriation under international law.¹²⁸

The fact that the word “measure” is defined broadly in Article 201:1 of the NAFTA lends further support to the above interpretation. According to the *Oxford English Dictionary*, “tantamount” means “[t]hat which amounts to as much, or comes to the same thing; something equivalent (to); an equivalent”.¹²⁹ Similarly, the French text of the NAFTA substitutes the word “tantamount” with “equivalent”: “. . . *ni prendre une mesure équivalente à la nationalisation ou à l'expropriation d'u tel investissement . . .*”

In the end, the phrase “measures tantamount to” should be read in a manner similar to an indirect expropriation. It merely ensures that the Parties cannot claim that Article 1110 of the NAFTA was intended to apply narrowly. As well, it will prevent Parties from arguing that certain forms of measures are excluded from Article 1110 of the NAFTA. Accordingly, for the purposes of the remainder of the paper, the phrase “measures tantamount to” an expropriation is treated as being synonymous with the phrase “indirect expropriation.”

IV. ARTICLE 1110 OF THE NAFTA AND THE ENVIRONMENT

Generally speaking, a measure enacted or adopted by a government will not amount to a compensable injury on the basis of an indirect expropriation unless the measure is unreasonably substantial or otherwise has more than an ephemeral impact on the ability of the property owner to use and enjoy his or her property. As noted, the dividing line is somewhat fluid, with some types of measures being more likely to result in an expropriation than others. In all cases, however, the mere fact that a measure has some injurious impact on the value, use or enjoyment of property is not sufficient to establish the expropriation. At the same time, and as referred to in a few instances above, in certain circumstances a measure may not give rise to a compensable injury notwithstanding that the threshold level imposed by an effects-based test is exceeded. Where a measure is enacted pursuant to a government’s police power, provided that the effect is not excessively

¹²⁷ Gloria L. Sandrino, *The NAFTA Investment Chapter and Foreign Direct Investment in Mexico: A Third World Perspective*, 27 VAND. J. TRANSNAT’L L. 259, 317 (1994); see also, Justine Daly, *Has Mexico Crossed the Border on State Responsibility for Economic Injury to Aliens? Foreign Investment and the Calvo Clause in Mexico after the NAFTA*, 25 ST. MARY’S L.J. 1147, 1179-1180 (1994).

¹²⁸ *Metalclad Corp. v. United Mexican States*, ICSID Case No. ARB(AF)/97/1 para. 29 (Aug. 31, 2000)

¹²⁹ THE OXFORD ENGLISH DICTIONARY (2d ed. 1989).

onerous, the government has a valid defense to having to pay compensation to the injured alien. As discussed below, the police power exception is an accepted principle of international law.

In the context of environmental and forest conservation measures, the police power defense serves as a potentially important tool for governments to enact or adopt necessary measures without having to compensate injured aliens. There are, however, limitations on how far governments can go before which their measures will give rise to a compensable injury. This section considers the hazy area of the police power exception. In turn, this discussion will be material to the later analysis of the application of Article 1110 of the NAFTA to the MB Acquisition.

A. Police Power Measures

1. *The Police Power Exception—The “Shadow Land” of Expropriation Law*

The police power represents the major exception to the requirement that property owners be compensated for their expropriated property. This exception, which is recognized under both international and municipal law, serves as the fundamental means by which a government can implement necessary programs in pursuit of safety, health, welfare, comfort and morals without being consequently held liable to compensate property owners whose property has been negatively impacted as a result of such measures. Justice Brennan of the United States Supreme Court explained the principle, as it applies under U.S. takings jurisprudence, as follows:

Suffice it to say that government regulation—by definition—involves the adjustment of rights for the public good. Often this adjustment curtails some potential for the use or economic exploitation of private property. To require compensation in all such circumstances would effectively compel the government to regulate by purchase.¹³⁰

Similar to the initial difficulty of establishing the difference between a mere interference with property rights and an expropriation, the demarcation between a police measure and a compensable injury (i.e., by definition, both are in pursuit of a valid public purpose) is, what Seymour Rubin terms, the “shadow land” of takings law.¹³¹

A major reason behind the confusion surrounding the police power exception has been the failure of either international or municipal law to offer a comprehensive and widely accepted grounding for identifying its nature

¹³⁰ *Andrus v. Allard*, 444 U.S. 51, 65 (1979).

¹³¹ Rubin states in SEYMOUR J. RUBIN, *PRIVATE FOREIGN INVESTMENT – LEGAL & ECONOMIC REALITIES* 34-5 (1956) that:

It is clear, thus, that private property may sometimes be taken without compensation. What is not clear is the *shadow land* between the two black-letter principles of just compensation for the taking of private property for public use and of legitimate exercise of the police power (emphasis added).

or scope. Both Grotius and Pufendorf, writing in the thirteenth century, recognized that property must be regulated and managed in a manner that advances public welfare.¹³² Similarly, the police power exception itself has existed as an accepted principle since at least before the inception of the United States Constitution.¹³³ Yet, the police power exception has remained an amorphous and indeterminate principle.

For all of its shortcomings, however, the police power exception represents a necessary limitation on private property rights. Penal measures represent a fitting illustration of the importance of the police power exception. How could a State enforce its penal laws if it was subsequently liable to property owners for the incursive effect of those laws (e.g., through a seizure of assets)?

Penal measures are local in character and vary between nations. According to Friedman, “[i]nternational law regards these measures [i.e., penal ones], which are described as confiscation, as falling strictly within the jurisdiction of the State in whose territory the unlawful act is committed.”¹³⁴ Similarly, in explaining the importance of penal measures in securing a safe society and advancing legitimate interests, Wortley notes that:

Moreover, legislation forbidding, on pain of forfeiture, the use of property for noxious or immoral trades is common to many systems of law. Such bona fide legislation imposing sanctions under criminal law is clearly in the public interest and, when it operates within the State imposing it, it cannot generally be regarded as improper by other States with similar legislation, since its object is to safeguard the public interest, that is the well-being of the generality of person and property under the State’s control, even though this is sanctioned by penalties or confiscations.¹³⁵

This line of reasoning also has been accepted by international courts and tribunals. For example, in the *Louis Chazen* case,¹³⁶ the Mexican Government confiscated a U.S. national’s property after he was suspected of smuggling property in violation of Mexico’s customs regulations. The claimant subsequently alleged that, *inter alia*, he was entitled to compensation on the basis of his loss of property. The Claims Commission, stating that “Mexico, as a sovereign State can promulgate such rules as it may deem convenient in order to protect the revenue in its Customs houses and

¹³² See WHITE, *supra* note 79, at 145. Sax notes that the public trust doctrine, which is similar to the police power exception in that it is aimed at protecting such things as navigable water and fisheries, also has its roots in Roman Law. See Joseph L. Sax, *Public Trust Doctrine in Natural Resource Law: Effective Judicial Intervention*, 68 MICH. L. REV. 471, 476 (1970); see also, Ralph W. Johnson and William C. Galloway, *Protection of Biodiversity Under the Public Trust Doctrine*, 8 TUL. ENVTL. L.J. 21, 22 (1994).

¹³³ See Hippler, *supra* note 86, at 298, where Harlan J. asserted that, unless formally excluded, police powers must be read into the Constitution.

¹³⁴ FRIEDMAN, *supra* note 74, at 1.

¹³⁵ WORTLEY, *supra* note 16, at 42.

¹³⁶ *Louis Chazen (U.S.A.) v. United Mexican States*, IV R.I.A.A. 564 (1930).

on its frontiers . . . ,”¹³⁷ found in Mexico’s favour on the basis that it was a valid penal measure that fell within its police powers. The Commission explained that a State may establish penal measures and confiscate property provided that it is necessary for advancing a valid police power objective.¹³⁸ At the same time, confiscations must comply with the rule against excessiveness, be in pursuit of generally accepted principles of international law and must not offend the international minimum standard of treatment.¹³⁹

The police power exception does not deny either the existence of a taking or an injury. Rather, it is grounded in the belief that certain goals are so important for advancing public welfare that the general rule requiring compensation must be set aside in favour of one that recognizes that private citizens, including foreign investors, must shoulder certain public responsibilities. The exact nature and scope of the police power exception, however, is far from clear.¹⁴⁰ The problem is generally not with defining the

¹³⁷ *Id.* at 567.

¹³⁸ As well, in *Sedco*, the Iran-U.S. claims Tribunal noted that: “[t]he one exception to this rule, forfeiture for crime, is distinguishable because in such cases the person(s) affected do not rightfully possess the title to property in question.” *Sedco Inc. v. Nat’l Iranian Oil Co.*, 84 I.L.R. 483, 513 (Iran-U.S. Cl. Trib. 1985). Forfeitures and confiscations are commonly employed by States for such things as fighting against the trafficking of narcotics, tax evasion and other offenses linking the acquisition with illicit activities. In the environmental sphere, a government can use the threat of confiscation as a powerful tool for ensuring that certain product/process standards, regulations or licence requirements are met.

¹³⁹ Wortley warns that the mere fact that a State points to a valid objective is not sufficient for alleviating it of its international legal responsibility:

Acts of confiscation or expropriation purporting to be based upon public international law itself will, however, be strictly construed against the expropriating Power, and failure to comply with the conditions laid down by that law may result in those acts being treated as void by foreign States and by tribunals applying international law.

WORTLEY, *supra* note 16, at 42.

¹⁴⁰ Some jurists have argued for a narrow approach whereby it only refers to measures which fall under the strict, traditional purposes of government. In this regard, Epstein argues that those measures that fall under the police power exception should be restricted to things that are necessary to “maintain peace and order within the territory” since, according to him, it ultimately defines the “central purpose” of government. See RICHARD A. EPSTEIN, *TAKINGS: PRIVATE PROPERTY AND THE POWER OF EMINENT DOMAIN* 16 (1985). As well, in *Armstrong v. United States*, referring to the so-called takings clause in the U.S. Constitution, the U.S. Supreme Court noted that a certain degree of protection is needed in order “to bar Government from forcing some people alone to bear public burdens which, in all fairness and justice, should be borne by the public as a whole.” *Armstrong v. United States*, 364 U.S. 40, 49 (1960). On the other hand, some commentators have argued for a broader right, recognizing that the needs and functions of government change as society becomes more urbanized and complex. For example, see Nicolau Tideman, *Takings, Moral Evolution, and Justice*, 88 COLUM. L. REV. 1714 (1988), for an argument against the morality of owning land and natural resources, and Sam D. Starritt and John H. McClanahan, *Land-Use Planning and Takings: The Viability of Conditional Exactions to Conserve Open Space in the Rocky Mountain West After Dolan v. City of Tigard*, 114 S.Ct. 2309 (1994), LAND AND WATER L. REV. 415 (1995), for an argument that placing strict controls on the ability of gov-

principle. Since the United States Supreme Court's decision in *Mugler*, most jurists agree that the police power covers measures in pursuit of "public health, the public morals, and the public safety . . ." ¹⁴¹ Instead, in the same sense as the expropriation issue more generally, the difficulty lies in determining the outer limits of the exception.

While the scope of the police power exception is not entirely clear, and a "shadow land" remains, the following are recognized limitations on the application of the police power exception: (a) for certain types of measures, a compensable injury will be found where all rights or incidents of ownership have been removed; (b) a valid police measure may ripen into a compensable injury where it is excessive; and (c) a measure may not be applied in an arbitrary or discriminatory manner. These three exceptions are explained in greater detail below.

B. Exceptions to the Police Power Defense

1. *Outright or Complete Destruction of Property*

The cases have generally held that a compensable injury may be established where a claimant loses all benefits of ownership. For example, in the case of a forest permit, which is the subject-matter of the Sierra Opinion discussed below, where all of the rights existing under a permit are removed, such as in pursuit of a forest conservation strategy, as opposed to, for example, the failure to comply with the terms of the permit, then a compensation requirement may still apply. As well, this may explain why in *Metalclad* the NAFTA arbitral tribunal stated that Mexico's Ecological Degree would amount to a taking for the purposes of Article 1110 of the NAFTA since the Claimant in that case effectively had its entire benefits of ownership removed. ¹⁴²

In *Sedco*, for example, after recognizing the existence of the police power as an accepted principle of international law, the Iran-U.S. Claims Tribunal provided that "[w]hen an action, as is the case with the application of Clause C, results in an outright transfer of title rather than incidental economic injury, however, a taking must be presumed to have occurred." ¹⁴³ As well, in the *De Garmendia* case, ¹⁴⁴ despite the fact that the specific measure likely constituted a police power measure, ¹⁴⁵ compensation was

ements to pass necessary land-use regulations may work against the protection of pristine ecological habitats.

¹⁴¹ Hippler, *supra* note 87, at 297.

¹⁴² *Metalclad Corp. v. United Mexican States*, ICSID Case No. ARB(AF)/97/1 para. 111 (Aug. 31, 2000)

¹⁴³ *Sedco Inc. v. Nat'l Iranian Oil Co.*, 84 I.L.R. 483, 513 (Iran-U.S. Cl. Trib. 1985).

¹⁴⁴ *De Garmendia Case*, VENEZUELAN ARBITRATIONS OF 1903 10, 13 (1903).

¹⁴⁵ Although not mentioning the police power exception directly, creating a clear view of the port could qualify as a police power measure. For example, in *Lucas v. South Carolina*

awarded to the Claimant after the Venezuelan Government destroyed the Claimant's wooden house in order to provide an unencumbered view of the port.¹⁴⁶ Finally, although finding that the particular facts of the case did not support an expropriation, in *French*, the New York Court of Appeals held that a taking may be found where all benefits are lost regardless of whether there actually has been a physical appropriation of property:

If the majority means that the pesos or the certificates have not been physically taken from Ritter's possession, no one will dispute with this. Since when, however, must there be a physical taking for there to be a "confiscation"? When a zoning law has been held unconstitutional as confiscatory, there is never an actual taking . . . The zoning analogy here is perfect. The police power may not be used to deprive a property owner of all enjoyment of his property. Likewise, the need to preserve a country's international economic position does not permit the destruction of all benefits of contractual rights without limit.¹⁴⁷

The case law seems to support the conclusion that where a measure in pursuit of a police power objective removes all benefits of ownership, either by physical appropriation or indirectly by denying an owner of all economi-

Coastal Council, the United States Supreme Court had to determine whether a taking had occurred after the California Coastal Commission demanded that, in return for a construction permit, the Plaintiff provide the State with a public easement over its property. *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003 (1992). The Commission argued, *inter alia*, that the easement was necessary because it would protect, "the public's ability to see the beach, assisting the public in overcoming the "psychological barrier" to using the beach created by a developed shoreline..." *Id.* Although Scalia J. did not say so definitively, it appears that he would have accepted the necessity of keeping sight-lines open as a valid police power measure (the Plaintiff won on different grounds). Notwithstanding the above, however, it is not clear that the Venezuelan Government's actions were in pursuit of a police power objective. For example, if the government's actions were geared specifically at the claimant's property because the claimant was a foreigner (*i.e.*, applying in a discriminatory manner), then it would not have been a legitimate police power. Alternatively, a tribunal may have found that the measure imposed too great a burden on one individual and was, therefore, not excusable under the police power exception. See *Armstrong v. United States*, 364 U.S. 40, 49 (1960).

¹⁴⁶In the *Upton* case, Commissioner Bainbridge awarded compensation to the claimant after the Venezuelan Government scripted his property into service in order to help the Government fight rebel forces. *Upton Case*, VENEZUELAN ARBITRATIONS OF 1903 172 (prepared by Jackson H. Ralston, 1904). Interestingly, Commissioner Bainbridge not only awarded damages for the property which was completely destroyed, but also awarded partial damage for a single piece of property which, in the Commissioner's opinion, retained some value and use. Considering that the taking here clearly fit within the State's police powers, it is unclear why compensation was awarded for that latter property. For example, in *Kugele*, (referred to favourably by both *Sedco* and the American Third Restatement of the Law) the Court held that a mere economic loss incurred during the exercise of the police powers will not by itself constitute a compensable injury. See *Kugele v. Poland* (*Germany v. Poland*), 6 Ann. Dig. 69 (Upper Silesian Arbit. Trib. 1932)

¹⁴⁷*French v. Banco Nacional de Cuba*, 66 I.L.R. 6, 33 (N.Y. 1968).

cally viable uses of his or her property, a compensable injury may be found.¹⁴⁸

2. *Excessive Measures*

In some cases, a measure aimed at a valid police power objective may result in a compensatory injury because of the excessive manner in which it is applied.¹⁴⁹ Possible marks of excessiveness include situations where a measure runs for an unreasonable period of time, where it applies too broadly, or where it imposes onerous requirements or sanctions. Accordingly, States have an obligation to ensure that their measures do not encroach upon alien property rights to an extent greater than is necessary to achieve their policy goals. According to Wortley, problems of excessiveness often breed in situations where a State misinterprets or misconstrues the nature and meaning of its sovereignty. In other words, where a State feels that it can disregard validly obtained property rights:

In its extreme form, the notion of eminent domain, whereby a State may seize any property for any public purposes on any terms, under its own law, confuses sovereignty with ownership and tends to see the sovereign, not as an institution for the protection of its subjects' rights within the rule of law, but as the real owner of those rights, which, for such reasons as it thinks fit, it may concede or withdraw at will by virtue of its sovereignty.¹⁵⁰

International expropriation law attempts to guard against such abuses. The *Bischoff* case represents an apt example of a valid police measure which resulted in a compensable taking because of the unreasonable length of time in which it applied.¹⁵¹ Despite the fact that Umpire Duffield found that:

The case shows . . . that the carriage was taken in the proper exercise of discretion by the police authorities. Certainly during an epidemic of an infectious

¹⁴⁸ Even this rule is unclear since, for example, penal measures regularly result in a complete loss of property, yet such a loss does not result in an expropriation.

¹⁴⁹ Since Justice Holme's well-cited decision in *Pennsylvania Coal Co. v. Mahon*, the U.S. takings jurisprudence has recognized that a valid police power measure which goes "too far" will entitle a property owner to compensation. 260 U.S. 393 (1922),

¹⁵⁰ WORTLEY, *supra* note 16, at 12-13.

¹⁵¹ In that case, a German national owned and operated a carriage business in Venezuela. In August 1898, after the Government learned that the claimant had carried two passengers with smallpox, the Government detained the carriage from the claimant's premises. At the time, the Government was fighting a small-pox epidemic and wanted to ward-off any further spread of the disease. However, the Government was subsequently informed that its information was incorrect and that the claimant's carriage had in fact not carried any infected passengers. The Government nevertheless kept the carriage for a long period of time. The claimant argued that he was entitled to compensation for the injuries that he sustained as a result of the carriage being detained. *Bischoff Case*, VENEZUELAN ARBITRATIONS OF 1903 581 (prepared by Jackson H. Ralston, 1904).

disease there can be no liability for the reasonable exercise of police power, even though a mistake is made.¹⁵²

He nevertheless held in the claimant's favour on the basis that:

But it is held in a number of cases before the arbitration commission involving the taking and detention of property, where the original taking was lawful, that the defendant government is liable for damages for the detention of the property for an unreasonable length of time and injuries to the same during that period.¹⁵³

The *Bischoff* case demonstrates that a police power measure, otherwise not compensable, may nevertheless result in a compensatory injury where it applies for an excessive period of time.¹⁵⁴

3. Measures which Apply in an Arbitrary or Discriminatory Manner

A fundamental element of a just and democratic legislative and judicial system is that it operates free from arbitrariness and discrimination. This principle is also recognized under international law.¹⁵⁵ The Court in *West*

¹⁵² *Id.* at 581.

¹⁵³ *Id.* Similar reasoning was employed by the U.S. Supreme Court in *First English Evangelical Lutheran Church of Glendale v. County of Los Angeles, California* (despite being a temporary measure, damages were awarded to the Plaintiff on account of the measure imposing an excessive burden on the Plaintiff property owner). 482 U.S. 304 (1987); see also, Glenn H. Boss II and Robert C. Apgar, *Concurrency and Growth Management: Lawyer's Primer*, 7 J. LAND USE & ENVTL. L. 1, 21 (1991).

¹⁵⁴ Of course, this does not mean that a tribunal or panel will always intervene. For example, in *Int'l Bank*, an arbitral tribunal was asked to consider whether the Dominican Republic's forest conservation measures, which imposed a number of cutting restrictions on lumber mills, amounted to an expropriation. In the Matter of Arbitration between Int'l Bank and Overseas Private Inv. Corp. 11 I.L.M. 1216 (1972). The tribunal, after deferring to the stated purpose of the measures, as well as giving leeway to the Government because of its inexperience with conservation measures, found against the Claimant. See *id.* According to the tribunal, the measures were not compensable because they amounted to a valid exercise of the Dominican Republic's right to implement police power measures. See *id.* However, the tribunal noted that compensation may be required where a valid police power measure imposes an excessive burden on an alien property owner:

We, of course, do not feel that any series of police regulations or bureaucratic delays establishing "stop and go" pattern would necessarily be reasonable, or not amount to a "taking" of property, but only that the particular regulations promulgated by the Dominican Government and administratively applied in this case were, under all of the circumstances of the case, not arbitrary, unreasonable, in violation of international law or a "taking" of property requiring payment of compensation under the relevant international standard.

Id. at 1227.

¹⁵⁵ The requirement against discriminatory measures has been rebuked by some jurists as both impossible to detect and unnecessary. These authors generally argue that many expropriations and nationalizations are inherently discriminatory because they are often specifically directed at foreigners in an attempt to facilitate the transfer of economic power and control from aliens to nationals. As well, they explain that it is extremely difficult, if not impossible, to detect. Somarajah, who in the past has argued for strong protection and rights for lesser-income countries, went so far as asserting that even racially-motivated discrimi-

asserted that an otherwise valid measure may be deemed to be an expropriation where it is "so unreasonable or grossly offends against the alien's right to fair and equitable treatment, or so clearly deviates from customary standards of behaviour."¹⁵⁶ In this respect, Dunn noted that:

From a functional point of view, a possible solution would be to retain the rule of intervention but except from its operation all governmental acts infringing upon vested property rights which were the result of *bona fide* social or economic reform, genuinely aimed to benefit the nation as a whole, and were not discriminatory against foreigners as such, nor liable to disturb to an substantial extent the existing methods of carrying on intercourse between nations. Such a rule, while discouraging arbitrary or dishonest governmental acts causing damage to foreigners, would at the same time provide the necessary flexibility in the present system to meet new conditions special conditions in particular part of the world arising from the peculiarities of different peoples. It would in ef-

natory measures should not be disallowed or ruled illegal. Instead, she argues that as long as compensation is available, there is no reason to explore a State's motives:

The better view and the view which the law should accept is to treat the nationalization motivated by reasons of racial discrimination as valid because, as a result of new developments in international law an alternative remedy is provided. Such nationalizations become evidence of racial discrimination and give rise to a distinct cause of action which could be pursued by an injured alien's state. This view would preserve the State's right to nationalize which is supported by modern developments while at the same time ensuring that aliens are protected and discriminatory conduct is deterred.

M. SORNARAJAH, *THE PURSUIT OF NATIONALIZED PROPERTY* 187-188 (1986).

At least on the surface, Somarajah's argument that States must be free to pass whatever measures they deem necessary appears fair. Upon closer review, however, it must be rejected. Somarajah's argument ignores the very meaning and existence of international law and membership in an international community. No system of law, whether it be international or municipal, can legitimately recognize destructive forms of discrimination (*i.e.*, as opposed to other forms, like "reverse-discrimination", which, because they favour one group of people over another, by definition are discriminatory. These forms of discrimination must be excluded because they serve a necessary role in ridding society of built-in biases and disadvantages between people). International law cannot, for example, sanction discriminatory measure similar to those practiced by Nazi Germany during the Second World War where the Nazis confiscated property owned by minorities and dissidents, even had compensation been given. International tribunals and arbitral panels have an important role in guarding against discriminatory measures. The requirement against arbitrariness and capriciousness is similarly required in municipal law. See Laura M. Schleich, *Takings: The Fifth Amendment Government Regulation, and the Problem of the Relevant Parcel*, 8 J. LAND USE & ENVTL. L. 381, 384 (1993).

¹⁵⁶ *West v. Multibanco Comermex SA*, 84 I.L.R. 187, 199 (1987) (relying on *MANN, supra* note 76, at 377). Similarly, Wortley asserted that:

Even genuine health and planning legislation...may be abusively operate, for example, if health or quarantine regulations are imposed not *bona fide* to protect public health, but with the real, though unavowed, purpose of ruining a foreigner trader. When the evidence of such indirect motive is clear, the foreign State concerned may properly protest on the ground that the trader is being unjustifiably deprived of his rights.

Wortly, *supra* note 16, at 110.

fect help to perpetuate the present system by making it more adaptable to a changing world.¹⁵⁷

Ultimately, Dunn asserted that a democratic system demands “just and fairness” by a State’s legislative and judicial processes. Any governmental initiative, whether it be in pursuit of an environmental or other valid police power objective, must not be arbitrary or discriminatory.¹⁵⁸

C. Assessment of the Application and Scope of the Police Power Exception

The full scope of the police powers exception under international law has not yet been fully developed. More case law and attention must be devoted to the exception. The influential *American (Third) Restatement of the Law* suggests that the scope of the police power exception under international law can be discerned through the U.S. takings jurisprudence. After noting in paragraph 712(g) of the *Restatement* that “[a] state is not responsible for loss of property or for other economic disadvantage resulting from bona fide general taxation, regulation, forfeiture for crime, or other action of the kind that is commonly accepted as within the police power of states, if it is not discriminatory,” the accompanying comment to that paragraph provides that “[i]n general, the line in international law is similar to that drawn in United States jurisprudence for purposes of the Fifth and Fourteenth Amendments to the Constitution in determining whether there has been a taking requiring compensation.”¹⁵⁹ According to the *Restatement*, deference should be paid to the U.S. jurisprudence on this matter.

While the suggestion in the *Third Restatement* that the U.S. takings jurisprudence should guide the determination of the scope of the police powers exception under international law is a good one, it is not sufficient. To begin, the scope of the police power exception under U.S. law also is not settled. Since the mid-1970s, there have been a plethora of takings cases at the state and federal levels which have given a wide range of scope—from very narrow to very wide—to the police power exception.¹⁶⁰ As well, the

¹⁵⁷Fredrick Sherwood Dunn, *International Law and Private Property Rights*, 28 COLUM. L. REV. 166, 180 (1928).

¹⁵⁸The requirements prohibiting arbitrary and discriminatory measures are unquestionably incorporated into the NAFTA. Paragraph (b) of Article 1110 provides that a NAFTA Party may not implement a measure which applies in a discriminatory manner. As well, paragraph (c) of that same Article requires that investments of NAFTA investors be accorded both due process of law and the international minimum standard of treatment. See NAFTA, *supra* note 1, arts. 1110(b) and (c).

¹⁵⁹RESTATEMENT, *supra* note 67, at 201, 211. This paragraph of the *Restatement* was favourably referred to in Pope & Talbot, *supra* note 6, at para. 99.

¹⁶⁰For example, in *Penn-Central Transp. Co. v. New York City*, the City of New York designated Grand Central Terminal a “landmark site pursuant to New York State’s “Landmarks Preservation Law”. 438 U.S. 104, 136 (1978). As a result of the designation, the Plaintiff was not permitted to construct a fifty-story building above its structure. The Plaintiff argued that its valuable air rights had been expropriated. The United States Supreme

U.S. courts have suggested numerous tests depending on whether there has been a “physical invasion,”¹⁶¹ no “average reciprocity of advantage,”¹⁶² a

Court did not agree, and held that it “does not interfere with what must be regarded as Penn Central’s primary expectation concerning the use of the parcel.” *See id.* Furthermore, the Supreme Court held that the law still allows the Plaintiff to obtain a “reasonable return” on its investment. Hence, the police power exception was interpreted broadly. This can be contrasted with the U.S. Supreme Court’s decision in *Lucas v. S.C. Coastal Council*, where the South Carolina’s Beachfront Management Act was held to constitute a compensable taking because it limited the Plaintiff’s ability to construct a home on his property. *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003 (1992); *see also Dolan v. City of Tigard* 512 U.S. 374 (1994).

¹⁶¹A physical invasion refers to a situation where a government formally or informally takes property. *Compare Pumpelly v. Green Bay Co.*, 80 US 166 (1871) (plaintiff’s property was flooded as a result of the government constructing a nearby dam), *with United States v. Causby*, 328 U.S. 256 (1946) (liability assessed against the government on the basis that it had authorized constant flights over the Plaintiff’s property). The Supreme Court has held that a permanent physical invasion of land constitutes a compensable injury regardless of the public purpose which it serves. *See Yee v. City of Escondido*, 503 U.S. 519 (1992); *Loretto v. Teleprompter Manhattan CATV Corp.*, 458 U.S. 419, (1982). There are a variety of reasons why a physical invasion has been treated as a bright-line test for establishing a taking. To begin, it is easy to identify. As well, there is a general fear against allowing governments to target certain individuals for expropriation. Some jurists, however, have criticized any attempt to use the physical invasion test as a sole determinant as to whether a taking has occurred. *See Richard A. Epstein, The Seven Deadly Sins of Takings Law: The Dissents in Lucas v. South Carolina Coastal Council*, 26 *LOY. L.A. L. REV.* 955, 959 (1992). Berger also argues that differentiating between losses caused by a physical invasion or a regulatory measure is not appropriate in terms of either justice or economics. *See Lawrence Berger, A Policy Analysis of the Taking Problem*, 49 *N.Y.U. L. REV.* 165, 171 (1974).

¹⁶²This refers to a situation where a property owner is required to do something to his or her property (generally in connection with other similarly situated property owners) and, while the property owner receives some benefit, it is intended to benefit society generally. Under this category, a property owner is not entitled to compensation because, despite the fact that the public receives a benefit, the property owner is better off as a result of the measure:

economic development should be encouraged to benefit the overall quality of life ... The idea that this development made the owner’s overall property interests monetarily more valuable was seen as at least a sufficient offset for the owner’s forced contribution of property or a monetary share of the costs. Although the owner had lost his or her freedom of choice as to how best use his or her property, society had made an efficient choice for the owner, and thus due process of law did not mandate that the regulation be accompanied by compensation.

Hippler, *supra* note 86, at 678.

The Supreme Court’s decision in *Keystone Bituminous Coal Assn v. DeBenedictis*, represents the high-water mark for the average reciprocity of advantage test. 480 U.S. 470 (1987). In that case, after reciting facts which were almost identical to those recited in *Pennsylvania Coal Co. v. Mahon*, the Court broadened the test to include those benefits which one naturally receives as a result of being a member of society: “[w]hile each of us is burdened somewhat by such restrictions, we in turn, benefit greatly from the restrictions that are placed on others.” 260 U.S. 393, 491 (1922); *see also Jackman v. Rosenbaum Co.*, 260 U.S. 22 (1922); *Mahon*, 260 U.S. 393 at 393; *Penn Central Transp. Co.*, 438 U.S. 104, 147 (Justice Rehnquist dissenting); *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003, 1016 (1992).

removal of all or certain strands in the “bundle of rights,”¹⁶³ a “nuisance”¹⁶⁴ or a “noxious use.”¹⁶⁵ Until settled, the U.S. takings jurisprudence cannot

¹⁶³ Property is sometimes described as consisting of numerous strands of rights totalling a “bundle”. Naturally, some of these rights, particularly the right to exclude, have been considered more worthy of protection than others. According to Hippler, the American courts have recently given full vigor and placed considerable emphasis on the “bundle of rights regulatory takings analysis.” Hippler, *supra* note 86, at 656. Generally, removal of one or a few strands from the bundle has been insufficient for establishing a taking. Thus, in *Andrus*, (commenting on two legislative acts which were aimed at protecting eagles and migratory birds and resulting in the Defendant being denied the right to, *inter alia*, sell, barter, export or import eagle feathers which were part of a Native American artefact) the Supreme Court provided that:

The regulations challenged here do not compel the surrender of artefacts, and there is no physical invasion or restraint upon them. Rather, a significant restriction has been posed on one means of disposing of the artefacts. But the denial of one traditional property right does not always amount to a taking, because the aggregate must be viewed in its entirety.

Andrus v. Allard, 444 U.S. 51, 57 (1979).

However, in *Kaiser Aetna v. United States*, the Supreme Court, explaining that “one of the most essential sticks in the bundle of rights that are commonly characterized as property” [is the] right to exclude others”, found for the Plaintiff even though only one strand, the right to exclude, had been removed. 444 U.S. 164 (1979); *see also Dolan*, 512 U.S. at 374.

¹⁶⁴ The principle that compensation will not be owed where a measure is aimed at preventing a nuisance derives from the common law and is embodied in the maxim *sic utere tuo ut alienum non laedas* which has been recognized in both municipal law and, to a lesser degree, international law. *See Village of Euclid, Ohio v. Ambler Realty Co.*, 272 U.S. 365, 388 (1926) [hereinafter *Village of Euclid*]; *Lucas v. South Carolina Coastal Council*, 505 U.S. 1003, 1029 (1992). A nuisance essentially refers to an “annoyance” or some risk caused by one property owner towards a third party or parties. Thus, in *Fertilizing Co. v. Hyde Park*, a Defendant was not required to compensate the Plaintiff after it restricted the Plaintiff’s right to transport wastes through public streets because of the foul smell, insects and health risks associated with the subject wastes. 97 U.S. 659 (1878). The general reason against compensating property owners for losses which they sustain as a result of complying with measures that prevent nuisances (the same applies for “noxious uses”), is that no one has a right to annoy or harm others. As well, it is often not an activity itself which constitutes a nuisance, but rather is the effect that the activity under the particular circumstances, has on others. Justice Sutherland explained a nuisance as “a right thing in the wrong place, like a pig in the parlor instead of the barnyard.” *Village of Euclid*, 272 U.S. at 388.

¹⁶⁵ There is generally little difference between a noxious use and a nuisance. A “noxious use” basically refers to a situation where a government is attempting to prevent the commission of a harm against a third party or parties. *See Hadacheck v. Sebastian*, Chief of Police of Los Angeles, 239 U.S. 394 (1915) (prohibition of a brickyard in a residential area); *Goldblatt v. Town of Hempstead*, 369 U.S. 590 (1962) (restriction against excavating sand and gravel below the water line); *Miller v. Schoene*, 276 U.S. 272 (1928) (destruction of diseased cedar trees in order to prevent infection of nearby apple orchards); *J. Parsons case* (Great Britain v. U.S.) American and British Cl. Arb. 587 (1925) (Report of F.K. Nielsen) (destruction of poisonous alcohol). Once again, the theory against compensating property owners who suffer a loss as a result of complying with an order aimed at a noxious use is that no one has a right to harm others. A restriction under this heading merely requires a property owner to do what she or he is otherwise required to do under the law (*i.e.*, ceasing a harmful activity or inactivity). While this line of reasoning seemingly makes sense, it has not been entirely welcomed. According to Sax, the basis for the noxious use or harm test is that “while in general established economic interests cannot be diminished merely because of a resulting

represent an *opinio juris*. While certain cases may be consulted by international tribunals, as a whole, it cannot be considered determinative.

While the scope of the police power exception is not entirely certain, it remains an important exception to the rule that aliens must be compensated where their property is expropriated or nationalized. For NAFTA Parties, their only excuse for not paying compensation to a NAFTA investor whose investment has been expropriated is if the expropriatory measure constitutes a police power measure. Accordingly, the principle is of vital importance to NAFTA Parties when they implement their environmental measures, such as forest conservation and other environmental programs. Of course, the measure must amount to an expropriation in the first place, otherwise it does not even give rise to a compensation requirement. A mere hindrance that has less than an ephemeral impact on the use and enjoyment of property is not sufficient to establish an expropriation claim.

public benefit, that rule does not apply where the individual whose interest is to be diminished himself created the need for public regulation by his conduct." Sax, *supra* note 133, at 48.

Sax argues that the test necessarily attaches some notion of "moral blameworthiness" in the sense that it places fault on an individual for doing something against the public interest. He complains that it is often not clear that a particular individual deserves that dubious distinction. In other words, a noxious use may derive out of innocuous situations, such as where a company locates to a particular region or site because it was either encouraged to do so or because, at the time of locating, the site or region was barren. In the end, Sax rejected the noxious use test on the basis that while it may be "easy" to administer, it ultimately suffers from the fact that "[i]f we are talking about blameworthiness, some moral wrongdoing or conscious act of dangerous risk-taking which induces us to shift the cost to a particular individual, it simply does not exist in these cases." *Id.* at 50. As well, although for a slightly different reason, Michelman also rejected the noxious use test. According to him, the problem can be illustrated in the following scenario:

For illustration of this approach, let us compare a regulation forbidding continued operation of a brick works which has been annoying residential neighbours with one forbidding an owner or rare meadowland to develop it so as to deprive the public of the benefits of drainage and wildlife conservation. According to the theories we are now to consider, a person affected by the second regulation would have the stronger claim to compensation. But even as to him, the matter is not free of ambiguity. To see this clearly, we can take as a third example a regulation forbidding the erection of billboards along the highway. Shall we construe this regulation as one which prevents the "harms" of roadside blight and distraction, or as one securing the "benefits" of safety and amenity? Shall we say that it prevents the highway abutter from inflicting injury on passing motorists, or that it enhances the value of the public's highway facility? This third example serves to expose one basic difficulty with the method of classifying regulations as compensable or not according to whether they prevent harms or extract benefits. Such a method will not work unless we can establish a benchmark of "neutral" conduct which enables us to say where refusal to confer benefits (not reversible without compensation) slips over into readiness to inflict harms (reversible without compensation).

Frank Michelman, *Property, Utility, and Fairness: Comments on the Ethical Foundations of 'Just Compensation' Law*, 80 HARV. L.R. 1165, 1197 (1967).

For Michelman, the key difficulty is in articulating the difference between a "benefit" and a "harm". However, see the dissenting opinion of Justice Blackmun in *Lucas*, where he criticizes this type of thinking because it ultimately calls into question the value of the common law generally. *Lucas*, 505 U.S. at 1052. Finally, Clarke also condemns this approach since "[e]veryone harms everyone else in one way or another and anything can be harmful." Charles H. Clarke, *The Owl and the Takings Clause*, 25 ST. MARY'S L.J. 693, 695 (1994).

V. MISCONCEPTION AND CONFUSION OVER THE APPLICATION OF CHAPTER
11 OF THE NAFTA

A. Comments on and Opposition to Chapter 11 of the NAFTA

Article 1110 of the NAFTA covers both direct and indirect expropriations, as well as measures tantamount to an expropriation. The specific obligations in Article 1110 are governed by, and are to be interpreted in accordance with, the following three sources of law: interpretation notes by the Commission; the terms of the NAFTA; and international law.

To date, no interpretation note has been issued by the Commission. As such, the only two sources upon which a NAFTA Tribunal could use when interpreting Article 1110 is the terms of the NAFTA itself, as well as general principles of international law.

As noted in Section II above, Article 1131 of the NAFTA provides that a Tribunal shall be guided by the NAFTA as a whole. Both the Preamble to the NAFTA and the *Environmental Side Agreement* provide a number of key objectives that may guide a Tribunal when it considers a claim that arises from an environmental measure. The Preamble to the NAFTA provides, for example, that the Parties are to promote sustainable development, develop and enforce their environmental laws and regulations, and adopt measures that are consistent with environmental protection and conservation. Article 1114 of the NAFTA provides that nothing in Chapter 11 shall be construed to prevent a Party from adopting, maintaining or enforcing any measure that is appropriate to ensure that the investment activity in its territory is undertaken in a manner sensitive to environmental concerns. The *Environmental Side Agreement* explicitly provides that each Party has the right to establish its own level of domestic environmental protection and environmental policies and programs. While none of these provisions trump the possible application of Article 1110 to a measure by a Party, they may assist a tribunal in the determination of the scope of its key terms, either on the basis of what is considered to be reasonable or in respect of the scope of the police powers exception.

In addition to being informed by the terms of the NAFTA itself, international law has developed a set of rules and principles to determine the existence of an expropriation. While some commentators on the NAFTA claim that any interference with property rights will result in a compensable injury, this is not consistent with general principles of international law. In order for an interference with the use and enjoyment of an investment to amount to an expropriation, the measure must be unreasonable and/or the negative effect on the investment must be more than ephemeral. While this is not explicitly stated in Chapter 11, it is required under international law; the law applicable to the interpretation of Chapter 11 of the NAFTA.

This is not to suggest, however, that expropriation law is completely settled and that no "shadow land" exists. There clearly is confusion over the dividing line between a reasonable and an unreasonable measure; a

temporary and a permanent interference; and an ephemeral versus a significant effect. However, flux in the application of the law is not unique to Article 1110, or to Chapter 11 generally. By its nature, law is constantly evolving. To suggest that because the law of expropriation is still evolving the NAFTA Parties should abandon Chapter 11 altogether is, to quote an oft repeated phrase, "to throw the baby out with the bath water." The underlying basis for Chapter 11, namely to encourage trilateral direct investments between the Parties, has not changed.¹⁶⁶ Furthermore, the arguments raised against Article 1110 ignore the existence of the police powers exception which gives the Parties wide latitude to implement measures in support of the environment or forest conservation.

Notwithstanding the wide and extensive attention given to Chapter 11, in reality, there have been relatively few claims initiated thereunder. Between 1994 and 1999, there have only been approximately fourteen notices of intent to initiate a claim under NAFTA Chapter 11:¹⁶⁷ six against Canada;¹⁶⁸ three against the United States;¹⁶⁹ and four against Mexico.¹⁷⁰ Considering that there has been hundreds of billions of dollars in foreign direct investment by NAFTA investors in the territory of the three NAFTA Parties, the total number of claims is minuscule.¹⁷¹

¹⁶⁶This purpose was explicitly recognized by the NAFTA arbitral tribunal in *Metalclad*.

¹⁶⁷Because the process is conducted behind closed doors, it is unclear just how many claims have been formally initiated against a Party. As such, it is entirely possible that there have been a few additional (or less) claims initiated pursuant to Chapter 11 than the fourteen stated herein. As well, it should be further borne in mind that some of the claims have not gone beyond the notice of intent stage.

¹⁶⁸Between 1994 and 1999, the following companies have been reported as having submitted a notice of intent to initiate a claim against the Government of Canada: Signa S.A. de C.V., Ethyl Corporation (the Government of Canada settled, see *supra* note 3), S.D. Myers Inc., Pope & Talbot (the arbitral tribunal released its decision with respect to Articles 1106 and 1110 only), Sun Belt Water, Inc., United Parcel Service, and Waste Management Incorporated. For a copy of pleadings, see *Trade Negotiations and Agreements*, Department of Foreign Affairs and International Trade, at <http://www.dfait-maeci.gc.ca/tna-nac/NAFTA-e.asp#UPS> (last updated Dec. 19, 2000).

¹⁶⁹Between 1994 and 1999, the following companies have been reported as having submitted a notice of intent to submit a claim against the U.S. Government: The Loewen Group, Inc., Methanex Corp, and Mondev (supporting documents on file with the author).

¹⁷⁰Between 1994 and 1999, the following companies initiated a claim against the Government of Mexico: DESONA, MetalClad Corp. (the Claimant was successful under both Articles 1105 and 1110 of the NAFTA), Waste Management Inc., and Karpa (on behalf of Corporacion de Exportaciones Mexicanas, S.A. de C.U. – CESMA) (supporting documents on file with the author).

¹⁷¹According to a recent report card on the NAFTA, investment to Canada from the United States reached Cdn\$147.3 billion in 1998, up 63% from 1993, while investment to Canada from Mexico reached Cdn\$464 million in 1998, tripling from 1993. In 1998, 68% of foreign direct investment in Canada originated from a NAFTA country. THE DEPARTMENT OF FOREIGN AFFAIRS AND INTERNATIONAL TRADE (CANADA), *THE NAFTA AT FIVE YEARS: A PARTNERSHIP AT WORK* 15-17 (1999).

Yet, notwithstanding that relatively few claims have been initiated under Chapter 11 and, in any event, that Chapter 11 is grounded in established principles of international law, there have been numerous doomsday predictions about the impact that Chapter 11 has, or will have, on the ability of the NAFTA Parties to implement necessary environmental and other social-based legislation. Such dire predictions have not only emanated from traditional opponents to free trade, but also from more mainstream commentators. For example, the following comments have been made regarding Chapter 11:

The controversial Chapter 11 clause of NAFTA, which the Canadian government is seeking to amend, allows companies to seek compensation from the governments of Canada, Mexico or the U.S. for imposing measures that impede commerce.¹⁷²

A largely defensive measure has become a strategic offensive weapon to promote the interests of some corporations. (David Runnalls, President of the International Centre of Sustainable Development)¹⁷³

I would say NAFTA negotiators did not expect this provision would be used as much as it has been by private companies. (Bill Merkin, Washington Trade Consultant and former U.S. negotiator)¹⁷⁴

As well, under Chapter 11, the "investor-state" clause of NAFTA, U.S. corporations have the right to sue for cash compensation if Canadian governments, federal or provincial, implement laws that affect their bottom-line profits. Several recent Chapter 11 challenges have prevented Canada from setting its own environmental and health standards and have placed its natural resources at risk. (Maude Barlow, National Chair of the Counsel of Canadians)¹⁷⁵

That's [Chapter 11], the provision that allows private corporations to sue countries for lost profits.

It would appear from some of the cases that have appeared that any time a company is damaged in some way or form, or even where they may not be damaged, they feel that they have a recourse to Chapter 11 and NAFTA, and that's clearly not the intent of the parties. (Second comment made by former Canadian International Trade Minister, Sergio Marchi)¹⁷⁶

Under the umbrella of international trade pacts, a spate of recent lawsuits by outsiders has toppled environmental laws and so-called selective purchasing laws in Massachusetts. In Mississippi, a Canadian funeral home operator is using NAFTA to challenge an unfavourable court verdict.

¹⁷² Southland Focus: Methanex Files Suit Over Gas Additive Ban, L.A. TIMES, June 25, 1999, at C-2.

¹⁷³ David Runnalls, *quoted in NAFTA Lawsuits on the Rise - Think Tank Warns Environment Will Suffer*, TORONTO STAR, June 23, 1999, at 1.

¹⁷⁴ Bill Merkin, *quoted in Damage Claims Upset NAFTA: Methanex Action may Boost Plan to Limit Damage Suits*, NATIONAL POST, June 17, 1999, at C-12.

¹⁷⁵ Maude Barlow, *Commentary*, TORONTO GLOBE AND MAIL, May 28, 1999, at A15.

¹⁷⁶ *NAFTA Members Taking Stock on 5th Anniversary - Marchi Hopes for Some Action on Trade Irritants*, TORONTO STAR Apr. 20, 1999, at 1.

U.S. and Canadian critics are worried about an obscure provision of the *North American Free Trade Agreement*, or NAFTA, that gives foreign investors a powerful weapon to attack laws they deem discriminatory, particularly in the environmental and health safety arenas.¹⁷⁷

As concerned as we were, we underestimated the potential power grab and damage potential to the fundamentals of governance. (Lori Wallach, Director, Public Citizen's Global Trade Watch)¹⁷⁸

No one quite understood or anticipated where it [Chapter 11 of the NAFTA] would go. (Barry Appleton, Canadian trade lawyer)¹⁷⁹

An issue that should not be neglected in considering potential threats to the Canadian health system is the impact of Chapter 11 of NAFTA. This chapter deals with the rights of cross border investors in the three countries. It contains provisions repeating the duty of states to compensate investors whose interests are expropriated. The object is to protect property owners in the event of a public taking of their property. However, in a number of instances (See Soloway, *Note in the 1999 Canadian Yearbook of International Law*) Companies subject to regulatory action by the NAFTA governments have argued that their property has been expropriated, or have otherwise suffered damage through a violation of Chapter 11. In one instance, where the Canadian government closed its borders to the importation of the gasoline additive MMT, without at the same time banning the production of the chemical in Canada, the company alleged and successfully won damages from the Federal Government on the grounds that their investment in Canada had been expropriated. This is arguably a very forced interpretation of the concept of expropriation but it was successful.

The concern that regulatory action in respect of public health will be characterized as expropriation is thus a serious issue. (Gottlieb & Pearson, for the Canadian Health Coalition)¹⁸⁰

¹⁷⁷ *Trade Pacts Accused of Subverting U.S. Policies Commerce: Critics say Agreements such as NAFTA Give Foreign Interests Legal Ammunition to Influence Economy as well as Safety, Health and Other Issues*, L.A. TIMES, Feb. 28, 1999, at A1.

¹⁷⁸ *Id.*

¹⁷⁹ *Id.* The newspaper article noted that Barry Appleton was of the view that the NAFTA has created an unexpectedly broad avenue for legitimate domestic regulations to be challenged under international law. Mr. Appleton's comments are interesting in light of the fact that of the six notices of intent to initiate a claim submitted to the Government of Canada under Chapter 11, Mr. Appleton has been involved on the claimants'-side for at least four of them. As such, possibly more than any person, Mr. Appleton has had a major influence in the types and breadth of claims initiated under Chapter 11 of the NAFTA.

¹⁸⁰ Canadian Health Coalition, *Who's Protecting Health and Medicare at Trade Talks*, (Oct. 29, 1999), at <http://www.healthcoalition.ca/release/10299.html>. Gottlieb and Pearson argued that health care should be exempt from international trade under the rubric of the precautionary principle. This would include trade matters pertaining to the sale of biotechnology products and the provision of health care services. Examples of how Chapter 11 could apply to the provision of health care services include, for example, if a party attempted to close a biotechnology lab, in whole or in part, because it considered that the lab's new developmental products were potentially unsafe; or, separately under Article 1102 if a party attempted to create rules and requirements designed to assist domestically owned controlled labs only.

An important, but little-known component of NAFTA is the new power it grants to private corporations to directly attack laws and policies they deem harmful to profitability. Under NAFTA's new investment protections (Chapter 11), the decisions made by local and national governments in all three NAFTA countries are now subject to challenge before NAFTA tribunals by corporate plaintiffs. . . And NAFTA has been wielded as a weapon to attack federal and sub-federal environmental and public health safeguards, with a series of legal challenges to countries environmental laws launched by corporations using NAFTA's investment provisions (Chapter 11).¹⁸¹

The above statements concerning the scope and application of Chapter 11 of the NAFTA are by no means exhaustive. However, a recurring theme in most of the criticisms of Chapter 11 is that the Chapter will expose the parties to costly claims arising from legislation or other measures which adversely impacts the value, profitability or use of their investments.

The majority of the criticisms regarding Chapter 11 ignore issues of degree and, either explicitly or implicitly, suggest that any negative impact on property rights will give rise to a compensable injury. In attempting to substantiate their criticisms of Chapter 11, these commentators variously point to the supposed successful claim by Ethyl (see the Ethyl decision at note 3) the "plethora" of cases initiated under Chapter 11 and the fact that NAFTA Chapter 11 requires the application of vague principles of international law. In reality, however the Canadian government's decision to compensate Ethyl was not necessarily based on the merits of Ethyl's claim but on the fact that an earlier AIT Panel already found that the Government did not have the necessary scientific evidence to support its legislation. In both *DESONA* and *Pope & Talbot*, the NAFTA arbitral tribunals refused to compensate the Claimants merely because the value of their investments had been negatively impacted by a valid governmental measure. Indeed, in *Pope & Talbot*, the NAFTA arbitral tribunal rejected the notion that reduced profitability is sufficient to make out a claim under Article 1110, instead finding that there must be evidence that the interference is substantial.¹⁸² In *Metalclad*, while the NAFTA arbitral tribunal found in favour of the Claimant, it is instructive to note that the Claimant lost all benefits of ownership. Notwithstanding the Tribunal's comments regarding the Ecological Decree, at the end of the day the NAFTA Tribunal's decision was unrelated to any environmental or health risk since the NAFTA Tribunal was satisfied that the Claimant was complying with all environmental, health and safety requirements of Mexico. While some hazy areas remain

¹⁸¹ Public Citizen Global Trade Watch, *School of Real-Life Results: A Report Card*, (December 1998), at [http://www.citizen.org/pctrade/NAFTA/reports/five years.htm](http://www.citizen.org/pctrade/NAFTA/reports/five%20years.htm).

¹⁸² Specifically, the arbitral tribunal stated that: "Even accepting (for the purpose of this analysis) the allegations of the Investor concerning diminished profits, the Tribunal concludes that the degree of interference with the Investment's operations due to the Export Control Regime does not rise to an expropriation (creeping or otherwise) within the meaning of Article 1110." *Pope & Talbot*, *supra* note 5, at para. 102.

over the demarcation point between an expropriation and the police power exception, to suggest that the law is completely unsettled or that there is a complete paucity of general principles of law is inaccurate and exaggerated.

A more tempered approach to Chapter 11 of the NAFTA is needed. The Canadian government has already suggested that either an amendment to or the adoption of an interpretative note is necessary in order to limit the scope of the Chapter and, thus, protect future environmental and health measures. In response to such suggestions, it was reported that Mexican Trade Minister, Hermino Blanco, noted that “[w]e still have to see the way in which panelists will decide in the different cases we have in front of us.”¹⁸³ Minister Blanco’s approach is the appropriate one. The governments of Canada, Mexico and the United States cannot allow their trade and investment agenda to be driven by a few vocal opponents to the NAFTA. Many of these opponents have an agenda that extends beyond Chapter 11. For many of these opponents, Chapter 11 represents an anchor upon which they can express their broader opposition to free trade and investment. While the Canadian government is now leading the charge towards the adoption of an amendment to or reform of Chapter 11, it was not long ago that the former Canadian Minister of International Trade, Sergio Marchi, wrote the following in an open letter to Ms. Maude Barlow, Chairperson of The Counsel of Canadians and an ardent opponent of free trade, with respect to Canada’s support of the (then) proposed MAI:

It appears, regrettably, that you and your organization do not want your fear-mongering to be impeded by knowledge of the facts.

My priority as Minister is trade promotion and promoting Canada’s best interests. Your priority appears to be book promotion and otherwise advancing your own interests. This is your prerogative, but I find it unfortunate that you persist in needlessly alarming and misleading Canadians while continuing to ignore the facts of the situation.

The Government of Canada will be well served to keep the above in mind when it considers either amending or reforming Chapter 11 of the NAFTA.¹⁸⁴

The so-called “fear-mongering” by the opponents to Chapter 11, as expressed by Minister Marchi in his letter to Ms. Barlow, has not been restricted to issues pertaining to broad policy matters. Recently, the Sierra Club attempted to use Chapter 11 of the NAFTA to thwart Weyerhaeuser’s Cdn \$3.59 billion acquisition of MB. The Sierra Club, along with certain

¹⁸³ *Mexico, Canada at Odds on NAFTA Rules Changes – Marchi Pushing for Clarification on Investments*, TORONTO GLOBE AND MAIL, June 19, 1999, at B2.

¹⁸⁴ Letter from Sergio Marchi, International Trade Minister, Canada, to Maude Barlow, National Volunteer Chairperson to The Council of Canadians (Mar. 19, 1998), at <http://www.dfait.maeci.gc.ca>. Minister Marchi’s comments were made in response to Ms. Barlow’s attempts to bring into question the efficacy of the MAI. Ms. Barlow was one of the key architects in the public interest campaign which ultimately led to the demise of the MAI.

other environmental groups, appeared at numerous public hearings to express their concern over the MB Acquisition, arguing that the British Columbia government would be susceptible to costly litigation by Weyerhaeuser under Chapter 11 of NAFTA. Ms. Lisa Matthaus, a policy analyst with the Sierra Club, was reported as stating that "Chapter 11 of NAFTA allows investors from one member country to demand compensation if the government of another member introduces a law that interferes with an investment."¹⁸⁵ The Sierra Club commissioned a legal opinion from a Canadian lawyer, Ms. Jessica Clogg, on the application of Chapter 11 to the MB Acquisition. In the end, the Sierra Opinion concluded that:

In my opinion, Minister of Forests' consent to the Weyerhaeuser acquisition of MB will create a NAFTA liability that will impede the realisation of these objectives:

NAFTA would allow Weyerhaeuser to seek compensation in situations where none would be payable to a Canadian company, or in greater amounts. In particular, NAFTA would create obstacles for reducing the cut on lands controlled by Weyerhaeuser. NAFTA also puts major limitations on the provincial government's capacity to effectively legislate in areas otherwise entirely within its jurisdiction.¹⁸⁶

B. Sierra Club of British Columbia's Opposition to the Acquisition of MacMillan Bloedel Limited by Weyerhaeuser Company

1. Description of the MacMillan Bloedel Acquisition

On June 21, 1999, Weyerhaeuser and MB jointly announced the then proposed MB Acquisition. Under the terms of this agreement, MB shareholders would receive, in exchange for each MB share, either 0.28 shares of common stock in Weyerhaeuser or 0.28 equivalent exchangeable shares in a new Weyerhaeuser Canadian subsidiary. According to a press release by Weyerhaeuser, the MB Acquisition would result in significant benefits to the combined shareholders, such as "through savings in transportation and distribution, improving purchasing practices, increasing the balance in its manufacturing system and streamlining operations."¹⁸⁷

Prior to the MB Acquisition, MB was the largest forest company in Canada, with operations in timberlands, containerboard packaging and solid wood products. As part of the transaction, Weyerhaeuser acquired, among

¹⁸⁵ MacBlo Takeover Approval May Put B.C. in Legal Bind: Timber Cutting Licences May Become Issue, Hearing Told, NATIONAL POST, Sept. 8, 1999, at C6.

¹⁸⁶ Jessica L. Clogg, Letter Regarding Proposed Acquisition of MacMillan Bloedel by Weyerhaeuser – NAFTA Chapter 11 Implications (Sept. 2, 1999), at <http://felix.vcn.bc.ca/wcel/forestry/0902weyernaftasub.html> [hereinafter Sierra Opinion].

¹⁸⁷ Weyerhaeuser Official Web Site, Press Release, *Weyerhaeuser Completes Acquisition Of Macmillan Bloedel; Haskayne To Join Weyerhaeuser Board Of Directors* (Nov. 1, 1999), at <http://www.wy.com/news/mb/default.asp>.

other assets, approximately 6.5 million acres of productive timberlands in Canada, three containerboard mills and 19 converting facilities, six lumbermills and sawmills in Canada, two Canadian plywood facilities and three oriented strand board (OSB) facilities.¹⁸⁸ Weyerhaeuser also sought the re-allocation of MB's four replaceable forest license agreements (two in partnership), two tree farm licenses and 263 timber licenses, which, in total, allowed MB to cut 5.6 million cubic metres of wood annually on Crown (British Columbia) lands.¹⁸⁹

Prior to the MB Acquisition, Weyerhaeuser, through its Weyerhaeuser Canada, Ltd. ("Weyerhaeuser Canada") subsidiary, was already a significant participant in the Canadian forest products industry. Weyerhaeuser Canada employed 5,800 people, with operations in British Columbia, Alberta, Saskatchewan and Ontario. As well, it held renewal, long-term licenses on more than 27 million acres of forest land.¹⁹⁰ Following the MB Acquisition, the Weyerhaeuser family of companies became not only the largest forest company in Canada, but one of the largest forest companies globally. Following both shareholder approval and the approval of and/or review by numerous regulatory authorities in Canada and in the United States, the MB Acquisition was completed on November 1, 1999.

Among the various regulatory authorities that had to approve or otherwise review the MB Acquisition was the B.C. Department of Forests. As part of its review process, the Department of Forests held numerous open town-hall meetings. The Sierra Club and other environmentalists appeared before the Department of Forests, urging the Minister of Forests to reject the MB Acquisition. In support of its position, the Sierra Club tabled the Sierra Opinion which, as discussed below, predicted that if the MB Acquisition were allowed to proceed, it would have dire consequences on the continued ability of the B.C. Government to regulate in favour of the environment, adopt forest conservation measures and settle First Nations' land claims. The general conclusions arrived at by Ms. Clogg in the Sierra Opinion are discussed in the subsection that follows.

2. *Sierra Opinion*

The Sierra Opinion concludes that Article 1110 of the NAFTA "would create obstacles for reducing the cut on lands controlled by Weyerhaeuser."

¹⁹¹ NAFTA also puts major limitations on the provincial government's capacity to effectively legislate in areas otherwise entirely within its jurisdiction. As a result, the Opinion recommends that the B.C. Government refuse

¹⁸⁸ See Press Release, *Weyerhaeuser Company completes acquisition of MacMillan Bloedel* (Nov. 1, 1999), at <http://www.wy.com/news/mb/qassets.htm>.

¹⁸⁹ See Sierra Opinion, *supra* note 186.

¹⁹⁰ See *Weyerhaeuser Operations in Canada: Overview* (Apr. 1, 1999), at <http://www.wy.com/canada>.

¹⁹¹ Sierra Opinion, *supra* note 186, at 12.

to grant the transfers necessary for Weyerhaeuser to complete the MB Acquisition.

The Sierra Opinion correctly noted that, following the MB Acquisition, Weyerhaeuser may be entitled to compensation in the event that its investments in Canada were expropriated. This is not, however, a particularly insightful or, even, significant statement. Provided that Weyerhaeuser could establish the prerequisites to establishing a claim, such as that the alleged expropriation occurred as a result of a “measure,” that Weyerhaeuser is an “investor” and that it controls an “investment in Canada,” all of which the Sierra Opinion assumes to be the case, and, for the purposes of this paper, is accepted to be true, provided that no lawful excuse exists (e.g., police powers measure or that a valid reservation exists), there is no debate that Article 1110 of the NAFTA would entitle Weyerhaeuser to compensation. Article 1110 states as much. The real significance is over the degree of effect that is necessary to establish a claim. It is here that the Sierra Opinion exaggerates and misstates the application of Chapter 11 of the NAFTA.

The Sierra Opinion assumes that virtually any measure in support of forest conservation or the environment that touches upon a NAFTA investor’s investment will amount to a compensable injury under the NAFTA, and, as a result, the B.C. Government will opt not to implement such measures. The Sierra Opinion notes that:¹⁹²

if [the B.C. government] did any of the following, Weyerhaeuser could claim compensation under Article 1110 of NAFTA, on the basis that the government had expropriated property or that its actions were tantamount to expropriation:

- created protected areas, including provincial parks, ecological reserves and designations under the *Environment and Land Use Act*, involving any Crown land under license to Weyerhaeuser or its subsidiaries;
- created critical wildlife areas under the *Wildlife Act* involving any Crown land under license to Weyerhaeuser or its subsidiaries;
- settled First Nations treaties involving any Crown land under license to Weyerhaeuser or its subsidiaries;

¹⁹² *Id.* at 6.

- established resource management zone objectives (e.g., special management zones) and landscape unit objectives (e.g., forest ecosystem networks or old growth management areas) under the Forest Practices Code that had the effect of reducing the cut levels of Weyerhaeuser or its subsidiaries;
- did not replace Weyerhaeuser's licenses when they came due for replacement but rather let them run their full term (this could occur as part of an initiative to reallocate the land or volume to communities when the licenses expired);
- reduced the allowable annual cut for a supply area, and the allowable annual cut for licensees in it under section 63 of the *Forest Act*, in order to redistribute the volume to other individuals, communities or companies;
- reduced, through the Timber Supply Review process, the annual allowable cut for Weyerhaeuser's tree farm licenses, or timber supply areas where Weyerhaeuser holds forest licenses.

The Sierra Opinion further states that under Canadian law the Crown retains the right to take away property without being liable to compensate injured property owners. In support of this, the Sierra Opinion cites numerous examples under B.C.'s *Forest Act*. For example, according to Ms. Clogg, the *Forest Act* permits the B.C. Government to do the following things without having to compensate licensees: (i) make proportionate reductions in the annual allowable cut for forest licensees; (ii) reduce the annual allowable cut when a licensee fails to live up to various environmental and processing obligations; and/or (iii) remove up to 5% of the volume or area of a license without compensation.¹⁹³ The Sierra Opinion implicitly, if not explicitly, concludes that, unlike under the *Forest Act*, a NAFTA investor, in this case Weyerhaeuser, would be entitled to compensation under Article 1110 of the NAFTA in the event that the B.C. Government exercised any of the above enumerated legislative powers which, as a result, negatively impacted upon its timber licenses.

¹⁹³ See *id.* at 7.

The Sierra Opinion, thus, argues that first, “. . . virtually any activity that reduces the profitability of the Weyerhaeuser subsidiaries carrying on business in B.C. could be caught by Article 1110 of NAFTA,”¹⁹⁴ and second, Chapter 11 “place(s) a major limitation on the provincial government’s capacity to effectively legislate in an area otherwise within its provincial jurisdiction.”¹⁹⁵

Ms. Clogg does not, however, cite a single case or authority for her conclusions. Rather, after stating that there “. . . has yet to be any arbitral or judicial consideration of the NAFTA expropriation and compensation provisions,” Ms. Clogg expressly admits that she has “. . . set out what I consider the most likely interpretations of these [i.e., Chapter 11 generally, and Article 1110 specifically] provisions; however, we simply cannot predict with certainty how a claim under Chapter 11 of NAFTA will be resolved.”¹⁹⁶ Rather than examining international law, the Sierra Opinion relies exclusively on the breadth of claims alleged under Chapter 11 of the NAFTA.

In addition to arguing that the NAFTA will have a drastic impact on the B.C. Government’s ability to legislate in favour of the environment and forest conservation, the Sierra Opinion also reviewed, and was critical of, the procedures for initiating a claim under Section B, Chapter 11 of the NAFTA. This aspect of the Sierra Opinion is outside of the scope of the paper and, as such, is not considered further herein. As well, the Sierra Opinion examined the scope of certain key provisions of Chapter 11, such as the meaning of investor and investment, but again this discussion is outside of the scope of this paper. Instead, borrowing from the discussion of the international law of expropriation in Sections III and IV above, the conclusions reached by the Sierra Opinion regarding the application of Article 1110 of the NAFTA to measures by the B.C. government in support of the environment and forest conservation, such as those prescribed under B.C.’s *Forest Act*, are considered in the next Section.

VI. ARTICLE 1110 OF THE NAFTA AND THE MACMILLAN BLOEDEL TRANSACTION

A. Principal Comments on the Sierra Opinion

The Sierra Opinion suggests that virtually any interference with an investment of a NAFTA-investor would give rise to a concomitant obligation on the offending Party to compensate the injured NAFTA-investor. Owing to this expansive interpretation of Article 1110, the Sierra Opinion recommended that the B.C. Government refuse to make the necessary realloca-

¹⁹⁴ *Id.* at 6.

¹⁹⁵ *Id.* at 7.

¹⁹⁶ *Id.* at 3.

tions necessary to allow Weyerhaeuser to complete the MB Acquisition. By so doing, the Sierra Opinion turned Chapter 11 on its head in that it used the Chapter, which establishes rules to ensure the fair, transparent and non-discriminatory treatment of investments of investors in the territory of a NAFTA Party, as a sword to argue against foreign investment in Canada.¹⁹⁷

The discussion in Sections III and IV of this paper demonstrated that the interpretation of Article 1110 suggested by the Sierra Opinion is, for the most part, exaggerated. The Sierra Opinion did not cite a single "judicial decision [or] teaching of the most highly qualified publicist," two sources of international law stated in Article 38(1)(d) of the *Statute of the ICJ*. While the Sierra Opinion correctly notes that the international law of expropriation is not entirely settled, it is a far cry from being non-existent. As already demonstrated, there exists significant jurisprudence regarding both expropriation and police powers in international law (i.e., the writings of esteemed jurists and arbitral decisions). Most of the confusion derives from the application of the facts of a particular case to the principles of law. However, a similar difficulty pervades both domestic and international law generally. There is a significant difference between unsettled and evolving, on the one hand, and non-existent and void of principles, on the other hand. The international law of expropriations falls into the former category.

Simply stated, in order for an impugned measure to constitute an (indirect) expropriation, or a measure tantamount to an expropriation, it must be unreasonable and/or must result in a substantial deprivation or effective loss of the use and enjoyment of an investment. A compensable injury will not arise where there has been a mere interference with property that does not exceed a threshold negative impact level. Where the impact of a measure on an investment is merely ephemeral, subject to the specific facts of the case, it will not amount to an expropriation. Furthermore, with respect to measures in support of the environment and forest conservation, international law recognizes the principle of police powers. Professor Brownlie explained the existence of the police power defense as follows:

¹⁹⁷Interestingly, had the B.C. Government followed the Sierra Opinion, and thus not allowed the MB Acquisition to be completed for fear of a potential future NAFTA claim, the B.C. Government would have been susceptible to a claim under Chapter 11 on the basis that such denial was discriminatory and, possibly expropriatory. Briefly, Article 1139 of the NAFTA defines an "investor of a non-Party" to include an investor that "seeks to make" an investment. On that basis, had the B.C. Government denied the MB Acquisition because it was susceptible to a future claim, depending on the facts (e.g., if a Canadian or non-NAFTA investor ended up being entitled to acquire MB), Weyerhaeuser may have been able to allege discrimination under either Articles 1102 or 1103, or expropriation under Article 1110. As well, the B.C. Government would not have had any justification to excuse its actions. Since Weyerhaeuser's loss would not have resulted, for example, from an environmental or forest conservation measure, but rather for fear that Weyerhaeuser may later initiate a claim under the NAFTA, the Government could not have pointed to the police powers exception. The Sierra Opinion may have, therefore, inadvertently recommended a strategy that would, itself, result in a compensable injury under Chapter 11.

State measures, prima facie a lawful exercise of powers of government, may affect foreign interests considerably without amounting to expropriation. Thus foreign assets and their use may be subjected to taxation, trade restrictions involving licenses and quotas, or measures of devaluation. While special facts alter cases, in principle such measures are not unlawful and do not constitute expropriation.¹⁹⁸

Similarly, as already noted, the *Third Restatement* confirms that “[a] state is not responsible for loss of property or for other economic disadvantage resulting from bona fide general taxation, regulation, forfeiture for crime, or other action of the kind that is commonly accepted as within the police power of states, if it is not discriminatory.”¹⁹⁹ While the demarcation first, between a regulatory interference and an expropriation, and second, between a compensable injury on the basis of an expropriation and a non-compensable injury on the basis of the police powers defense, is not entirely certain, a NAFTA Tribunal would be informed by the environmental principles expressed in the NAFTA (e.g., in the Preamble, in Article 1114 and in the *Environmental Side Agreement*).

Ms. Clogg was of the view that any incursion on an investment is compensable. For example, the Sierra Opinion indicates that any of the following incursions on Weyerhaeuser’s investment would amount to an expropriation: creation of protected areas or wildlife areas; reduction in cut levels; reduction in allowable annual cut for timber supply areas; 5% holdback on the volume or area of a license; etc. Except in the case of the 5% holdback, the Sierra Opinion does not delineate different treatment depending on the degree of impact that these measures have on an investor’s investment. However, the previous review of the law suggests that in order to constitute an expropriation, the affect on the investor or investment must be substantial. The 5% holdback is certainly not more than ephemeral. However, to conclude that all of the above-stated measures would automatically be compensable under Article 1110 of the NAFTA, as the Sierra Opinion does, is not consistent with the law.²⁰⁰

¹⁹⁸ BROWNLIE, *supra* note 15, at 532.

¹⁹⁹ RESTATEMENT, *supra* note 67, at § 712, cmt. g. This Commentary was adopted by the Iran-U.S. Claims Tribunal in *Emanuel Too v. Greater Modesto Insurance Associates* (29 December 1989), 23 *Iran-U.S. C.T.R.* 378, 387 (1991).

²⁰⁰ In fact, the Sierra Opinion itself seems to acknowledge that the nature of a measure cannot be considered in a vacuum, but instead must be considered in light of its affect on an investor. At page 6 of the Opinion, Ms. Clogg states that “government action that affects property controlled directly or indirectly by Weyerhaeuser in BC is caught by Article 1110”. Sierra Opinion, *supra* note 186, at 6. The Opinion then provides a shopping list of measures that, if carried out by the B.C. Government, would constitute an expropriation. *Id.* at 7. The Sierra Opinion, then compares this to Canadian law where, according to Ms. Clogg, in order for a measure to be expropriatory the value of the negatively impacted property must approach zero: “In general, before expropriation is said to occur in Canadian law, the value of the property expropriated must be reduced to zero, and there must be a corresponding acquisition of that value by the government.” *Id.* A comparison of the two above statements

The Sierra Opinion relied entirely on the breadth of the claims initiated by investors under Chapter 11 to conclude that Article 1110 of the NAFTA has extended broad rights to NAFTA investors. While this could, arguably, be a barometer for the types of claims that may be initiated under the NAFTA, it is certainly not binding or particularly meaningful to an analysis of the application of Article 1110. In any event, since the Sierra Opinion was prepared, the decision in *DESONA* and *Pope & Talbot* demonstrate that NAFTA arbitral tribunals are not going to greatly expand the scope of Chapter 11. In *DESONA*, for example, the NAFTA Tribunal firmly held that, in order to establish that a Party violated its commitment under Chapter 11, the impugned measure must be one that falls within the four corners of a specific obligation under that Chapter. Specifically, commenting on the claimant's argument that the Ayuntamiento (the relevant governmental authority in Mexico) expropriated its investment through the breach (termination) of its concession contract over local waste disposal operations, the NAFTA Tribunal stated that:

To put it another way, a foreign investor entitled in principle to protection under NAFTA may enter into contractual relations with a public authority, and may suffer a breach by that authority, and *still not be in a position to state a claim under NAFTA*. It is a fact of life everywhere that individuals may be disappointed in their dealings with public authorities, and disappointed yet again when national courts reject their complaints. It may safely be assumed that many *Mexican* parties can be found who had business dealings with governmental entities which were not to their satisfaction; Mexico is unlikely to be different from other countries in this respect. NAFTA was not intended to provide foreign investors with blanket protection from this kind of disappointment, and nothing in its terms so provides.²⁰¹

made in the Sierra Opinion would seem to suggest that international law and domestic law are drastically different in that virtually any negative impact would be a compensable injury under the former but not under the latter. However, it seems that the Sierra Opinion later acknowledges that the degree of impact is also important to establishing a claim under international law. In particular, the Sierra Opinion states that:

Experience with other claims made under Article 1110 indicates that Weyerhaeuser could conceivably seek compensation for virtually any government action that reduces the operations or profits of its Canadian subsidiaries, in any part of its licence areas, or in relation to any of its processing facilities. However, experience also demonstrates that *such a claim would become more likely as the reduction in the value of its investment approached 100 percent* (emphasis added).

Id. at 8.

Unfortunately, the Sierra Opinion never definitively acknowledged that the degree of impact, rather than just any impact, is important to establishing a claim under Article 1110 of the NAFTA.

²⁰¹ See Robert Azinian, Kenneth Davitan & Ellen Baw v. United Mexican States, 14 ICSID Rev.-FILJ 538, para. 83 (1999). In fact, on the issue of whether the breach of a concession contract amounted to an expropriation, absent other factors, such as that the impugned measure being confiscatory, the NAFTA tribunal specifically stated that mere contractual disputes will not be sufficient in order for an investor to initiate a claim under Section B, Chapter 11 of the NAFTA. Specifically, the tribunal stated that: "NAFTA does not, however, allow investors to seek international arbitration for mere contractual breaches.

In *Pope & Talbot*, the NAFTA arbitral tribunal refused to find a taking on the basis of a loss of profitability; while in *Metalclad*, the NAFTA Tribunal found a taking to exist after the Claimant lost all benefits of ownership of its landfill.

In the end, the Sierra Opinion exaggerates the potential impact of Article 1110 of the NAFTA on the ability, legally and practically, of NAFTA Parties to implement necessary environmental and conservation measures.

B. Secondary Comments on the Sierra Opinion

The primary criticism of the Sierra Opinion, as expressed above, is that it ignores international law for interpreting the scope and meaning of Article 1110 of the NAFTA. However, certain of the other conclusions reached by the Sierra Opinion over the substantive application of Article 1110 deserve brief mention. In particular, the Sierra Opinion either made the following observations that are not necessarily true, or failed to raise the following issues which demand closer attention.

The Sierra Opinion concluded that the MB Acquisition will "impede" the B.C. Government's ability "to complete its protected areas system, honourably settle the First Nations' land question and redistribute control over our forest in ways that create new opportunities for BC communities."²⁰² Furthermore, the Opinion asserted that Chapter 11 places "a major limitation on the provincial government's capacity to effectively legislate in an area otherwise entirely within its jurisdiction."²⁰³ However, the Sierra Opinion ignores the fact that the NAFTA does not preclude the right of a Party to expropriate, but, in fact, confirms that right. Second, the Sierra Opinion ignores the distribution of legislative powers in Canada under the *Constitution Act*²⁰⁴ and the *Constitution Act, 1982*, whereby the provinces have been granted exclusive legislative jurisdiction over a number of relevant matters, including property and civil rights in a province, as well as the exploration, development and conservation of natural resources in a province.²⁰⁵ Thus, notwithstanding that Article 105 of the NAFTA obligates the Parties to ensure that the provisions of the NAFTA are observed by their state and provincial governments, the NAFTA itself does not remove the B.C. Government's inherent constitutional right to regulate in support of its forest resources. The Government of Canada alone would be the Party to a claim under Chapter 11 and, if necessary, responsible for compensation. It then would be a matter of negotiation between B.C. Gov-

Indeed, NAFTA cannot possibly be read to create such a regime, which would have elevated a multitude of ordinary transactions with public authorities into potential international disputes." *Id.* para. 87

²⁰² Sierra Opinion, *supra* note 186, at 11.

²⁰³ *Id.* at 7.

²⁰⁴ Constitution Act, 1867 (U.K.), 30-31 Vict., Chap. 3.

²⁰⁵ See *id.* at paras. 92(13) and (16).

ernment and the Government of Canada as to how the costs would be apportioned.

The MB Acquisition did not extend any additional rights to Weyerhaeuser. As noted, prior to the MB Acquisition, through its existing Canadian subsidiary, it was already a significant player in the Canadian forest industry. As such, Weyerhaeuser did not need the MB Acquisition to initiate a claim should, in the future, the Government of Canada violate Chapter 11 of the NAFTA.

Article 1139(b) of the NAFTA defines an "investment" to include "an equity security of an enterprise." Accordingly, if the Sierra Opinion was correct when it explained that any measure that affects the profitability of an enterprise is subject to a claim under Chapter 11, then, assuming that there were numerous existing U.S. shareholders of MB, the BC Government was already susceptible to an expropriation claim in the event that its environmental measures negatively affected the value of such U.S. investors' MB shares. In this sense, the MB Acquisition did not make the B.C. Government (Federal Government) more susceptible to a claim, but rather only affected the ultimate identity of the claimant(s).

As noted, since Article 1139 defines an "investor of a Party" to include an enterprise "that seeks to make . . . an investment," had the B.C. Government decided not to permit the MB Acquisition to proceed because of the possibility of a future claim by Weyerhaeuser, this decision itself may have amounted to an expropriation and, therefore, impose a concomitant obligation on the B.C. Government (Federal Government) to compensate Weyerhaeuser.

The Sierra Opinion assumes that Weyerhaeuser would have viewed a claim under Chapter 11 of the NAFTA to be a zero-sum game. However, except where an investor plans on exiting its host State altogether, it is doubtful that many investors would ignore the potential political fallout that may result by initiating a claim under Chapter 11. Many investors would likely hesitate before initiating a claim or otherwise harass its host government. Furthermore, when considering the likelihood of an investor using Chapter 11 merely as a harassing technique, it should be borne in mind that a NAFTA investor could always threaten to initiate proceedings against a federal or provincial government under Canadian law and before a Canadian court.

While none of the above points are individually significant, considered collectively, they further call into question the merits of the views expressed in the Sierra Opinion.

VII. CONCLUSIONS

Chapter 11 merely extends certain basic, fundamental rights to NAFTA investors, such as non-discrimination, minimum standards of treatment and transparency, and then empowers individual investors to enforce these obligations before a binding dispute settlement regime. Con-

trary to the views expressed in the Sierra Opinion, Chapter 11 of the NAFTA will have no greater impact on the "capacity," explicitly or implicitly, of provincial, state and federal governments to adopt necessary environmental and forest conservation measures than does every day factors. From a legal perspective, provided that the requirements in paragraphs (1)(a)-(d) of Article 1110 are met, Article 1110 (and confirmed by Article 1114) explicitly permits Parties to expropriate the investments of NAFTA investors. However, practically, the NAFTA does not alter the basic right of private citizens to sue their (host) government. If a NAFTA investor merely intends to harass its host Party, it could do so just as easily under domestic law. At best, the NAFTA provides NAFTA investors with an alternative forum from which to pursue a claim. On that basis, Chapter 11 of the NAFTA is relatively neutral as to its impact on whether a Party will implement necessary environmental and forest conservation measures.

To date, most of the criticisms of Article 1110, and of Chapter 11 more generally, have not been based on a well-considered and mature analysis of general principles of international law. The Parties have agreed to ensure that NAFTA investors in their territories will be accorded a certain minimum level of treatment. To that end, the Sierra Opinion is correct to note that it is theoretically possible that a NAFTA Party may be forced to provide certain treatment or a certain standard of compensation to NAFTA investors than they may otherwise have to provide their own citizens under domestic law. This is, however, the precise purpose of Chapter 11, and, more generally, of international legal agreements between nations, whether such agreements deal with, for example, human rights, the environment or fiscal matters. Chapter 11 ensures that NAFTA investors, at a minimum, are on a level playing field with domestic and foreign investors in the territory of a Party. This includes a commitment that NAFTA investors receive fair market value for their expropriated property.²⁰⁶

However, before a NAFTA investor is entitled to receive compensation for an interference with his or here investment, there first must be an expropriation. The mere allegation of an expropriation is not sufficient. Similarly, the fact that a measure has a detrimental impact on the investment is not necessarily sufficient to make out an expropriation. Rather, the effect must exceed a certain threshold level. The police powers defense further recognizes the inherent right of a Party to regulate in support of the public interest and, provided that it does not go too far or is not otherwise discriminatory, will absolve the Party from paying compensation. The Sierra Opinion, unfortunately, either missed or ignored this distinction.

²⁰⁶ See NAFTA, *supra* note 1, art. 1110:2,

