NAFTA, INVESTMENT AND THE CONSTITUTION OF CANADA: WILL THE WATERTIGHT COMPARTMENTS SPRING A LEAK?

Mark A. Luz*

Les décisions arbitrales récentes rendues en application de l'Accord de libre-échange nord-américain (ALÉNA) en matière de l'enfouissement de déchets dangereux et de l'exportation de bois d'oeuvre ainsi que les différends en suspens concernant l'exportation en vrac de l'eau et de l'essence ont ravivé la controverse relative aux dispositions du chapitre 11 de l'ALÉNA garantissant la protection de l'investisseur. Cet article cherche à établir si les dispositions du chapitre 11 sont constitutionnellement exécutoires à l'égard des provinces canadiennes, en particulier si une province peut être tenue responsable en droit de payer l'indemnisation ordonnée par le tribunal d'arbitrage lorsqu'elle est déclarée responsable d'un manquement à ses obligations en vertu du traité. Une analyse du pouvoir fédéral de réglementation du trafic et du commerce, et des aubains, révèle qu'il y a un fondement juridique convaincant pour conclure que les provinces sont liées par les dispositions du chapitre 11 en vertu du pouvoir général de réglementation des échanges et du commerce. De plus, des décisions de la Cour suprême et du Conseil privé fondent la conclusion

Recent North American Free Trade Agreement (NAFTA) arbitration rulings regarding hazardous waste landfills and timber exports, as well as pending disputes over bulk water exports and gasoline additives, have rekindled the controversy surrounding the investor protection provisions contained in Chapter 11 of the NAFTA. This article examines whether the provisions of Chapter 11 are constitutionally enforceable against the Canadian provinces, and more specifically, whether or not a province could be legally compelled to pay an arbitration award if that province were responsible for the treaty violation. An analysis of the federal power over trade and commerce, and over aliens, reveals a compelling legal basis for binding the provinces to the provisions in Chapter 11 by virtue of the "general branch" of the trade and commerce power. Further, judgments of the Supreme Court and the Privy Council support the conclusion that, notwithstanding any argument that a province could enjoy Crown immunity and that s.126 of the Constitution Act, 1867 protects the provinces from appropriations of their consolidated revenue funds, it would be constitutionally valid for the federal

---

* B.A. (McGill), M.A. (Chicago), LL.B./B.C.L. candidate (2001) Faculty of Law, McGill University. I would like to thank Professor Stephen Scott for his advice and support for this paper, which was originally written for his seminar Problems of Canadian Constitutional Law.

My appreciation also goes to Professor Armand de Mestral for his insights, and to my 1999 Philip C. Jessup International Law Moot Court Competition teammates and coach (Kathryn Khamsi, Melanie Koszegi, Elodie Fleury and M.J. Fernandes) who were responsible for sparking my interest in this area of law. Finally, special thanks go to my wife Alison Grant for her unending inspiration. I can be reached at <markluz@hotmail.com>.

que, nonobstant l'argument qu'une province peut jouir de l'immunité de la couronne et que l'art. 126 de la Loi constitutionnelle de 1867 *protège les provinces contre l'appropriation de leur fonds du revenu consolidé, il serait constitutionnellement valide que le gouvernement fédéral édicte une loi exigeant que les provinces versent les dommages-intérêts ordonnés par un tribunal d'arbitrage à l'investisseur lésé qui est partie à l'ALÉNA si la violation est le résultat d'une loi ou d'une mesure* provinciale contraire au chapitre 11.

government to pass legislation requiring the provinces to pay an arbitration damages award to an aggrieved NAFTA investor when it came as the result of a provincial law or measure that violated Chapter 11.

TABLE OF CONTENTS

I. INTRODUCTION

Changes to the Canadian economy as a result of globalization have been astounding, and the number of trade and investment agreements to which Canada has become a party in recent years is indicative of this trend. Since 1988, Canada has signed a free trade agreement with the United States (FTA),[1] expanded that agreement to include Mexico under the *North American Free Trade Agreement* (NAFTA),[2] signed separate free trade agreements with Chile[3] and with Israel[4] and is currently negotiating free trade agreements with Costa Rica[5] and Singapore.[6] Canada was part of the historic consolidation of the Uruguay Round of the General Agreement on Tariffs and Trade (GATT),[7] culminating in the creation of the World Trade Organization (WTO),[8] has entered into numerous Foreign Investment Protection Agreements (FIPAs) with countries ranging from Ukraine[9] to Uruguay,[10] is pushing for the establishment of an agreement on Free Trade of the Americas to encompass 34 countries in the Western Hemisphere[11] and was, for a while, a leading proponent of the creation of the now-

---

[1] *Canada-United States Free Trade Agreement*, 2 January 1988, 27 I.L.M. 281 (entered into force 1 January 1989).

[2] *North American Free Trade Agreement Between the Government of Canada, the Government of Mexico and the Government of the United States*, 17 December 1992, Can T.S. 1994 No. 2, 32 I.L.M. 289 (entered into force 1 January 1994) [hereinafter *NAFTA* cited to I.L.M.].

[3] *Canada-Chile Free Trade Agreement*, 5 December 1996, 36 I.L.M. 1067, online: Department of Foreign Affairs and International Trade [hereinafter DFAIT] <http://www.dfait-maeci.gc.ca/tna-nac/cda-chile/menu.asp> (date accessed: 10 November 2000) (entered into force 5 July 1997).

[4] *Free Trade Agreement Between The Government of Canada and The Government of the State of Israel*, 31 July 1996, online: DFAIT <http://www.dfait-maeci.gc.ca/tna-nac/cifta-e.asp> (date accessed: 10 November 2000) (entered into force 1 January 1997).

[5] DFAIT, News Release No. 170, "Free Trade Negotiations with Costa Rica Launched" (30 June 2000), online: DFAIT <http://198.103.104.118/minpub/Publication.asp?FileSpec=/Min_Pub_Docs/103533.htm> (date accessed: 10 November 2000).

[6] DFAIT, News Release No. 135, "Canada and Singapore to Explore Possible Free Trade Deal" (5 June 2000), online: DFAIT <http://198.103.104.118/minpub/Publication.asp?FileSpec=/Min_Pub_Docs/103434.htm> (date accessed: 10 November 2000).

[7] 30 October 1947, 58 U.N.T.S. 187, Can. T.S. 1948, No. 31 (entered into force 1 January 1948).

[8] *Agreement Establishing the World Trade Organization*, 15 April 1994, 33 I.L.M. 1144 (entered into force 1 January 1995).

[9] *Agreement Between the Government of Canada and the Government of Ukraine for the Promotion and Protection of Investments*, 24 October 1994, Can T.S. 1995, No. 23 (entered into force 24 July 1995).

[10] *Agreement Between the Government of Canada and the Government of the Eastern Republic of Uruguay for the Promotion and Protection of Investments*, 29 October 1997, Can T.S. 1999, No. 31 (entered into force 2 June 1999).

[11] DFAIT, Backgrounder, "Free Trade of the Americas (FTAA)" (March 2000), online: DFAIT <http://www.dfait-maeci.gc.ca/tna-nac/ftaa_background2-e.asp> (date accessed: 10 November 2000).

abandoned Multilateral Agreement on Investment.[12]

Canadian exports of goods and services topped $412.4 billion in 1999 (equivalent to 43.1% of GDP) and imports amounted to $384.6 billion (equivalent to 40.2% of GDP).[13] Of course, Canada's trading relationship with the U.S. is preeminent. In the past decade, Canadian exports to the U.S. have increased by 169% and represented 28.4% of GDP in 1998 (up from 15% of GDP in 1989)[14] and imports have gone up 149%.[15] In 1999, two-way trade in goods and services between the two countries reached $622.7 billion, up from $235.2 billion a year in 1989; the U.S. alone accounts for four fifths of Canada's exports and 3/4 of imports.[16] As for foreign direct investment (FDI), which covers broadly the subject of this paper, inflows from the U.S. increased by 57.2% in 1999, amounting to $38.4 billion[17] – at the end of 1999, the total stock of FDI in Canada stood at $240 billion.[18] It is an understatement to say foreign trade in goods, services and investment sustains the Canadian economy, and will only increase in the future.

What is also inevitable is that the global economy will have a profound impact on Canadian federalism, particularly through the influence of comprehensive trade agreements. The debate regarding the implementation of treaties into Canadian domestic law has never been more relevant than in the past decade. The federal and provincial governments are increasingly compelled to coordinate their efforts to negotiate and implement trade agreements that affect the most local levels of the economy, and the division of powers embodied in the *Constitution Act, 1867*,[19] will likely undergo new judicial scrutiny as the implementation of federal treaty obligations further encroaches on core provincial powers.

This paper will focus on a unique subunit of Canada's most important trade agreement. Chapter 11 of the NAFTA outlines certain rights and standards of treatment for investors and their investments in each of the NAFTA countries. It is also arguably the most controversial of the NAFTA chapters because it creates a private right of action by investors before an international arbitral tribunal directly against governments for breaches of its provisions. As such, it is ideally suited to a consideration of the impact of trade treaties on Canada's domestic constitutional order. More specifically, I am

---

[12] OECD, Directorate for Financial, Fiscal and Enterprise Affairs, *The Multilateral Agreement on Investment*, Doc. No. DAFFE/MAI/NM(97)2 (1997), online: Multinational Agreement on Investment <http://mai.flora.org/mai-info/9710_p00.htm> (date accessed: 10 November 2000).

[13] DFAIT, *Trade Update 2000: First Annual Report on Canada's State of Trade*, 2d ed. (Ottawa: DFAIT, 2000) at 3, online: DFAIT <http://www.dfait-maeci.gc.ca/eet/state_of_trade/state_of_trade0600-e.pdf> (date accessed: 10 November 2000) [hereinafter *June 2000 Trade Update*].

[14] 40% of Ontario's GDP depends on exports to the U.S. as of 1998, which is double the amount from 1989. J. McCallum, "Two Cheers for the FTA: Tenth-Year Review of the Canada-U.S. Free Trade Agreement" June 1999 Royal Bank of Canada Economics Department Study at 3, online: <http://www.royalbank.com/economics/market/pdf/fta.pdf> (date accessed: 10 November 2000).

[15] *Ibid.* at 2-4.

[16] *June 2000 Trade Update*, *supra* note 13 at 6.

[17] *Ibid.* at 33.

[18] *Ibid.* at 34.

[19] *Constitution Act, 1867 (U.K.)*, 30 & 31 Vict., c.3, reprinted in R.S.C. 1985, App. II, No. 5 [hereinafter *Constitution Act, 1867*].

interested in examining whether Chapter 11, viewed as a distinct entity within the NAFTA, is enforceable against the provinces and what the consequences are of provincial laws or actions that result in a finding of a breach of Chapter 11 and damages being awarded by an arbitral tribunal.

This paper is divided into four parts. The first section will outline Chapter 11 and provide some hypothetical scenarios of how provincial actions might transgress its provisions, thereby leaving Canada in breach of its obligations under the treaty and owing compensation to an investor. It will also highlight some of the important findings of the first set of arbitration tribunal rulings that have come out since 1999. The second section will provide a brief overview of the law on treaty implementation in Canada and highlight some past examples of provincial violations of trade agreements. The third section will examine whether Chapter 11 could fall within the federal trade and commerce power pursuant to section 91(2) of the *Constitution Act, 1867*, and/or section 91(25) regarding naturalization and aliens. The final section will consider the effects on inconsistent provincial laws or actions if Chapter 11 is found to fall under one or both of the aforementioned federal heads of power. The key issue which this paper addresses is whether or not the federal government can compel a province responsible for a breach of Chapter 11 to pay the compensation owed in the event an arbitral panel ruled in favour of the investor.

I conclude that under Canadian constitutional law, the federal government can implement the provisions of Chapter 11 pursuant to its general trade and commerce power – section 91(2) – notwithstanding any argument that a province would enjoy Crown immunity and cannot be compelled to make monetary payments without its consent – section 126. Thus, it would be constitutionally valid for the federal government to pass legislation requiring the provinces to pay the damages awarded by an arbitral tribunal to an aggrieved NAFTA investor as the result of a provincial law or measure which breached the provisions of Chapter 11. Any limitations on this federal power would have to be considered in the context of the particular dispute, but it would require a substantiated and very compelling argument that core provincial powers would be fundamentally impaired if the province responsible for the breach of a provision of Chapter 11 were to be compelled by federal legislation to pay the compensation award.

Whether or not the Canadian government can constitutionally force a province to pay for a violation of NAFTA is of fundamental importance. For the federal government, this is not only a question of liability and responsibility for damages incurred by the act of a province, but a test of its legal ability to implement the obligations assumed under Canada's most important international trade agreement. For the provinces, millions of dollars and core constitutional powers could be at stake. Finally, NAFTA investors contemplating arbitration under Chapter 11 because of an action taken by a province need to be aware that even if they win an arbitration award, the enforcement of that award trenches upon a minefield of difficult constitutional and political questions that have no clear answers. NAFTA investors, especially those unfamiliar with the Canadian constitutional framework, need to know that using Chapter 11 may be far more complicated than the text of NAFTA suggests.

II. CHAPTER 11

Chapter 11 is unique among international investment treaties because it allows for a private right of action by an individual investor against the government of a party before an international arbitration tribunal for actions taken in violation of its provisions.

If the conditions precedent to the submission of an arbitration claim are fulfilled, consent to arbitration by the respondent NAFTA government is enshrined in the treaty itself.[20] This is unlike Canada's Foreign Investment Protection Acts (FIPAs) and other typical bilateral investment treaties which are very difficult to utilize because an investor either has to convince its home government to take up its cause diplomatically, or in some cases, must get the subsequent agreement of the foreign government to submit the dispute to arbitration.[21] Chapter 11 is also unlike WTO mechanisms that employ only state-to-state dispute resolution panels, although it is very often corporations that push their governments to take action.[22] Whereas investment disputes against governments in the past have usually been resolved by negotiation or domestic legal remedies, under Chapter 11, aggrieved investors have the opportunity to challenge a government on their own initiative and, if a violation of the treaty by the respondent government is found, monetary damages could be awarded by the international arbitral panel and that ruling will be legally enforceable in Canada.[23]

---

[20] Article 1122(1) (Consent to Arbitration) states "[e]ach Party consents to the submission of a claim to arbitration in accordance with the procedures set out in this Agreement": *supra* note 2 at 605. Article 1122(1) explicitly states that this consent satisfies the requirements for agreement to arbitrate as defined in the: *Convention on the Settlement of Investment Disputes between States and Nationals of Other States*, 19 March 1965, 575 U.N.T.S. 159, 4 I.L.M. 532 [hereinafter *ICSID Convention*] and the Additional Facility Rules, online: World Bank <http://www.worldbank.org/icsid/facility/1.htm> (date accessed: 10 November 2000); *Convention on the Recognition and Enforcement of Foreign Arbitral Awards*, 10 June 1958, 330 U.N.T.S. 38 [hereinafter *New York Convention*]; and Organization of American States, *Inter-American Convention on International Commercial Arbitration*, OR/OEA/Ser.A/20/Doc.42 (1975). The arbitration tribunal in *Waste Management, Inc.* v. *United Mexican States* (2000), Case No. ARB(AF)/98/2 (ICSID), online: World Bank <http//:www.worldbank.org.icsid/cases/waste-award.pdf> (date accessed: 10 November 2000) [hereinafter *Waste Management*] pointed out that the conditions precedent in Article 1121 must be strictly complied with given the automatic agreement by the NAFTA governments to arbitrate under Article 1122.

[21] Some of the newer FIPAs are fashioned on the NAFTA model but only the *Canada-Chile Free Trade Agreement*, *supra* note 3, has a dispute resolution mechanism similar to that of NAFTA (Chapter G). A list of Canada's FIPAs as of May 1999 can be found online at: <http://www.dfait-maeci.gc.ca/tna-nac/fipa-e.asp>. See generally R.K. Paterson, "Canadian Investment Promotion and Protection Treaties" (1991) 29 Can.Y.B. Int'l L. 373, and G. Sacerdoti, "Bilateral Treaties and Multilateral Instruments on Investment Protection" (1997) 269 Rec. des Cours 251.

[22] Recent WTO disputes in which Canada has been involved include: *Canada-Term of Patent Protection (Complaint by the United States)* (2000), Doc. No. WT/DS170/AB/R (WTO, Appellate Body), online: WTO <http://www.wto.org/english/tratop-e/disp-e/170abr-3.pdf> (date accessed: 10 November 2000); *Canada-Measures Affecting the Export of Civilian Aircraft (Complaint by Brazil)* (2000), Doc No. WT/DS70/AB/RW (WTO, Appellate Body), online: WTO <http://www.wto.org/english/tratop-e/disp-e/70abrw-e.pdf> (date accessed: 10 November 2000); *Canada - Certain Measures Affecting the Automotive Industry* (2000), Doc. No. WT/DS139/AB/R, WT/DS142/AB/R (WTO, Appellate Body), online: WTO <http://www.wto.org/english/tratop-e/disp-e/139-142-12-e.pdf> (date accessed: 10 November 2000).

[23] The losing government is bound by Article 1136(2) to "abide by and comply with an award without delay", and by Article 1136(4), which states that "[e]ach Party shall provide for the enforcement of an award in its territory": *supra* note 2 at 609-10. International arbitration awards are enforceable in Canada pursuant to federal and provincial legislation implementing the *New York Convention*, *supra* note 20. See J.G. Castel *et al.*, eds., *The Canadian Law and Practice*

As of the time of writing this paper, there have been several interim and final awards by arbitral tribunals constituted under Chapter 11 of NAFTA[24] and numerous cases pending.[25] While an extensive evaluation of the recent awards is unnecessary for the purposes of this paper, they have established some important precedents that, although not legally binding on future arbitral tribunals, dispel some of the myths and uncertainties about the more controversial provisions of Chapter 11, in particular, Article 1110 (Expropriation and Compensation). References to these ruling will be made throughout this paper as appropriate.

A. *Investment*

The goals of Chapter 11 are to establish a secure investment climate for investors from the NAFTA countries through transparent rules for fair treatment – national treatment and most-favoured-nation (MFN) treatment – to remove barriers to investment and to provide an effective means of resolving disputes between a NAFTA investor and a host country. Article 1101 outlines the scope of the investment provisions:

> 1. This Chapter applies to measures adopted or maintained by a Party relating to:
>
> (a) investors of another Party;
>
> (b) investments of investors of another Party in the territory of the Party *existing at the date of entry into force of this Agreement as well as to investments made or acquired thereafter by such investors; and*

---

of International Trade with Particular Emphasis on Export and Import of Goods and Services, 2d ed. (Toronto: Emond Montgomery Publications, 1997) at 745-50.

[24] *Ethyl Corporation* v. *The Government of Canada* (1999), 38 I.L.M. 708 [hereinafter *Ethyl*]. The Ethyl case was settled before any award was made. See J. Urquhart, "Canada Removes Its Ban on Ethyl's Additive; U.S. Firm to Terminate Its Legal Fight", *The Wall Street Journal* (21 July 1998) A4; *Azinian, Davitian & Baca* v. *United Mexican States* (1999), 14 I.C.S.I.D. Rev. 538 [hereinafter *Azinian*]; *Waste Management, supra* note 20; *Pope & Talbot Inc.* v. *The Government of Canada (Interim Award)* (2000), online: DFAIT <http://www.dfait-maeci.gc.ca/tna-nac/nafta-e.asp> (date accessed: 20 December 2000) [hereinafter *Pope & Talbot*]; *Metalclad Corporation* v. *United Mexican States* (2000), Case No. ARB(AF)/97/1 (ICSID), online: <http://www.naftaclaims.com/metalclad.pdf> (date accessed: 10 November 2000) [hereinafter *Metalclad*].

[25] Recent claims include a $230 million suit by the courier company United Postal Service against Canada for allegedly unfair subsidies to Canada Post (S. Arnold, "Courier UPS Pursues Canada Post Under NAFTA, Alleging Unfair Competition" *Canadian Press* (19 September 2000), online: Westlaw (2000 WL 26705218)) and a US$970 million suit by Methanex Corporation of Vancouver, which is seeking damages from the American government in compensation for a ban by California of its methanol gasoline additive MRBE (P. Morton, "$1B Methanol Battle Fires up this Week - Methanex Corp. In Face-off with US Government: Canadian Firm Claims California Violated NAFTA When it Banned Fuel Additive" *National Post* (5 September 2000) C1.

> (c) with respect to Article 1106[26] and 1114, all investments in the territory of the Party *existing at the date of entry into force of this Agreement as well as to investments made or acquired thereafter.*[27]

The definition of "investor" and "investment" are inclusive and will have to be interpreted by arbitral tribunals given the particular facts of a case. Article 1139 provides definitions for both:

> **investment of an investor of a Party** means an investment owned or controlled directly or indirectly by an investor of such Party;
>
> **investor of a Party** means a Party or state enterprise thereof, or a national or an enterprise of such Party, that seeks to make, is making or has made an investment.[28]

What is remarkable is the breadth of the definition of investment.[29] While too lengthy to reproduce here, a particularly important provision is subparagraph (g) under the definition of "investment" in Article 1139: "real estate *or other property*, tangible or intangible, acquired in the expectation or used for the purpose of economic benefit or other business purposes" [emphasis added]. This expansive definition also includes, among other things, controlling interests in enterprises, equity securities and contractual interests.[30] Subjects covered by NAFTA's investment provisions that likely encroach upon provincial jurisdiction include securities legislation and legislation covering real estate like land transfer tax or rent control legislation.[31]

The arbitral tribunal in *Pope & Talbot* made an important finding as to what could fulfill the definition of an investment as defined in Article 1139 and its use in the context of the expropriation provision (Article 1110). Pope & Talbot, an American forestry company, filed a $381 million claim against Canada on March 25, 1999, that argued that the 1996 Softwood Lumber Agreement between Canada and the U.S. violates Canada's obligations under NAFTA, specifically, Article 1102 (National Treatment), Article 1105 (Minimum Standard of Treatment), Article 1106 (Performance

---

[26] Article 1106, *supra* note 2 at 640, prohibits certain performance requirements such as requiring an investor to export a given percentage of its goods or services, using a certain level of domestic content or transferring its technology to another person.

[27] *Ibid.* at 639, when combined with Note 39 to the NAFTA, *ibid.* at 703.

[28] *Ibid.* at 648.

[29] For the purposes of the ICSID rules, the characteristics of an investment might include (1) a long-term relationship, (2) expectation of return, (3) assumption of risk by both parties, (4) substantial value, and (5) significance to the state's economic development. See C. Schreuer, "Commentary on the ICSID Convention: Art. 25" (1996) 11:2 ICSID Rev. Foreign Invt. L.J. 318 at 372-73.

[30] J. Johnson, *The North American Free Trade Agreement: A Comprehensive Guide*, (Aurora: Canada Law Book, 1994) at 284. See *e.g.* subsection (h) of the definition of investment, which covers "interests arising from the commitment of capital or other resources in the territory of a Party to economic activity in such territory, such as under (i) contracts involving the presence of an investor's property in the territory of the Party, including turnkey or construction contracts, or concessions, or (ii) contracts where remuneration depends substantially on the production, revenues or profits of an enterprise": *supra* note 2 at 647.

[31] Johnson, *ibid.*

Requirements) and Article 1110 (Expropriation).[32] The five-year Agreement, which expires on March 31, 2001, establishes a quota system for exports of softwood lumber from British Columbia, Alberta, Ontario and Quebec to the United States through which fees are collected for exceeding yearly quotas; the United States has agreed to forgo any trade retaliation for the duration of the Agreement. An important argument that Pope & Talbot Inc. (the "Investor") had to submit in order to make a claim of expropriation was that access to the U.S. market by its British Columbia subsidiary Pope & Talbot Ltd. (the "Investment") was a property interest subject to protection under Article 1110.

Canada argued that the Investor's ability to alienate its product to the American market could not be classified as a property right and therefore could not be a subject of dispute under Article 1110. However, the tribunal rejected this argument by saying that it is not the terminology that is important but rather what interests are affected. The tribunal reasoned that access to the U.S. market

> is, in fact, a very important part of the 'business' of the Investment. Interference with that business would necessarily have an adverse effect on the property that the Investor has acquired in Canada, which, of course, constitutes the Investment .... the true interests at stake are the Investment's asset base, the value of which is largely dependent on its export business.[33]

While the reasoning behind this conclusion in the ruling is rather scanty, it nonetheless shows the willingness of an arbitral tribunal to adopt an inclusive approach to the definition of investment under Article 1139.

Articles 1102-1113 outline the standards of treatment to be afforded to investors and investments, including national treatment (Article 1102), MFN treatment (Article 1103), treatment in accordance with international law (Article 1105), a prohibition against certain performance requirements (Article 1106),[34] permissive transfers relating to an investment of an investor (Article 1109) and a prohibition against directly or indirectly nationalizing or expropriating an investment except in accordance with the international legal standards stipulated in the provision (Article 1110). Article 1108 permits existing nonconforming measures to be stipulated in Schedules to the Annexes as reservations or exceptions, while Article 1114 stipulates that Chapter 11 should not be construed as preventing a party from adopting necessary environmental legislation.

The provision that has caused a great deal of controversy in Canada is Article 1110, which prohibits direct or indirect expropriation or nationalization (or measures tantamount to) of an investment owned or controlled by an investor of another party to

---

[32] The latter two claims were dismissed by the arbitral tribunal in its interim award, see *Pope & Talbot, supra* note 24. Pope & Talbot's national treatment and minimum standard of treatment claims are continuing.

[33] *Ibid.* at para. 98.

[34] *Ibid.* at paras. 45-80. The tribunal concluded that the Softwood Lumber Agreement did not impose or enforce requirements – it only established a tariff-rate export restraint regime fixing the level of fees to be imposed to different levels of exports. This did not, in the opinion of the tribunal, amount to a requirement for establishing, acquiring, expanding, managing, conducting or operating a foreign owned business in Canada, as per Article 1106.

the agreement.[35] It reads, in part, as follows:

> 1. No Party may directly or indirectly nationalize or expropriate an investment of an investor of another Party in its territory or take a measure tantamount to nationalization or expropriation of such an investment ("expropriation"), except:
>
> (a) for a public purpose;
>
> (b) on a non-discriminatory basis;
>
> (c) in accordance with due process of law and Article 1105(1); and
>
> (d) on payment of compensation in accordance with paragraphs 2 through 6.
>
> 2. Compensation shall be equivalent to the fair market value of the expropriated investment immediately before the expropriation took place ("date of expropriation"), and shall not reflect any change in value occurring because the intended expropriation had become known earlier. Valuation criteria shall include going concern value, asset value including declared tax value of tangible property, and other criteria, as appropriate, to determine fair market value.
>
> 3. Compensation shall be paid without delay and be fully realizable.[36]

It is important to note that Article 1131 provides that the arbitration panel "shall decide issues in dispute in accordance with this Agreement and applicable rules of international law."[37] Thus, a party can only legally expropriate an investment if it is done in accordance with the aforementioned principles, which are indicative of the Western conception of customary international law.[38] An unlawful expropriation may be subject to more onerous compensation, including restitution, payment of damages and invalidity of the transfer of title.[39]

While it is possible that measures considered non-compensable regulation under Canadian law could be judged a compensable "taking" of property or "tantamount to" an expropriation under international law,[40] the first group of Chapter 11 arbitral awards have made it clear that concerns about the ability of corporations to use Article

---

[35] This provision was the focal point of Ethyl Corporation's initiation of arbitration proceedings when Parliament banned all intraprovincial and international trade in the fuel additive MMT, produced by the Virginia-based company: see *Ethyl*, *supra* note 24. See also J.A. Soloway, "NAFTA's Chapter 11: The Challenge of Private Party Participation" (1999) 16:2 J. Int. Arb. 1 at 5.

[36] *Supra* note 2 at 641.

[37] *Ibid.* at 645.

[38] American Law Institute, *Restatement of the Law Third: The Foreign Relations Law of the United States*, vol. 2 (St. Paul, Minn.: American Law Institute Publishers, 1987) at section 712; R. Jennings & A. Watts, eds., *Oppenheim's International Law*, 9th ed., vol. 2 (London: Longman Group, 1996) at 911-22 and cases cited therein; I. Brownlie, *Principles of Public International Law*, 5th ed., (Oxford University Press, 1998) at 533-38.

[39] *BP Exploration Company (Libya) Limited v. Government of the Libyan Arab Republic* (1973), 53 I.L.R. 297 (G. Lagergren, Sole Arbitrator).

[40] See *Manitoba Fisheries Ltd.* v. *The Queen*, [1997] S.C.R. 101, 88 D.L.R. (3d) 462.

1110 for virtually any measure that affected their investment are exaggerated.[41] *Pope & Talbot* confirmed that form should not take precedence over substance when it comes to evaluating whether a government measure constitutes an expropriation.[42] Importantly, the tribunal found that the term "tantamount to" an expropriation, as used in Article 1110(1), meant nothing more than "equivalent" (the term used in the equally authentic French and Spanish texts of Article 1110) and that NAFTA *does not* broaden the ordinary conception of expropriation under international law, as counsel for Pope & Talbot had argued.[43] Accordingly, the tribunal found that although export quotas certainly interfered with Pope & Talbot's ability to export softwood lumber to the U.S., and even caused it financial harm, it was not enough to constitute an expropriation under international law.

In *Azinian,* the arbitral tribunal soundly rejected the claimant's argument that the annulment of a waste disposal concession agreement by Mexican courts was an expropriation under international law. In a sternly worded ruling, the tribunal decisively stated that claims cannot be submitted to arbitration under Chapter 11 unless they are founded on an alleged violation of the obligations established in Section A of Chapter 11 (Articles 1101-1114): "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*".[44] Any contractual breach must, therefore, stand on its own under an ordinary analysis of what constitutes an expropriation under international law, which, as both *Azinian* and

---

[41] Particularly vociferous in its criticisms of NAFTA and Chapter 11 in particular is the Council of Canadians. See *e.g.* Council of Canadians, News Release, "Latest NAFTA Lawsuit Proves Threat Of Chapter 11 To Health And Environmental Laws, Again" (16 June 1999), online: Council of Canadians <http://www.canadians.org/campaigns/campaignstrademedia.html> (date accessed: 10 November 2000). See also H. Mann and K. von Moltke, "NAFTA's Chapter 11 and the Environment: Addressing the Impacts of the Investor-State Process on the Environment" (1999), online: International Institute for Sustainable Development <http://iisd.ca/trade/chapter11.htm> (date accessed: 10 November 2000). Even Schneiderman's argument that a broad definition of what constitutes a "taking" will likely be influenced by American jurisprudence stemming from the Fifth and Fourteenth Amendments of the U.S. Constitution is probably overstated: see D. Schneiderman, "NAFTA's Takings Rule: American Constitutionalism Comes To Canada" (1996) 46 U.T.L.J. 499. There is a wealth of international jurisprudence on what constitutes an expropriation and, given the arbitral tribunal's obligation to apply international law, there is no reason to expect radical interpretations of Article 1110 or application of norms any different than those Western countries have held the developing world to for many years. While the line between a regulation and an expropriation is not always clear, it usually depends on the degree of interference with the property interest. International jurisprudence addressing this issue includes: *The Oscar Chinn case (United Kingdom* v. *Belgium)* (1934), P.C.I.J. (Ser. A/B), No. 63; *Hauer* v. *Land Rheinland-Pfalz*, C-44/79, [1979] E.C.R. 3727; *Kugele* v. *Polish State*, [1931-32] Ann. Dig. Int't. L. 69 (Upper Silesian Arbitral Tribunal); *Sporrong and Lönnroth* v. *Sweden* (1982), 52 Eur. Ct. H.R. (Ser. A.), 5 E.H.R.R. 35; *Sedco Inc. v. N.I.O.C.* (1985), 9 Iran-U.S. C.T.R. 248 (First Interlocutory Award); *Case Concerning Electronica Sicula S.p.A. (ELSI) (United States of America* v. *Italy)*, [1989] I.C.J. Rep. 15.

[42] See Brownlie, *supra* note 38 at 534, as well as *Southern Pacific Properties (Middle East) Limited* v. *Arab Republic of Egypt* (1993), 8 I.C.S.I.D. Rev. 328; *Starrett Housing Corp.* v. *Iran* (1983), 4 Iran-U.S. C.T.R. 122 [hereinafter *Starrett Housing*]; *Amoco International Finance Corporation* v. *Iran* (1987), 15 Iran-U.S. C.T.R. 189.

[43] *Pope & Talbot, supra* note 24 at para. 104.

[44] *Azinian, supra* note 24 at para. 83 (emphasis in original).

Pope & Talbot showed, requires a rigorous substantive analysis. In the *Azinian* case, given that there were strong legal grounds for invalidating the concession agreement and that there was no argument that the annulment by the Mexican courts of the waste removal contracts constituted a denial of justice or blatantly contradicted international law, there could be no expropriation under international law.[45]

On the other hand, in the only Chapter 11 arbitration at time of writing to make a final award in favour of the investor, the Metalclad Corporation was awarded close to $16.7 million in compensation for unfair treatment and the expropriation of their investment in a hazardous waste landfill in the Mexican municipality of Guadalcazar in the state of San Luis Potosi.[46] After having received the requisite federal construction permit, state land use permit, environmental regulatory approval and apparent political support from the state government, Metalclad's Mexican subsidiary began construction of the landfill in May 1994. Soon thereafter, however, the municipality ordered a halt to construction despite federal government assurances that there was no legal barrier to continuing the project (there was apparently no known administrative procedure for obtaining a municipal construction permit in Guadalcazar, which the local government argued was needed even though there was no evidence to show that it had ever been required for any other construction project in the municipality). The company continued to rely on representations from federal authorities that it had fulfilled all the necessary legal and environmental obligations, but pressure from the municipal government forced Metalclad to stop construction on the landfill and prompted it to launch a suit pursuant to Chapter 11.

The first legal issue that the tribunal disposed of, which must be carefully noted for the subject of this paper, was the responsibility of the Mexican government for the actions of the municipality. The tribunal's ruling restated a well-settled rule of international law: a state cannot plead a violation of, or deficiencies in, its internal law to absolve itself of responsibility for the breach of an obligation pursuant to a treaty.[47] Mexico did not dispute this, as NAFTA Article 105 clearly makes Mexico and the United States responsible for their respective state governments, and Canada responsible

---

[45] Denial of justice by the courts is a serious claim to make against a state. See *Neer (USA) v. United Mexican States* (1926), 4 R.I.A.A. 60 at 61-62 (General Claims Commission); *Case Concerning the Barcelona Traction, Light and Power Company, Limited (Belgium v. Spain)*, [1970] I.C.J. Rep. 4 at 159. However, this is one of the claims Canada's Loewen Group, a major funeral home conglomerate, is alleging in its $725 million NAFTA suit against the United States for a series of court cases in Mississippi that Lowen claims unfairly forced it into bankruptcy. See "NAFTA Effects: U.S. contracts could be voided by free-trade agreements, as a case involving Loewen Group shows" *CFO Magazine* (1 March 2000), online: <http://www.cfo.com/Pge_Channel_Article_Detail/1,1864,3|22|AD|830|0,00.html> (date accessed: 12 January 2001).

[46] *Metalclad, supra* note 24.

[47] See Article 46 of the *Vienna Convention on the Law of Treaties*, 22 May 1969, U.N. Doc. A/CONF. 39/27, 8 I.L.M. 679 (entered into force 27 January 1980); Brownlie, *supra* note 38 at 34-35. The tribunal cited Article 10 of the "Report of the Commission of the General Assembly" (1975) 2 Y.B. Int'l. L. Comm'n 47 at 61: "The conduct of an organ of a State, of a territorial government entity or of an entity empowered to exercise elements of the governmental authority, such organ having acted in that capacity, shall be considered as an act of the State under international law even if, in the particular case, the organ exceeded its competence according to interval [sic] law or contravened instructions concerning its activity."

for the actions of its provinces.[48]

The tribunal went on to find that the actions of the municipality of Guadalcazar were below the minimum standard of treatment owed to investors according to international law (Article 1105), not only because there were no established rules regarding the need or application process for a municipal construction permit (which Metalclad was pressured to obtain, notwithstanding doubts as to whether the municipality could even legally regulate this particular issue), but also because it relied, to its detriment, on the representations of government officials that it had fulfilled all legal and environmental requirements.[49]

In finding that the sum of these actions constituted an indirect expropriation of Metalclad's investment, the tribunal stated that:

> expropriation under NAFTA includes not only open, deliberate and acknowledged takings of property, such as outright seizure or formal or obligatory transfer of title in favour of the host State, but also covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use or reasonably-to-be-expected economic benefit of property even if not necessarily to the obvious benefit of the host State.[50]

B. *Dispute Settlement*

Section B of Chapter 11 (Articles 1115-1138) outlines comprehensive procedures for investors to initiate an action against a NAFTA party for an alleged violation of a provision in Section A. Investors may submit a claim to an arbitration panel established under the provisions of Chapter 11 and either the International Committee on Settlement of Investment Disputes (ICSID) rules, the rules under the ICSID Additional Facility[51] or the United Nations Commission on International Trade Law (UNCITRAL) Arbitration Rules.[52] Once the tribunal is constituted and finds that it has jurisdiction to hear the complaint, awards for monetary damages caused by a party's breach of an obligation in Section A of Chapter 11 could be given and are directly enforceable in the domestic courts of the NAFTA members.[53] If the respondent NAFTA party fails to comply with a final award, Article 1136(5) allows for another NAFTA party whose investor was the claimant to ask the Free Trade Commission to

---

[48] *Metalclad, supra* note 24 at para. 73.

[49] *Ibid.* at para. 74-101.

[50] *Ibid.* at para. 103. This statement finds solid support in international jurisprudence. See *e.g. Case Concerning Certain German Interests in Polish Upper Silesia (The Merits) (Germany v. Poland)* (1926), P.C.I.J. (Ser. A.) No. 7; *Norwegian Shipowners' Claims (Norway v. U.S.A.)* (1922), 1 R.I.A.A. 307; *AGIP Co. v. Popular* [sic] *Republic of the Congo* (1979), 21 I.L.M. 726; *Tippetts, Abbett, McCarthy, Stratton v. TAMS-AFFA* (1984), 6 Iran-U.S. C.T.R. 219; *Starrett Housing, supra* note 42; *Biloune v. Ghana Investments Centre* (1993), 95 I.L.R. 183.

[51] The Additional Facility Rules, *supra* note 20, apply to disputes where either the state party to the dispute or the state whose national is a party to the dispute, but not both, is not a contracting state to the ICSID Convention. Mexico is not a signatory to the ICSID Convention.

[52] United Nations Commission on International Trade Law Arbitration Rules, UN GAOR, 31st Sess., Supp. No. 17, U.N. Doc. A/31/17 (1976) at 46.

[53] See J.A. VanDuzer, "Investor-State Dispute Settlement Under NAFTA Chapter 11: The Shape of Things to Come?" (1997) Can. Y.B. Int'l L. 263 at 276-89.

establish a state-to-state dispute settlement panel under NAFTA Chapter 20.

There is a provision for reservations to Chapter 11 and for "grandfathering" any existing non-conforming measures by both NAFTA federal governments and state/provincial governments, all of which are to be specified in the Annex to the chapter. However, no reservations are permitted in respect of the minimum standard of treatment obligation (Article 1105), the transfers obligation (Article 1109) or the expropriation and compensation provision (Article 1110). The provinces were required to annex any of their existing non-conforming measures within two years of the date of entry into force of the NAFTA, but did not do so.[54]

To give effect to the treaty in Canadian law, the *North American Free Trade Agreement Implementation Act*[55] was given Royal Assent on June 23, 1993, and proclaimed in force on January 1, 1994.[56] The preamble states that the Agreement "applies generally throughout Canada" and recites that "it is necessary, in order to give effect to the Agreement, to make related or consequential amendments to certain Acts."[57] Section 4 outlines the purpose of the Act and the objectives of the NAFTA, which includes the elimination of barriers and facilitation of cross-border movement of goods and services, to increase substantially investment opportunities and create effective measures for the application of the Agreement and resolution of disputes. Section 10 of the Act simply approves the Agreement in its entirety.

What is important to note is that section 5 of the *NAFTA Implementation Act* states that "[t]his Act is binding on Her Majesty in right of Canada".[58] Although the provinces are not bound by the implementing law, section 9 of the legislation states:

> [f]or greater certainty, nothing in this Act, by specific mention or omission, limits any manner the right of Parliament to enact legislation to implement any provision of the Agreement or fulfill any of the obligations of the Government of Canada under the Agreement.[59]

While this issue will be addressed in Part IV of this paper, it is clear that Parliament left

---

[54] "NAFTA Parties to Protect Existing Sub-Federal Measures Indefinitely" *Inside NAFTA* (3 April 1996) at 3-5. The federal government was apparently under intense pressure from the provinces to grandfather all existing legislation as of January 1, 1994, rather than submitting a list of specific non-conforming laws to be exempted from Chapter 11. By 1996, the United States agreed to the idea of a general reservation because its own process of collecting non-conforming laws from the states was proving to be extremely tedious. See J.P. McIlroy, "NAFTA and the Canadian Provinces: Two Ships Passing in the Night?" (1997) 23 U.S.-Can. L.J. 431 at 436-37. In March 1996, one reservation was submitted concerning all existing non-conforming measures of the provinces and territories. There is no phase commitment and no obligation under the NAFTA to reserve these measures again in the future; however, presumably these reservations and those of the American states will be the subject to future negotiations, whenever they take place. All existing non-conforming legislation may not be amended or changed unless to make it more liberalizing [e-mail correspondence: Paul Henry, Deputy Director, Regional Agreements Section, Department of Foreign Affairs and International Trade (December 8, 1999)].

[55] S.C. 1993, c. 44 [hereinafter *NAFTA Implementation Act*].

[56] SI/94-1, C. Gaz., 1994.II.604.

[57] *Supra* note 55, preamble.

[58] *Ibid.*, s. 5.

[59] *Ibid.*, s. 9.

the issue of binding the provinces to the obligations of the NAFTA until it becomes necessary. Canada is bound by the NAFTA to ensure that the provinces respect its provisions: Article 105 of the Agreement states "[t]he Parties shall ensure that all necessary measures are taken in order to give effect to the provisions of this Agreement, including their observance, except as otherwise provided in this Agreement, by state and provincial governments".[60]

The question, of course, is whether or not the federal government has the constitutional authority to do so. The problem of primary concern for this paper arises when the province does something that is entirely within its constitutional jurisdiction but gives rise to a claim by a NAFTA investor. If the incorporation of the NAFTA, and particularly Chapter 11, into Canadian domestic law can be said to be *intra vires* Parliament under a federal head of power, can Parliament enact a law that would be paramount to the provincial law, thereby severing a conflicting provincial provision or making it non-applicable? This might be possible in certain circumstances where Parliament's law is not overly intrusive into provincial jurisdiction – for example, if a province enacted a law which is directly aimed at a NAFTA investor or investment. In this situation, the context is self-contained and remedied by a pith and substance test.

A more troublesome situation arises where a comprehensive, but constitutionally valid, provincial law affects a large number of investors and investments, some of whom are NAFTA investors in Canada and have a remedy under Chapter 11. If an arbitral tribunal gave a damage award to an aggrieved NAFTA investor, could a province be compelled to pay compensation? What if the province had to scale back or even abandon the entire legislation because the compensation owed to investors would be cost-prohibitive? Would the courts even accept such a tremendous restraint on the ability of provinces to exercise their constitutional powers?

From the aforementioned description of Chapter 11, its far-reaching implications are evident and one can envision many scenarios of how a valid provincial law might conflict with a provision in Chapter 11. For example, if a province were to create protected areas like provincial parks or nature reserves involving any provincial Crown land under licence to a NAFTA logging or mining company, it might be required to pay compensation if an arbitral tribunal found that the province's actions constituted a direct or indirect expropriation or a measure tantamount to an expropriation pursuant to Article 1110.[61] Another example provided by the Attorney General of Ontario, Ian Scott, during the FTA negotiations would be if a province sought to create a new public insurance scheme such as no-fault car insurance–would the province be bound to pay compensation to all NAFTA investors even if the legislation did not provide for

---

[60] *Supra* note 2 at 298.

[61] Section 92(5) of the *Constitution Act, 1867*, *supra* note 19, provides for the management and sale of provincial lands and the timber and wood on them and section 109 provides that provinces have ownership over "Lands, Mines, Minerals and Royalties". This has been of great concern in British Columbia regarding the purchase of MacMillan Bloedel by Weyerhaeuser Company of Washington. A recent and illustrative international example involving compensation for the expropriation of property in order to create a protected environmental area is *Compañía del Dessarrollo de Santa Elena, S.A. v. Republic of Costa Rica (Final Award)* (2000) 15 I.C.S.I.D. Rev. 157.

compensation?[62]

It will not be very long before the Canadian federal and provincial governments will have to face this issue head on – Mexico has already lost a case because of an action taken by a municipal government and there are similar actions pending against the United States and Canada. One such arbitration pending against Canada is the Sun Belt Water case, which provides a good example of how a valid provincial law might infringe provisions of Chapter 11. Sun Belt Water Inc. of Santa Barbara, California, has, pursuant to Article 1119 of NAFTA, filed a Notice of Intent to Submit a Claim to Arbitration on November 30, 1998, for damages that it estimates to be between US$105.2 to $219.5 million.[63] The company alleges that British Columbia violated the national treatment, MFN treatment and the minimum standard of treatment provisions of Chapter 11. The dispute stems from a 1990 agreement between it and Snowcap Waters Ltd. of Vancouver to export water from British Columbia.[64] Without commenting on the merits of the case, the claim centres on actions taken by British Columbia to regulate inter-basin transfers and bulk water exports from the province. The government in March 1991 declared a moratorium on bulk water exports and subsequently enacted legislation to give it legal effect.[65] Sun Belt Water alleges, among other things, that the government discriminated against it in violation of national treatment compared to that of its Canadian partner, Sno Cap Water Ltd., with whom British Columbia settled for the revocation of its licence for $335,000.

Given this background, the next section of this paper addresses treaty implementation in Canadian law. It will also note disputes under the framework of the GATT that have involved actions by provinces that put Canada in default of its international treaty obligations.

III. LABOUR CONVENTIONS DOCTRINE AND TREATY IMPLEMENTATION

The status of international treaties under Canadian domestic law stems from the law of the United Kingdom. Under English law, the executive branch of government has, by Royal Prerogative, the right to negotiate and conclude a treaty on behalf of Canada.[66] However, if the treaty requires actions that go beyond what can be

---

[62] See M.L. Pilkington, "Free Trade and Constitutional Jurisdiction", in M. Gold & D. Leyton-Brown, eds., *Trade-Offs On Free Trade: The Canada-U.S. Free Trade Agreement* (Toronto: Carswell, 1988) 92. This very issue was the cause of extensive litigation in British Columbia in the 1970s: see *Canadian Indemnity Co., et al. v. British Columbia (A.G.)*, [1977] 2 S.C.R. 504, 73 D.L.R. (3d) 111.

[63] E. Iritani, "Trade Pact 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" *Los Angeles Times* (28 February 1999) A1; "U.S. Water Firm Sues Canada For Up To $10.5 Billion", *Reuters News Service* (22 October 1999) (on file with the author); DFAIT, "Questions and Answers (Trade)", (Ottawa: United States Bureau, Department of Foreign Affairs and International Trade, 2000), online: DFAIT <http://www.dfait-maeci.gc.ca/geo/usa/water4-e.asp> (date accessed: 10 November 2000).

[64] A summary of the facts is given in *Snowcap Waters Ltd.* v. *British Columbia*, (1997) 34 B.C.L.R. (3d) 139, [1997] B.C.J. No. 1010 (S.C.), online: QL (BCJ). See also Mann & von Moltke, *supra* note 41.

[65] *Water Protection Act*, S.B.C. 1995, c. 34.

[66] P.W. Hogg, *Constitutional Law of Canada*, 4th ed. (Scarborough: Carswell, 1997) at 290.

done under the Royal Prerogative, Parliamentary action is required to implement the treaty in domestic law.[67] Thus, treaties entered into by Canada might be binding in international law, but they do not change the domestic law of the country unless Parliament enacts legislation giving effect to the necessary parts of the treaty, i.e., treaties are not self-executing in Anglo-Canadian law.[68]

The *Labour Conventions* case[69] established the law of treaty implementation in Canada. It dealt with section 132 of the *Constitution Act, 1867,* which provides that "[t]he Parliament and Government of Canada shall have all the Powers necessary or proper for performing the Obligations of Canada or of any Province thereof, as Part of the British Empire, towards Foreign Countries, arising under treaties between the Empire and such Foreign Countries."[70] It is clear that the Fathers of Confederation did not contemplate that Canada would eventually attain full sovereignty and be able to enter into treaties on its own behalf, a power that in 1867 remained with the British government. Once this occurred through the Balfour Declaration in 1926[71] and formally consummated in the Statute of Westminster (1931),[72] the question became whether section 132 could be used as a constitutional basis for a fully independent Canada to implement treaties within Canada.

This was answered in *Labour Conventions.* Between 1919 and 1928, the International Labour Organisation adopted three conventions pursuant to which members, including Canada, agreed to enact laws limiting the working hours of employees and requiring a weekly minimum rest and a minimum wage. Canada ratified all three treaties in 1935 and introduced legislation in Parliament to give legal effect to the provisions of the treaty that required domestic legislative reform. On appeal from the Supreme Court of Canada, which divided evenly on whether Parliament had the power to implement these treaties, the Privy Council held that the laws were *ultra vires.*

Lord Atkin, writing for their Lordships, soundly rejected the notion that Parliament should be able to implement treaties for which it otherwise had no constitutional authority to legislate. He rejected the application of section 132 because it only authorized the implementation of treaties between the Empire and foreign countries that bound Canada as part of the British empire, which did not give Canada a similar treaty power to match its newly independent status. Thus, he reasoned, in the absence of a distinct federal treaty power, the authority to implement treaties falls to the

---

[67] R. St. J. Macdonald, "International Treaty Law and the Domestic Law of Canada" (1975) 2 Dal. L.J. 307.

[68] Courts will, however, interpret provincial statutes so as to conform with a treaty, or international law in general, as far as possible. In *Re Tax on Foreign Legations,* [1943] S.C.R. 208, 2 D.L.R. 481, the Supreme Court found that Ontario had no power to authorize municipalities to levy property taxes on foreign legations. This would be a violation of general principles of international law, and the Court felt that general legislation should not be construed as intending to violate those principles. This case is different from one involving NAFTA, of course, because there was no federal implementing legislation. See also G.V. La Forest, "May The Provinces Legislate In Violation Of International Law?" (1961) 39 Can. Bar Rev. 78.

[69] *Canada (A.G.) v. Ontario (A.G.) et al.,* [1937] A.C. 326, 1 D.L.R. 673 (P.C.) [hereinafter *Labour Conventions* cited to A.C.].

[70] *Supra* note 19, s. 132.

[71] See *Reference Re Resolution to Amend the Constitution,* [1981] 1 S.C.R. 753 at 789-90, (*sub nom. Reference Re Amendment of the Constitution of Canada (Nos. 1, 2, 3)*) 125 D.L.R. (3d) 1 at 33-34 [hereinafter *Patriation Reference* cited to S.C.R.].

[72] 1931 (U..K.), 22 & 23 Geo. 5, c. 4, reprinted in R.S.C. 1985, Appendix II, No. 27.

level of government that has the appropriate jurisdiction under the constitution for the subject-matter covered in the treaty:

> [t]here is no existing constitutional ground for stretching the competence of the Dominion Parliament so that it becomes enlarged to keep pace with the enlarged functions of the Dominion executive .... In other words, the Dominion cannot, merely by making promises to foreign countries, clothe itself with legislative authority inconsistent with the constitution which gave it birth.[73]

This case has been criticized and praised in equal measure, but its status has remained relatively intact for more than half a century. Its basic rule is that "there is no such thing as treaty legislation as such"[74] and the court must look to the substantive subject matter of the implementing statute to determine whether Parliament has the jurisdiction to adopt the law pursuant to the *Constitution Act, 1867*.[75] Since the border between the federal power over trade and commerce and the provincial power over property and civil rights in the province is notoriously vague, the implementation of any type of trade treaty is never a straightforward act.

In the past, Canada has faced difficulties dealing with breaches of its international economic obligations caused by actions of the provinces. Three GATT panel decisions dealing specifically with violations caused by provincial legislation are illustrative of the dilemma the federal government faces in enforcing international trade provisions against the provinces.[76] A brief review of the cases is provided here because they represent the typical dilemmas faced when implementing international trade obligations domestically.

In the first case, a GATT panel considered whether the maintenance of a retail sales tax on imported gold coins, after an amendment of the Ontario *Retail Sales Tax Act* exempted similar Canadian coins from the tax, violated the principle of national

---

[73] *Labour Conventions*, *supra* note 69 at 352.

[74] *Ibid.* at 351.

[75] In *Arrow River & Tributaries Slide & Boom Company* v. *Pigeon Timber Company*, [1932] S.C.R. 495, 2 D.L.R. 250, the federal government argued that the *Lakes and Rivers Improvement Act*, R.S.O. 1927, c. 43, which authorized a company to charge tolls for lumber along the Pigeon River was a violation of the Ashburton Treaty of 1842, which designated the river as an international boundary, and so the Ontario legislation was *ultra vires* the Legislature. The province countered that the treaty had never been implemented by legislation, which, under English (and Canadian law), was required to make a treaty binding. The Supreme Court agreed with Ontario that the treaty, which had no implementing legislation, could not override a provincial law adopted within its jurisdiction under section 92 of the *Constitution Act, 1867* and that a treaty required federal implementing legislation to give it force and effect in Canada. This rule was reiterated in *Francis* v. *The Queen*, [1956] S.C.R. 618 at 621, 3 D.L.R. (2d) 641 at 643, where Kerwin C.J.C. stated: "it is clear that in Canada such rights and privileges as are here advanced of subjects of a contracting party to a treaty are enforceable by the Courts only where the treaty has been implemented or sanctioned by legislation."

[76] It should be noted, however, that the GATT 1994 implementation legislation did not purport to bind the provincial Crowns or give the Governors in Council the power to adopt legislation to force the provinces to respect GATT obligations. See *An Act to Implement the Agreement Establishing the World Trade Organization*, S.C. 1994, c. 47, ss. 4, 13.

treatment in Article III:2.[77] South Africa invoked the dispute resolution provisions of the GATT. The panel found that the Ontario tax violated Article III:2 and pointed out that Article XXIV:12 of the GATT required member States to "take such reasonable measures as may be available to it to ensure observance of the provisions of this Agreement by the regional and local governments within its territory".[78] The panel found that Canada had not taken all reasonable measures to secure Ontario's compliance and was thus bound to compensate South Africa for loss of competitive opportunities until the measure was withdrawn.[79] This, of course, created a problem for the federal government since subsection 92(2) of the *Constitution Act, 1867* permits the provinces to make laws for "direct taxation within the province in order to the raising of a revenue for provincial purposes."[80] The dispute was resolved, however, when Ontario repealed the provision two years later.

The two subsequent GATT disputes dealt with provincial restrictions on imported alcohol. In the first alcoholic drinks case before the GATT,[81] the European Communities (EC) alleged, among other things, that provincial differential price mark-ups and certain provincial prohibitions on the sale of imported wine and beer in grocery stores violated Canada's GATT obligations. The panel ruled in favour of the EC and recommended that the Contracting Parties to the GATT request that Canada take reasonable measures to ensure observance of Canada's obligations. The EC argued that reasonable measures must include the enactment of paramount legislation or the initiation of a constitutional challenge to the provincial rules on import mark-ups and discriminatory market access.

Canada argued that the EC's proposals were not "reasonable" because it did not believe it had the constitutional authority to compel the provinces to eliminate the discriminatory provisions. It told the panel that "any overriding federal legislation would have to be of a detailed, regulatory character and would have to intervene directly in the specifics of retailing policy"[82] but "the federal power did not allow for the regulation of a single industry or trade"[83] or for "tak[ing] over the detailed regulation of a specific economic sector in its local aspects."[84] Canada also denied that the "general trade and commerce" power, which the EC cited as a head of power Canada could employ, could be given practical effect.[85]

---

[77] *Canada – Measures Affecting the Sale of Gold Coins (Complaint by South Africa)* (17 September 1985), GATT Doc. L/5863, online: Westlaw (1985 WL 291500).

[78] *Ibid* at para. 10.

[79] *Ibid* at para. 72. For a discussion of the panel's report on this matter, see S.M. Kierstead, "An International Bind: Article XXIV:12 of GATT and Canada" (1993) 25 Ottawa L. Rev. 315 at 325-26.

[80] *Supra* note 19, subs. 92(2).

[81] *Canada - Import, Distribution and Sale of Alcoholic Drinks by Canadian Provincial Marketing Agencies,* GATT Report of the Panel adopted on 22 March 1988 L/6304, 35th Sess., 35th Supp. B.I.S.D. (1987-1988) 37.

[82] *Ibid.* at para. 3.73.

[83] *Ibid.*

[84] *Ibid.*

[85] *Ibid.* at para. 3.66. Of course, it must be remembered that Canada, in defending itself and provincial legislation before the GATT panel, was essentially arguing what the position of a province would be in a domestic court. Nonetheless, the arguments are worth noting because they represent the corpus of the argument for and against the constitutional authority to implement GATT obligations on the provinces.

The second GATT panel to deal with provincial liquor practices stemmed from an American complaint in 1991 that alleged that Canada had not fulfilled its obligations to implement the previous panel ruling, as well as putting forward additional allegations of violations of GATT obligations.[86] Again, despite Canadian assurances that it had taken reasonable measures, the panel ruled against Canada. While the panel did not go to the extent of recommending that Canada enact legislation to override existing provincial measures, it did find that Canada had not taken sufficient measures to bring the provinces in line with GATT obligations.

In all three cases, the provinces eventually agreed to take measures to remedy the situation, but they did so for policy reasons rather than out of a legal obligation imposed by the federal government.[87]

IV. FEDERAL HEADS OF POWER UNDER THE *CONSTITUTION ACT, 1867*

Given the longstanding *Labour Conventions* doctrine, any argument that a province could be compelled to pay an arbitration award under Chapter 11 must necessarily first be grounded in a federal head of power before one can move on to the trickier question of whether the federal government has the constitutional authority to compel payment of an arbitration award. The following analysis focuses on the federal trade and commerce power and federal power over aliens – subsections 91(2) and 91(25) of the *Constitution Act, 1867*, respectively.

A. *Trade and Commerce - Subsection 91(2)*

The most likely federal head of power that would support the constitutionality of the NAFTA in general, and Chapter 11 specifically, is the "trade and commerce" power in subsection 91(2) of the *Constitution Act, 1867*. The leading case of *Citizens Insurance Co.* v. *Parsons* [88] established that 91(2) was composed of two elements: (1) interprovincial and international trade and commerce, and (2) the "general regulation of trade affecting the whole dominion". The words of Sir Montague Smith are worth repeating here:

> Construing therefore the words "regulation of trade and commerce" by the various aids to their interpretation above suggested, they would include political arrangements in regard to trade requiring the sanction of parliament, regulation of trade in matters of inter-provincial concern, and it may be that they would include general regulation of trade affecting the whole dominion. Their Lordships abstain on the present occasion from any attempt to define the limits of the authority of the dominion parliament in this direction. It is enough for the decision of the present case to say that, in their view, its authority to legislation for the regulation or trade and commerce does not comprehend the power to regulate by legislation the contracts of a particular business or trade, such as the business of fire insurance in a single province,

---

[86] *Canada – Import, Distribution, and Sale of Certain Alcoholic Drinks by Provincial Marketing Agencies*, GATT Report by the Panel, adopted on February 18, 1992, DS17/R, 48th Sess., 39th Supp. B.I.S.D. (1991-1992) 27.

[87] Castel *et al.*, *supra* note 23 at 25.

[88] [1882] 7 App. Cas. 96, 8 C.R.A.C. 406 (P.C.) [hereinafter *Citizens Insurance* cited to App. Cas.].

> and therefore that its legislative authority does not in the present case conflict or compete with the power over property and civil rights assigned to the legislature of Ontario by No. 13 of sect. 92.[89]

1. *First Branch: International Trade*

Prima facie, the regulation of investment is a matter of property and civil rights and is thus within provincial jurisdiction. Seen broadly, investment covers the power of individuals and companies to establish, purchase, and own business enterprises and other assets, as well as to manage and dispose of those investments. However, there is definitely a "double aspect" to investment since the federal government has legislative competence over international and interprovincial trade and commerce, which includes foreign investment as well as the import and export of goods and services. The problem is that "investment" as defined in Chapter 11 is difficult to classify under the federal trade and commerce power. National treatment of goods falls more neatly into federal power than does investment – goods by their very nature travel in and out of provinces, but it is very possible that an investment or investor covered by Chapter 11 will operate exclusively inside one province for many years and conduct business in the same way as a local Canadian investor would.

Provincial non-tariff barriers to international trade and investment might infringe upon 91(2), but probably only if they are aimed specifically at foreign investors or investment. A regular pith and substance analysis can reveal the true intent of the provincial legislation, and if it is found to be aimed at interprovincial or international trade, it can be struck down as *ultra vires*. Professor Sullivan has suggested that "the touchstone of invalidity is the intention by a province to distort the competitive performance of its products in the export market."[90] For example, in *Manitoba (A.G.)* v. *Manitoba Egg & Poultry Assn.*,[91] it was found that the marketing scheme was aimed at controlling the sale of imported eggs in order to benefit Manitoba producers, and was thus *ultra vires* the Legislature.[92] In *Central Canada Potash and Canada (A.G.)* v. *Saskatchewan*,[93] the Supreme Court found that the legislation at issue was aimed at controlling the price of exported products in order to protect Saskatchewan's share of the market in the U.S. and was, therefore, invalid.

However, provincial legislation can, if it is aimed at an intraprovincial activity within a provincial head of power, incidentally affect, for example, federal corporations, without trenching upon the federal trade and commerce power.[94] In *Carnation Co.* v. *The Quebec Agricultural Marketing Board*,[95] legislation authorizing the Quebec Agricultural Marketing Board to fix the price of raw milk effectively controlled the price

---

[89] *Ibid.* at 113. This passage was referred to with approval by Viscount Haldane L.C. in *John Deere Plow Co.* v. *Wharton*, [1915] A.C. 330 at 340-41, 18 D.L.R. 353 [hereinafter *John Deere* cited to A.C.].

[90] R.E. Sullivan, "Jurisdiction to Negotiate and Implement Free Trade Agreements in Canada: Calling the Provincial Bluff" (1987) 24 U.W.O. L. Rev. 63 at 77.

[91] [1971] S.C.R. 689, 19 D.L.R. (3d) 169 [hereinafter cited to S.C.R.].

[92] *Ibid.* at 689.

[93] [1979] 1 S.C.R. 42, 88 D.L.R. (3d) 609.

[94] See *e.g. Canadian Indemnity Co.* v. *B.C. (A.G.)*, [1977] 2 S.C.R. 504, 73 D.L.R. (3d) 111.

[95] [1968] S.C.R. 238, 67 D.L.R. (2d) 1.

of Carnation's processed milk, most of which was exported from Quebec. The legislation was upheld because the law was not *aimed* at the regulation of trade in matters of interprovincial concern. This logic could reasonably be applicable to foreign investors: valid provincial legislation can incidentally affect them, and they are bound to operate like other investors.

Can Chapter 11 be justified only under the first branch? Professor Stephen Scott has proposed that it is "constitutionally sufficient" for the courts to rely on the finding in *Citizens Insurance* that the first branch includes "political arrangements in regard to trade with foreign governments, requiring the sanction of Parliament".[96] Professor Sullivan has made a similar argument, suggesting that by virtue of that case, subsection 91(2) confers on Parliament a limited treaty implementation power specifically in regards to international trade agreements "consisting of the power to enact whatever legislation might be needed to give effect to treaties in respect of trade."[97]

Prima facie, this is an attractive argument and is a strong justification for a finding that Chapter 11 falls under the international trade head of power and, despite its potential for deep intrusion into provincial jurisdiction, the rights and privileges afforded to NAFTA investors are necessary and justifiable. As Professor Scott has pointed out, Canada has no choice but to be part of international trade agreements, the terms of which it cannot unilaterally dictate, and those agreements inevitably deal with issues at the local level, be they non-tariff barriers or investment.[98] This is true, and Canada's dependence on a globalized economy makes it inevitable that the courts will have to allow for greater federal intrusion into what was once exclusively provincial jurisdiction. The ability of Parliament to enact a law proscribing a particular provincial action that it would not otherwise be competent to do might be considered *intra vires* because "the prohibited practice was the subject of reciprocal obligations in an international treaty designed to reduce barriers to trade," which is "powerful (although not conclusive) evidence that the federal law was indeed in relation to international trade."[99]

However, even if Chapter 11 could be seen as falling into the first branch of 91(2), considering the infinite number of scenarios of how provincial legislation could conflict with its provisions, it becomes difficult to rely *solely* on this branch as a justification for such an extensive intervention into the full legislative competence of the province. While Sir Montague Smith in *Citizens Insurance* said that 91(2) "does not comprehend the power to regulate by legislation the contracts of a particular business or trade,"[100] the nature of Chapter 11 will likely mean that the federal government would have to stray into that territory to give effect to its provisions. To illustrate with a fanciful example, if P.E.I. passed a law giving a tax break to any restaurant in the province which uses locally-grown potatoes for more than 50% of its French fries, a NAFTA investor such as McDonald's or Burger King could allege a breach of Article

---

[96] S.A. Scott, "NAFTA, the Canadian Constitution and the Implementation of International Trade Agreements" in A.R. Riggs and T. Velk, eds., *Beyond NAFTA: An Economic, Political and Sociological Perspective* (Vancouver: Fraser Institute, 1993) 245.

[97] Sullivan, *supra* note 90 at 80.

[98] Scott, *supra* note 96 at 241.

[99] Hogg, *supra* note 66 at 304.

[100] *Citizens Insurance, supra* note 88 at 113.

1106(3)(a) and (b).[101] If a NAFTA arbitral panel awarded compensation against P.E.I., the federal government would be bound to ensure that compensation was paid. If it tried to force P.E.I. to reverse its legislation or pay the damages award, this would amount to a measure which *Citizens Insurance* and other cases specifically contemplated as being excluded from 91(2).

Instead of being "constitutionally sufficient", the fact that Canada is a trading nation whose economy is intrinsically linked to other countries through trade agreements would be the "cement" that would hold the various constitutional bricks together. Although it would prove to be a powerful argument for fulfilling the test the Supreme Court has developed for assessing the relative intrusion into provincial powers by a law justified under the federal trade and commerce power, I believe more will be needed in cases where the effect on provincial jurisdiction is significant.

The prospect that these political arrangements "in regard to trade" with foreign governments will extensively interfere with provincial jurisdiction will make the courts wary of recognizing a trade treaty implementation power, especially considering the traditional judicial approach to treaty implementation since *Labour Conventions*. In *Lawson* v. *Interior Fruit Tree and Vegetable Committee of Direction*, Duff J. stated:

> The scope which might be ascribed to head 2, s. 91 (if the natural meaning of the words, divorced from their context, were alone to be considered), has necessarily been limited, in order to preserve from serious curtailment, if not from virtual extinction, the degree of autonomy which, as appears from the scheme of the Act as a whole, the provinces were intended to possess. Therefore, it has been found necessary to say that this head does not comprise the regulation, by a system of licences, of a particular business within any one or within all of the provinces. But there is no lack of authority for the proposition that regulations governing external trade, that is, trade between Canada and foreign countries, as well as regulations in matters affected with an interprovincial interest, or regulations which are necessary as auxiliary to some Dominion measure relating to trade generally throughout the Dominion, and dealing with matters not falling within s. 92, such as, for example, the incorporation of Dominion companies, are within the purview of that head.[102]

There are other points to be made to caution against a trade treaty implementation power. First, given the context of *Citizens Insurance*, it is not entirely appropriate to rely exclusively on that case to allow for the wholesale implementation of contemporary trade treaties. At the time of that case, "trade" was considered to be limited only to the import and export of manufactured and agricultural goods, whereas NAFTA covers a much broader range of measures than simply the tariffs applicable to imported and exported goods. "Investment" as contemplated in Chapter 11 was not a

---

[101] Article 1106(3) states that "[n]o Party may condition the receipt or continued receipt of an advantage, in connection with investments in its territory of investors of a Party or of a non-Party, on compliance with any of the following requirements: (a) to achieve a given level or percentage of domestic content; (b) to purchase, use or accord a preference to goods produced in its territory, or to purchase goods from producers in its territory": *supra* note 2 at 640. Further, Article 1102 requires that each NAFTA party is to accord investors from the other parties national treatment – i.e., the same treatment it gives to its own investors in like circumstances: *ibid.*

[102] *Lawson* v. *Interior Tree, Fruit and Vegetable Committee of Direction*, [1931] S.C.R. 357 at 366, 2 D.L.R. 193 at 200.

subject contemplated by their Lordships.[103] Customs tariffs were at the center of trade arrangements between countries. While the (British-American dictated) international legal norms in regards to the protection of foreign investment from expropriation were established at the turn of the century, they were largely imposed on developing countries and enforced diplomatically – either from embassies or gunboats.[104] The inevitable effects of Chapter 11 at the local level go far beyond what was contemplated by their Lordships in 1881.

Second, if we accept the argument that the federal government has a specific treaty implementation power with regards to trade arrangements with foreign countries, the increasing linkages between trade and the environment and labour and human rights will mean that the courts will necessarily have to overturn *Labour Conventions* if a general trade treaty implementation power is recognized, unless a court considered these types of provisions constitutionally severable from a trade agreement implemented in domestic law. Whereas a trade arrangement with a foreign government, at the time of *Citizens Insurance*, would have never included environmental and labour standards, NAFTA does.[105] Similarly, part of the failed WTO Millennium Round included attempts to put labour standards and the environment on to the WTO agenda.[106] Many have called for a repudiation of *Labour Conventions*, which could happen given the *dicta* in cases like *Macdonald* v. *Vapor Canada Ltd*,[107] but it is doubtful that the Supreme Court will go that far when it could find another constitutional solution.

Third, for years the *Labour Conventions* doctrine has prompted "cooperative federalism" between the provinces and the federal government when it comes to the implementation of treaties in Canada, and the Supreme Court might be wary of rendering that negotiation process legally unnecessary. As unwieldy as it may be at times, the federal government's understanding that it must seek cooperation with the

---

[103] Richard Rosencrance has noted that in 1913, British foreign trade in goods totaled 43.5% of GNP and involved primarily an exchange of manufactured goods for food and raw materials. About 90% of British investment was portfolio investment; that is, small holdings of foreign shares that could easily be disposed of on the stock exchange. Direct investment (more than a 10% share of total ownership of a foreign firm) was only one-tenth of the total. See R. Rosecrance, *The Rise of the Trading State: Commerce and Conquest In the Modern World* (New York: Basic Books, 1986) at 146. The distinction between trade in goods and other areas that are now intrinsic to comprehensive trade agreements like NAFTA and GATT was noted indirectly by Laskin C.J.C. in *Re Anti-Inflation Act*, [1976] 2 S.C.R. 373 at 426, 68 D.L.R. (3d) 452 at 498 [hereinafter *Anti-Inflation Reference* cited to S.C.R.]: "[t]he *Anti-Inflation Act* is not directed to any particular trade. It is directed to suppliers of commodities and services in general and to the public services of governments."

[104] See generally C. Lipson, *Standing Guard: Protecting Foreign Capital in the Nineteenth and Twentieth Centuries* (Berkeley: University of California Press, 1985) at 53-64.

[105] Two side agreements, the *North American Agreement on Environmental Cooperation*, 14 September 1993, 32 I.L.M. 1480 (entered into force 1 January 1994), and the *North American Agreement on Labor Cooperation*, 14 September 1993, 32 I.L.M. 1499 (entered into force 1 January 1994), are not assumed to be fully within federal jurisdiction since both require that the Canadian provinces specifically indicate their willingness to be bound by the agreements: Castel *et al.*, *supra* note 23 at 72-73.

[106] "The Battle in Seattle" *The Economist* 353:8147 (27 November–3 December 1999) 21.

[107] [1977] 2 S.C.R. 134 at 167-73, 66 D.L.R. (3d) 1 at 27-32, per Laskin C.J.C [hereinafter *Vapor* cited to S.C.R.].

provinces for the domestic implementation of a treaty forces it to take provincial opinions seriously. A complete reversal of *Labour Conventions* for trade treaties, especially in an era of globalization, might do Canada more harm than good.

Fourth, while Canada's economic development is very much dependent on its competitiveness in the international economy, there is an argument to be made that this should not automatically justify an unfettered federal right to implement trade agreements *in toto*. The cost of federalism may be that Canada has to be cautious about what international obligations it undertakes. As Robert Howse put it, "[w]hy should the economic efficiency concerns that dictate global cooperation necessarily trump provincial autonomy concerns, including social regulation and the protection of underdeveloped communities and regions?"[108] Some authors are very concerned about provinces which are so "willing to suppress their passion for provincial rights to pursue their love of laissez-faire economics."[109] Of course, Canada's federal system is constantly evolving, and will be forced to evolve by the increasing number of treaties that require local effect, but it is unlikely that the courts will wholeheartedly grant the federal government a limited trade treaty implementation power without developing some judicial mechanism of ensuring provincial rights are not sacrificed at the altar of globalization.[110] As La Forest J. stated in *R.* v. *Crown Zellerbach Canada Ltd.*,[111] "[t]he challenge for the courts, as in the past, is to allow the federal Parliament sufficient scope to acquit itself of its duties to deal with national and international problems while respecting the scheme of federalism provided by the Constitution." The courts will have to balance the words in *Citizens Insurance*, in its context, with almost seventy years of jurisprudence under *Labour Conventions*. It is therefore unlikely (and, in my opinion,

---

[108] R. Howse, "The Labour Conventions Doctrine in an Era of Global Interdependence: Rethinking The Constitutional Dimensions of Canada's External Economic Relations" (1990) 16 Can. Bus. L.J. 160 at 171.

[109] A. Petter, "Free Trade and the Provinces" in Gold and Leyton-Brown, *supra* note 62 at 147. In the same volume, Dale Gibson writes of the Canada-U.S. Free Trade Agreement: "[E]ven if one were to lay aside concerns about Canada's cultural, social and economic future, as a collectivity, the opportunity that the FTA presents to the federal authorities to impose a uniform economic model (and therefore largely uniform political and social models) on all the provinces should be profoundly disturbing to anyone who values federalism." D. Gibson, "The Free Trade Agreement and the Provinces: A Counter for the Sale of Constitutional Wares?" in *ibid.* at 118.

[110] Gibson, *ibid.*, calls for an "unorthodox approach" to try to limit the effects of the paramountcy principle, which he believes will inevitably result in the nullification of a conflicting provincial law if an orthodox application of constitutional principles to the question as to whether the federal government has the power to implement the FTA. He suggests that one could argue that "federal legislation implementing the FTA would reach so far into areas normally under provincial control as to jeopardize the basic federal principle upon which the constitution of Canada rests": *ibid.* at 122. Lederman makes the argument that to protect federalism but at the same time give the federal government the ability to implement treaties, the court's should rely on the federal 'peace, order and good government' power where the treaty matters "have an identity and unity that is quite limited and particular in its extent" but deny the federal implementation if it trenches upon a matter of fundamental provincial jurisdiction: W.R. Lederman, "Legislative Power to Implement Treaty Obligations in Canada", in *Continuing Canadian Constitutional Dilemmas* (Toronto: Butterworths, 1981) at 350-58. Sullivan, *supra* note 90 at 69-70, critiques this position as lacking a constitutional underpinning, although Lederman's approach was adopted by Beetz J. in *Anti-Inflation Reference*, *supra* note 103 at 451-52. See also Hogg, *supra* note 66 at 303.

[111] [1988] 1 S.C.R. 401 at 448, 49 D.L.R. (4th) 161 at 196.

undesirable) that the Supreme Court will recognize an unfettered right on the part of the federal government to implement international trade agreements simply because they are classified as such. Rather, the courts will likely recognize the general principle established in *Citizens Insurance* that trade agreements are under a federal head of power and will give wide leeway for necessary intrusions into provincial jurisdiction where necessary and justified.[112] However, as will be argued below, this may be limited depending on the extent of the intrusion.

2. *Second Branch: General Trade and Commerce Power*

Until *General Motors* v. *City National Leasing*,[113] the second branch of *Parsons* was never accepted as a legal basis of support for federal economic regulations. Prior to *City National Leasing*, the only cases in which the general trade and commerce power was referred to as an independent legal justification were *Ont. (A.G.)* v. *Canada (A.G.)*[114] and *John Deere*. The courts have been historically cognizant of Sir Montague Smith's observation in *Citizens' Insurance* that, if unrestrained, virtually any aspect of local trade could come under the federal trade and commerce power. Thus, the scope of the general trade and commerce power had never been clearly elucidated. The Privy Council initially adopted an inclusive approach in *John Deere*, but later reversed that position in *In re the Board of Commerce Act, 1919, and the Combines and Fair Practices Act, 1919*.[115] In the latter case, which dealt with anti-combines prohibitions, Viscount Haldane wrote that the federal trade and commerce power could not stand on its own but could only be invoked as ancillary to other federal powers. Although Lord Atkin distanced himself from this position later in *Proprietary Articles Trade Association* v. *Canada (A.G.)*,[116] the general trade and commerce power was consistently rejected by the Privy Council.[117]

The general trade and commerce power would not be resurrected as an independent entity until 1989, but the 1977 *Vapor* case established a basis for its reemergence. At issue in that case was the validity of subsection 7(e) of the *Trade Marks Act*[118] which prohibited unfair competition practices such as passing-off, making false or misleading statements against a competitor as well as a vague prohibition against "any other business practice contrary to honest industrial or commercial usage in Canada".[119] The Court found that the provision was *ultra vires* Parliament because, in the absence of a federal regulatory administration to oversee its prescriptions, there

---

[112] See G. La Forest, "The *Labour Conventions* Case Revisited" (1974) 12 Can. Y.B. Int'l L. 137.

[113] [1989] 1 S.C.R. 641, 58 D.L.R. (4th) 255 [hereinafter *City National Leasing* cited to S.C.R.].

[114] [1937] A.C. 405, 1 D.L.R. 702 (P.C.).

[115] [1922] 1 A.C. 191, 1 W.W.R. 20 (P.C.).

[116] [1931] A.C. 310, 1 W.W.R. 552 (P.C.).

[117] See *Canada (A.G.)* v. *Alta. (A.G.)*, [1916] 1 A.C. 588, 10 W.W.R. 405 (P.C.); *Toronto Electric Commissioners* v. *Snider*, [1925] A.C. 396, 1 W.W.R. 785 (P.C.); *R.* v. *Eastern Terminal Elevator Co.*, [1925] S.C.R. 434, 3 D.L.R. 1 (P.C.); *B.C.(A.G.)* v. *Canada (A.G.)* [1937] A.C. 377, 1 D.L.R. 691 (P.C.).

[118] At the time, R.S.C. 1970, c. T-10, as am. by s. 64(2) of the *Federal Court Act*, 1970 (Can.), c.1 [hereinafter *Trade Marks Act*].

[119] *Ibid.*, s. 7(e).

is no federal power available to justify it. However, Laskin C.J.C. did suggest that legislation might be upheld under the second branch of the trade and commerce power if it met three criteria: (1) the impugned provision must be part of a general regulatory scheme, (2) the scheme must be monitored by an overseeing regulatory agency, and (3) the legislation must be concerned with trade as a whole rather than with a particular industry.[120] In 1983, Dickson J. (as he was then) used these *dicta* to argue that the general trade and commerce power was a legitimate basis upon which to legally justify the federal Competition Act. In *Canada (A.G.)* v. *Canadian National Transportation*,[121] he added two factors to those suggested by Laskin C.J.C. in *Vapor*[122] that would be indicative of a valid use of the general trade and commerce power: "(i) that the provinces jointly or severally would be constitutionally incapable of passing such an enactment and (ii) the failure to include one or more provinces or localities would jeopardize successful operation in other parts of the country."[123]

The combination of these factors proved to be decisive in *City National Leasing*. In that case, City National Leasing (CNL) initiated an action against General Motors (GM) pursuant to section 31.1 of what was then the *Combines Investigation Act*.[124] CNL claimed that GM had been paying preferential interest rate support to its competitors and alleged that this was a form of price discrimination for which CNL was entitled to recover damages against GM. GM, supported by provincial Attorneys-General, argued that Parliament had no competence to enact section 31.1 because it fell into provincial jurisdiction; specifically, property and civil rights – subsection 92(13) of the *Constitution Act, 1867* – and/or matters of a merely local or private nature – subsection 92(16) of the *Constitution Act, 1867*. They argued that this provision did not fall under the federal trade and commerce power; and even if the Court found that the *Combines Investigation Act* as a whole was *intra vires* Parliament – which was implicitly conceded – the civil cause of action could not be characterized as necessarily incidental to a valid scheme regulating trade and commerce.

Thus, the two constitutional questions at issue before the Court were: (a) was the *Combines Investigation Act*, in whole or in part, within federal legislative competence under subsection 91(2) of the *Constitution Act, 1867*, and (b) was section 31.1 of the *Combines Investigation Act* within federal legislative competence? Dickson C.J.C. recognized that the judicial attitude towards 91(2) was based on a need to balance the federal power over trade and commerce with provincial jurisdiction over property and civil rights so that federal legislation would not destroy provincial powers. However, he did feel that the five factors established in *Vapor* and *CN Transportation* were appropriate characteristics of a federal regulatory scheme which could be a justifiable encroachment on a strictly local economic activity. In the end, the Supreme Court found both the federal competition legislation and the impugned provision were valid as being sufficiently integrated into the regulatory scheme.

---

[120] *Vapor, supra* note 107 at 164-65. Hogg notes that Laskin C.J.C.'s *dicta* is not based on previous case law: P.W. Hogg, *Constitutional Law of Canada*, 4th student ed., (Scarborough: Carswell, 1998) at 542.

[121] [1983] 2 S.C.R. 206, 3 D.L.R. (4th) 16 [hereinafter *CN Transportation* cited to S.C.R.].

[122] *Vapor, supra* note 107 at 164-65.

[123] *CN Transportation, supra* note 121 at 267-68.

[124] R.S.C. 1970, c. C-23.

3. *Application of the* City National Leasing *Criteria to Chapter 11*

Dickson C.J.C. did point out that these elements were not exhaustive and the presence or absence of any of the five is not necessarily determinative. However, a strong case could be made that Chapter 11 fulfills all the criteria necessary for it to be upheld under the general trade and commerce power.

(a) *General Regulatory Scheme*

Dickson C.J.C. concluded in *City National Leasing* that three components would constitute an integrated scheme of regulation: "elucidation of prohibited conduct, creation of an investigatory procedure, and the establishment of a remedial mechanism".[125] The *Combines Investigation Act* was clearly a general economic regulatory scheme by this description. Similarly, the NAFTA, in its entirety, can be seen as a national regulatory scheme for free trade with the United States and Mexico. More specifically, these components are definitely present in Chapter 11. It establishes a comprehensive regime for the standard of treatment to be afforded foreign investors and their investments and provides a remedy for breaches of those standards. It is divided into two sections. The first outlines who and what is entitled to benefit from its provisions and the standards that each NAFTA party must apply to those beneficiaries (Articles 1101-1114), plus the Annexes where existing non-conforming legislation is specified, and the specific reservations each party has acknowledged as operating notwithstanding the obligations in Chapter 11. The second section deals with the settlement of disputes between a NAFTA party and an investor of another party (Articles 1115-1139). International arbitration conventions make up an intrinsic part of the dispute resolution mechanism. The law to be applied to resolve disputes is that contained within the NAFTA itself and in accordance with international law (Article 1131). The application of an entirely separate body of law for resolving disputes is a critical factor in proving its distinctness.

There are structural similarities between the impugned provision in *City National Leasing* and the remedy provided in Chapter 11. In the former case, section 31.1 of the *Combines Investigation Act* created a civil cause of action to anyone who suffered loss or damage as a result of conduct that violated the specified provisions of the Act. The Supreme Court found this provision to be valid because it was functionally related to the Act: "the inclusion of a private right of action in a federal enactment is not constitutionally fatal."[126] In the case of the NAFTA, Article 1116(1) states:

> 1. An investor of a Party may submit to arbitration under this Section a claim that another Party has breached an obligation under:
>
> (a) Section A or Article 1503(2) (State Enterprises), or
>
> (b) Article 1502(3)(a) (Monopolies and State Enterprises) where the monopoly has acted in a manner inconsistent with the Party's obligations under Section A, and that the investor has incurred loss or damage by reason

---

[125] *City National Leasing, supra* note 113 at 676.
[126] *Ibid.* at 674.

of, or arising out of, that breach.[127]

From this overview, which does not include a consideration of its relation to the rest of the Agreement, a court could reasonably conclude that this qualifies as a "general regulatory scheme" for the purposes of the general trade and commerce power.

(b) *Oversight of a Regulatory Agency*

Unlike the *Competition Act*, there is no regulatory agency *per se* to oversee the implementation and enforcement of the specific provisions of Chapter 11. However, the fact that it provides for binding arbitration with its own procedures pursuant to international treaties and requires the application of international legal standards as to whether a party's action is in conformance with the NAFTA should be sufficient to qualify as providing "oversight" for the rules in Chapter 11.

Further, the NAFTA itself does have an overseeing Secretariat and a Free Trade Commission, both established under Article 2001 and playing an important role in the implementation of the NAFTA, including dispute resolution under Chapter 11. The Commission is composed of one cabinet level official from each of Canada, the U.S. and Mexico who meet several times a year to supervise and manage disputes amongst the parties. The Commission, along with the national secretariats, also oversees the various committees and working groups established pursuant to various NAFTA chapters.

The Commission would play a role in enforcing any final award by a Chapter 11 arbitration panel. Article 1136(5) states:

> If a disputing Party fails to abide by or comply with a final award, the Commission, on delivery of a request by a Party whose investor was a party to the arbitration, shall establish a Panel under Article 2008 (Request for an Arbitral Panel). The requesting party may seek in such proceedings:
>
> (a) a determination that the failure to abide by or comply with the final award is inconsistent with the obligations of this Agreement; and
>
> (b) a recommendation that the Party abide by or comply with the final award.

The Chapter 20 arbitral panel, which is established at the behest of a government for any dispute arising under the NAFTA, has extensive powers and may order remedies such as compensation, remedial action or the suspension of the application of equivalent benefits.[128]

(c) *Concern with Trade as a Whole*

This criterion is clearly met by Chapter 11. Its provisions apply to all investors and their investments in whatever economic field to which Chapter 11 applies.[129]

---

[127] *Supra* note 2 at 642-43.

[128] Castel *et al.*, *supra* note 23 at 709-20.

[129] Chapter 11 does not apply to financial services (Article 1101(3)) or to those exceptions outlined in Annex III.

Companies who have used, or are in the process of using, the investor protection mechanisms in Chapter 11 include those in the business of waste management, forestry, courier services, funeral homes and gasoline additives.

(d) *Provincial Incapacity*

It is clear that the provinces could not undertake to devise such a comprehensive foreign investment scheme, legally or practically. First of all, it is unlikely that the provinces would be able to legally enter into foreign investment agreements with other States. Such an attempt would undoubtedly be opposed by the federal government on the grounds that it alone can enter into treaties as such.[130] Second, it is unrealistic to think that either the United States or Mexico would agree to enter into such an agreement with individual provinces given the inconsistency in legislation as amongst the provinces that would inevitably result. Third, the porous nature of investment that flows across provincial and international borders makes it impractical, if not impossible, for provinces to singly regulate foreign investment in general in a manner similar to Chapter 11.

(e) *Effect of Failure to Include One or More Provinces*

Free trade agreements are based on reciprocal concessions; thus, if one province failed to adhere to the terms of the NAFTA, or was found to be constitutionally exempt from its provisions, benefits for the other provinces and the federal government would likely be withheld,[131] thereby neutralising the general applicability of the agreement and its dispute resolution mechanism. As Fairley has pointed out, the Agreement and its subcomponents, like Chapter 11, can be seen as a "non-severable organic whole .... [M]utually interdependent concessions make it very much of an all-or-nothing affair."[132]

In conclusion, Chapter 11 fits neatly into the criteria outlined in *City National Leasing*. The remaining issue is exactly how far Chapter 11 restricts provincial power in a given context, which will undoubtedly be the most difficult question for a court to deal with.

4. *Impairment of Provincial Powers*

B.C. (A.G.) v. *Canada (A.G.) (Re Natural Products Marketing Act, 1934)*,[133]

---

[130] See *In the Matter of a Reference by the Governor General in Council Concerning the Ownership of and Jurisdiction Over Off-Shore Mineral Rights*, [1967] S.C.R. 792, 65 D.L.R. (2d) 353; J.S. Ziegel, "Treaty Making And Implementing Powers in Canada: The Continuing Dilemma" in B. Cheng & E.D. Brown, eds., *Contemporary Problems of International Law: Essays in Honour of Georg Schwarzenberger On His Eightieth Birthday* (London: Stevens & Sons, 1988) at 333, 350-53.

[131] Howse, *supra* note 108 at 182.

[132] H.S. Fairley, "Implementing the Canada-United States Free Trade Agreement" in D.M. McRae & D.P. Steger, eds., *Understanding the Free Trade Agreement* (Halifax: Institute for Research on Public Policy, 1988) 193 at 200.

[133] [1937] A.C. 377; 1 D.L.R. 691 (P.C.).

and *R.* v. *Klassen*[134] both emphasized that there may be valid ancillary regulations that are necessary to federal regulation of external and interprovincial trade which would otherwise be within provincial jurisdiction. *City National Leasing* vindicates this position by accepting the notion that there can be valid federal legislation to regulate certain strictly intraprovincial trade and transactions. The regulation of particular business or trades, which normally falls under provincial jurisdiction, can take on a federal dimension "when what is at issue is general legislation aimed at the economy as a single integrated national unit rather than as a collection of separate local enterprises."[135]

From the above analysis, there seems to be strong judicial precedent to find that Chapter 11, considered on its own, falls under the first branch of the trade and commerce power in some circumstances but under the general trade and commerce power in all. In Dickson C.J.C.'s view, however, the necessity of balancing federal and provincial rights and interests under the Constitution requires more than a simple pith and substance test. In order to ensure that federal power would not run roughshod over provincial powers, but recognizing that both levels of government need to be accorded a degree of latitude to pursue legitimate objectives, he suggested that a constitutional analysis of a particular provision requires three steps.[136] First, the court will consider whether and to what extent the impugned provision can be characterized as intruding on provincial powers. Second, the provision's relationship to legislation must be considered: is the act itself valid and justified under the trade and commerce power (most likely characterized by the presence of a regulatory scheme)? Third, can the provision be constitutionally justified by reason of its connection with valid legislation? In regards to the final step, integration into the scheme must be considered in light of the seriousness of the invention into provincial jurisdiction.

The provisions of Chapter 11 are not, *prima facie,* overly intrusive into provincial jurisdiction. For example, national treatment of investments does not necessarily infringe on provincial powers to any great extent – it still leaves provinces with regulatory power, but NAFTA investors cannot be treated any differently than local investors. Provincial legislation would not necessarily be rendered totally invalid – it might be inoperative vis-à-vis the foreign investor. Given the billions of dollars of foreign investment in the Canadian economy, as well as the fact that Canadian direct investment abroad amounts to $257 billion,[137] there is a strong argument to be made that the federal government has the duty to ensure that transparency and fair standards of treatment of foreign investors, especially those from our major trading partners, are upheld.

However, one can easily envisage scenarios whereby a province is significantly hindered, or even prevented, from exercising its constitutional powers.[138] Parliament

---

[134] (1959), 20 D.L.R. (2d) 406, 29 W.W.R. 369 (Man. C.A.), leave to appeal to S.C.C. refused [1959] S.C.R. ix.

[135] *CN Transportation, supra* note 121 at 267.

[136] *City National Leasing, supra* note 113 at 667-72.

[137] 52.2% of that Canadian direct investment abroad is located in the United States while the U.S. accounted for 72.2% of the total stock of foreign direct investment in Canada in 1999: *June 2000 Trade Update, supra* note 13 at 33-34.

[138] Gibson suggests that the single-handed implementation of the FTA (now NAFTA) would "hobble the ability of provincial governments to devise social or economic programs designed to promote the interests of provincial residents or provincial businesses by measures

had a rude awakening in 1998 when it sought to ban the interprovincial trade of the gasoline additive MMT; the federal government actually reversed its legislation when faced with the prospect of a NAFTA challenge. If it had decided to fight the case and lost, it could have been liable for as much as $250 million.[139] As noted above, Sun Belt Water from California is claiming up to $220 million for allegedly biased treatment by the British Columbia government.[140]

The example provided earlier regarding the creation of a no-fault auto insurance scheme is also illustrative. If a province was required to compensate U.S. or Mexican insurance companies for an expropriation of its investment in the province, this could be so cost-prohibitive that it would frustrate the creation of the entire scheme. Even though the payment of compensation to the investors may be ancillary and necessary for the implementation of the treaty and is thus *intra vires* Parliament, the extent of the intrusion might be unacceptable to a court concerned with the federal-provincial balance. In such a situation, it is very possible that the Supreme Court would find that the intrusion into provincial powers is simply too great to be justified under the federal trade and commerce power. This could leave the federal government to pay the NAFTA investor itself with no chance of recouping the amount from the province responsible for the breach of Chapter 11 in the first place.

All things considered, this may be the only thing to do in the name of protecting the federal principle. One does not need to be the type to protest on the streets of Seattle to find it disconcerting that a valid provincial law to create a provincial park, public insurance scheme, settle native land claims or ensure that the bulk export of water does not destroy a precious resource might be rendered impotent because compensation must be paid to a foreign investor, even when it is not given to domestic investors in similar circumstances. In cases where the federal-provincial balance is truly threatened, a strong argument could be made that Canada's international treaty obligations may have to come second and that the federal government will have to bear the financial burden for Chapter 11 by itself.

Of course, one cannot speculate on the endless array of possibilities where a province might settle with the investor, the federal government might "twist the arm" of the provincial legislature into remedying the situation, or a damage award, if small enough, will simply be paid without question. Perhaps the two levels of government will split the bill. Perhaps such extreme incidents will never arise. Nonetheless, when it comes to a judicial review of a specific dispute, a court will have to take into account

---

such as creative taxation, subsidies, developmental grants, public ownership, or purchasing preferences. Canadian federalism's capacity for diversity and experiment would be crippled": *supra* note 109 at 127.

[139] See Soloway, *supra* note 35 at 5; "Canada Lifts Ban on Ethyl's Additive" *The Wall Street Journal* (21 July 1998) A2.

[140] Inflated (and, *prima facie,* ridiculous) compensation claims seems to be the early strategy for Chapter 11 claimants. Metalclad proposed one formula for compensation that would have amounted to a damage award of approximately $115 million. It was awarded significantly less than that. See *Metalclad, supra* note 24 at paras. 114-15. Vancouver-based Methanex Corp. is suing the United States for $970 million in response to California's recent decision to ban MTBE, a gasoline additive made with methanol, Methanex's only product. See Methanex News Release, "Methanex Seeks Damages Under NAFTA for California MTBE Ban" (15 June 1999), online: <http://www.methanex.com/investorcentre/newsreleases/nafta.pdf> (date accessed: 10 November June 18, 1999).

the extent of the intrusion, which will depend on the issue and, perhaps more importantly, the amount of the damages awarded by the arbitration panel.

In conclusion, the federal government can be confident that Chapter 11 falls strongly within the general trade and commerce power. While any constitutional analysis would necessarily occur in the context of a particular issue, a court would likely uphold the federal law dealing with compensation under Chapter 11 *unless* the intrusion into provincial jurisdiction power was so significant that it actually frustrates the substantial exercise of a section 92 power.

B. *Aliens – Subsection 91(25)*

Foreign investment could also be addressed under the federal power over naturalization and aliens.[141] Chapter 11 applies to "investors of another Party" and "investments of investors of another party in the territory of the Party".[142] A NAFTA investor is defined as "a Party or state enterprise thereof, or a national or an enterprise of such Party, that seeks to make, is making or has made an investment". This definition clearly indicates that Chapter 11 applies to non-nationals and *prima facie* falls under subsection 91(25) of the Constitution.[143]

NAFTA countries are bound to treat investors from each others' countries in accordance with international legal standards, which are incorporated into Chapter 11 by reference (Article 1105).[144] Since it is Canada that has external sovereignty, not the provinces,[145] and since the federal government will be liable at international law for breaches of Canada's obligations to treat aliens according to international legal norms,[146] jurisdiction over aliens should logically fall within federal jurisdiction.[147] Provinces

---

[141] *Constitution Act, 1867, supra* note 19.

[142] Chapter 11 also applies to "all investments in the territory of the Party" in regards to Article 1106 (Performance Requirements) and Article 1114 (Environmental Measures). Article 1106 precludes the application or enforcement of certain performance requirements (e.g. exporting a given level of goods or services or achieving a certain level of domestic content) against "an investment of an investor of a Party or of a non-Party in its territory": *supra* note 2 at 640.

[143] An "enterprise of a Party" is defined in Article 1139 as "an enterprise constituted or organized under the law of a Party, and a branch located in the territory of a Party and carrying out business activities there": *ibid.* at 647. The status of an enterprise under NAFTA does not depend on nationality, meaning that to be an "investor of a Party" the enterprise need only be organized under the laws of a NAFTA country but need not be controlled by nationals of that country. Under NAFTA 1113, if it is controlled by nationals of a non-NAFTA country, benefits can only be denied to it if the enterprise does not have substantial business activities in the NAFTA country under which it is constituted or if the NAFTA country in question does not maintain diplomatic ties with the non-NAFTA country. Thus, a Canadian subsidiary of a French multinational must be given the benefits of Chapter 11 by the U.S. and Mexico when investing in those countries even though the company is not controlled by Canadians: see Johnson, *supra* note 30 at 284.

[144] See generally M. Sornarajah, *The International Law on Foreign Investment* (Cambridge: Cambridge University Press, 1994).

[145] *Re Continental Shelf Offshore Nfld.*, [1984] 1 S.C.R. 86 at 126, 5 D.L.R. (4th) 385 at 418; *Metalclad, supra* note 24 at para. 73.

[146] *Reference Re Ownership of Offshore Mineral Rights*, [1967] S.C.R. 792 at 821, 65 D.L.R. (2d) 353 at 380 [hereinafter *Offshore Minerals Reference* cited to S.C.R.].

[147] E.J. Arnett, "Canadian Regulation of Foreign Investment: The Legal Parameters" (1972) 50 Can. Bar Rev. 213 at 227.

may, of course, under subsection 92(13) or another head of power, incidentally affect aliens if the legislation is in pith and substance within provincial jurisdiction. If, however, federal law "touching on the rights and disabilities of aliens" conflicts with provincial law, then the provincial legislation will become legally ineffective to the extent of that inconsistency.[148]

However, the question here is whether the type of economic rights that are outlined in Chapter 11 can reasonably be said to fall within the federal aliens power. As noted above, investment does not fall as neatly into the federal trade and commerce power because it usually becomes integrated into the local economy and can lose its "international" character except for its relationship to the owner. Nonetheless, if the federal government can dictate the terms of entry into Canada and restrict the businesses in which they may invest, is it not logical to accept that the federal government can also grant foreign investors specific rights of treatment? That is, can the federal government prescribe *rights* in addition to *duties*? While the federal power over aliens has not received extensive judicial elaboration, the established case law seems to indicate that the federal government does have the power to grant non-nationals specific rights of treatment such as that found in Chapter 11.

The early cases dealing with discrimination against people of Asian ancestry and federal attempts at regulating insurance provide insight into the boundary between subsections 91(25) and 92(13). *Union Colliery Co.* v. *Bryden* (1899)[149] dealt with a British Columbia prohibition on the employment of "Chinamen" in section 4 of the *Coal Mines Regulation Act, 1890*. The Privy Council ruled that the provision was *ultra vires* the Legislature because, according to their Lordships, it applied to "Chinamen who are aliens or naturalized subjects", whose status fell within federal jurisdiction: "[t]heir Lordships see no reason to doubt that, by virtue of s. 91(25), the legislature of the Dominion is invested with exclusive authority in all matters which directly concern the rights, privileges, and disabilities of the class of Chinamen who are resident in the provinces of Canada."[150] They found that, in pith and substance, the impugned provision was a statutory prohibition affecting aliens and naturalized subjects, and therefore was *ultra vires* the Legislature. While it seems evident that the Privy Council missed the point that this legislation was based on race rather than alien status, which caused much confusion in subsequent cases, *Union Colliery* is foundational for this area of Canadian law.

This was clarified in *Cunningham* v. *Tomey Homma*,[151] when the applicant, a Japanese native but also a naturalized British subject, was turned away when he attempted to place his name on the provincial voters registration list pursuant to the *Provincial Elections Act of British Columbia*.[152] The Privy Council found the law to be within provincial jurisdiction since it was based on race rather than alienage. Of importance for considering where the federal power ends and provincial jurisdiction begins, the Privy Council stated:

---

[148] *Reference Re Reciprocal Insurance Legislation*, [1924] A.C. 328 at 345, 1 D.L.R. 789 at 802 [hereinafter *Reciprocal Insurance* cited to A.C.].

[149] [1899] A.C. 580, 12 C.R.A.C. 175 (P.C.) [hereinafter *Union Colliery* cited to A.C.].

[150] *Ibid.* at 587.

[151] [1903] A.C. 151, 13 C.R.A.C. 111 [hereinafter *Tomey Homma* cited to A.C.].

[152] R.S.B.C., 1897, c. 67.

> Could it be suggested that the province of British Columbia could not exclude an alien from the franchise of that province? Yet, if the mere mention of alienage in the enactment could make the law *ultra vires*, such a construction of s. 91, sub-s 25, would involve absurdity. The truth is that the language of that section does not purport to deal with the *consequences* of either alienage or naturalization. It undoubtedly reserves these subjects for the exclusive jurisdiction of the Dominion – that is to say, it is for the Dominion to determine what shall constitute either the one or the other, but the question as to what consequences shall follow from either is not touched. The right of protection and the obligations of allegiance are necessarily involved in the nationality conferred by nationality; but *the privileges attached to it, where these depend on residence, are quite independent of nationality.*[153]

A similar approach – distinguishing between a law dealing with persons of a certain racial origin versus one dealing with a person of a particular nationality – was taken in *R.* v. *Quong-Wing.*[154] A Saskatchewan prohibition against the employment of "any white woman or girl" by a Chinese restaurant owner was upheld since it was not "aimed at alien Chinamen simply or Chinamen having any political affiliations. It was against 'any Chinamen' whether owing allegiance to the rulers of the Chinese Empire, of the United States Republic, or the British Crown.... at Chinamen as men of a particular race or blood and whether aliens or naturalized."[155]

In *Brooks-Bidlake and Whittale* v. *British Columbia A.-G (1923)*,[156] the Privy Council continued the more focused pith and substance approach in *Tomey Homma* and found that the condition on provincial timber licences that no Chinese or Japanese labour was to be employed was *intra vires* the Legislature. Their Lordships found that while Parliament may be able to legislate as to the rights and disabilities of aliens, it is unable to "regulate the management of public property in the Province, or to determine whether a grantee or licensee of that property shall or shall not be permitted to employ persons of a particular race."[157] Thus, Viscount Cave felt that in pith and substance, the legislation dealt with subsection 92(5) – "Management and sale of public lands belonging to the Province and of the Timber and Wood thereon" – and/or section 109, which provides that all property, land and mines belong to the province.

This approach was echoed in the Insurance cases. In *A.-G. Can.* v. *A.-G. Alta (Insurance)*,[158] *Reciprocal Insurance*,[159] and *Re Insurance Act of Canada*,[160] the Privy Council refused to construe the aliens power as granting the authority to regulate foreign insurance companies operating in the provinces. However, in the *Insurance Reference*, the Privy Council did say that "by properly framed legislation," Parliament could require foreign insurance companies or other businesses owned by aliens to get a federal licence as a condition of carrying on a business in the country.[161] While this does not

---

[153] *Tommy Homma, supra* note 151 at 156-57 (emphasis added).

[154] (1914), 49 S.C.R. 440, 18 D.L.R. 121 [hereinafter *Quong-Wing* cited to S.C.R.].

[155] *Ibid.* at 449-50.

[156] [1923] A.C. 450, 2 D.L.R. 189 (P.C.) [hereinafter *Brooks-Bidlake* cited to A.C.].

[157] *Ibid.* at 457.

[158] [1916] 1 A.C. 588 at 597, 26 D.L.R. 288 at 292-93 (P.C.) [hereinafter *Insurance Reference*].

[159] *Supra* note 148 at 346.

[160] [1932] A.C. 41 at 51, [1932] 1 D.L.R. 97 at 105 (P.C.).

[161] *Supra* note 158.

mean that federal legislation can regulate a particular industry, it can prohibit aliens from entering the country to engage in a business without a licence and "further they might furnish rules for their conduct while in Canada".[162] This last sentence from the *Insurance Reference* suggests that the rules of treatment of foreign investors as outlined in Chapter 11 might be within the federal aliens power. However, given the case law, it does not seem to be very convincing.

How far those "rules of conduct" can extend to granting aliens rights and privileges – such as national treatment or protection against indirect expropriation – which they may assert against the provinces even when the provinces are acting within their competence, has never been judicially decided. Some insight can be gleaned from *Re Japanese Treaty Act, 1913.*[163] In that case, the Privy Council had to deal with an issue that was unnecessary to decide for the disposal of the case the year before in *Brooks-Bidlake*, namely the potential conflict with a British Treaty signed with the Japanese Emperor granting Japanese subjects the better of national treatment or MFN treatment when it came to employment and education. Pursuant to this treaty, Parliament passed the *Japanese Treaty Act,*[164] which declared the treaty to have the force of law in Canada. In the 1924 reference, Viscount Haldane ruled that the British Columbia statute was invalid as it violated the national treatment principle in the treaty, the enactment of which was authorized by section 132 of the *Constitution Act, 1867.*

This case supports the argument that the federal government has the constitutional ability to grant rights of treatment to aliens, although it is not conclusive. The provincial law in *Re Japanese Treaty Act* was held invalid by the Privy Council because it conflicted with section 132, which was an unfettered implementation power for Empire treaties. Their Lordships avoided a pronouncement as to whether the provincial statute was in regards to aliens.[165] This question divided the Supreme Court of Canada[166] prior to the Privy Council's ruling: while Idington J. found the provision to be *intra vires* the Legislature, Davies C.J. found that it violated both subsection 91(25) and section 132, Duff J. did not find that it trenched upon subsection 91(25) but only section 132,[167] and Anglin J. found that the law contravened section 91 and made no mention of the federal treaty implementation power.[168] Thus, the question remains whether the federal power over aliens could be found to be broad enough so as to be

---

[162] *Supra* note 160.

[163] *A.-G. B.C.* v. *A.-G. Can. (Re Japanese Treaty Act)*, [1924] A.C. 203, [1923] 4 D.L.R. 698 (P.C.) [hereinafter *Re Japanese Treaty Act* cited to A.C.].

[164] (1913), 3 & 4 Geo. 5, c. 27 (Can.).

[165] *Re Japanese Treaty Act, supra* note 163 at 212.

[166] *Reference Re Act to Validate and Confirm Orders in Council and Provisions Relating to the Employment of Persons on Crown Property (British Columbia)*, [1922] 63 S.C.R. 293, 65 D.L.R. 577 [hereinafter *Re Employment of Aliens* cited to S.C.R.].

[167] His comments (*ibid.* at 328) are worth noting: "I am unable .... to agree with the view that the Dominion authority in relation to aliens comprehends the power to give aliens rights having primacy over the rights of the provinces in relation to the grants of public money or grants of interests in private land." Brodeur J. concurred with Duff J.

[168] He wrote, "Properly appreciated, the orders in council which the British Columbia legislation of 1921 purports to validate are devised to deprive Chinese and Japanese, whether naturalized or not, of the ordinary rights of the inhabitants of British Columbia in regard to employment by lessees and licensees of the Crown and are not really aimed at the regulation and management of Crown properties or Crown rights": *ibid.* at 334. At 341, Migneault J. agreed that it violated subsection 91(25).

paramount over such provincial legislation. If so, then this case would support the contention that the federal government can grant foreign investors national treatment and other standards of treatment pursuant to subsection 91(25). However, I find this case unsatisfying: national treatment as to employment and education pursuant to section 132 is unrestricted by virtue of the treaty implementation power, but treatment of aliens under subsection 91(25) is limited by a pith and substance test.

The content of the federal aliens power in this regard is simply not clear. It is reasonable to suggest that Parliament has the right to regulate the entrance and exit of investment,[169] as it does through the *Investment Canada Act*,[170] but whether or not this power allows it to stipulate what standards of treatment foreign investors should receive is uncertain. In some provincial laws, discrimination between foreign and non-foreign investments may betray the pith and substance of the provincial legislation or action and will probably infringe on the federal power.[171] However, if a province enacts a law that only incidentally affects foreign investors, the case law does not seem to support a contention that this would infringe subsection 91(25).

The latter argument is supported by *Morgan* v. *A.-G. (Prince Edward Island)*.[172] In that case, if the province had prohibited aliens or non-citizens from owning land, it would have been *ultra vires* the Legislature. However, the law was based on residency, so all non-residents, Canadians or not, were precluded from owning the quantum of land specified in the Act. Thus, the law could be characterized as a reasonable limit on land ownership that the Legislature could exercise by virtue of subsection 92(13). The Supreme Court found this to be similar to the situation of federally incorporated companies:

> The case law, dependent so largely on the judicial appraisal of the thrust of the particular legislation, has established, in my view, that federally-incorporated companies are not constitutionally entitled, by virtue of their federal incorporation, to any advantage, as against provincial regulatory legislation, over provincial corporations or over extra-provincial or foreign corporations, so long as their capacity to establish themselves as viable corporate entities (beyond the mere fact of their incorporation), as by raising capital through issue of shares and debentures, is not precluded by the

---

[169] J.B. Nixon and J.H. Burns, "An Examination of the Legality of the Use of the Foreign Investment Review Act By the Government of Canada to Control Intra- and Extraterritorial Commercial Activity By Aliens" (1984) 33 I.C.L.Q. 57.

[170] R.S.C. 1985, c.28 (1st Supp.), as am. See generally Castel *et al.*, *supra* note 23 at 622-27. Hogg, *supra* note 66 at 490, points out that there has not been a constitutional challenge to this Act or its predecessor, the *Foreign Investment Review Act*, S.C. 1973-74, c.46.

[171] Arnett, *supra* note 147 at 229. Evidence of the federal assertion over property rights of aliens can be found in section 35 of the *Citizenship Act*. R.S.C. 1985, c. C-29. That section authorizes a province to "prohibit, annul or in any manner restrict the taking or acquisition directly or indirectly of, or the succession to, any interest in real property located in the province by persons who are not citizens or by corporations or associations that are effectively controlled by persons who are not citizens." However, this does not permit the province to make any decision or take any action that "(b) conflicts with any legal obligation of Canada under any international law, custom or agreement." This clearly indicates that despite the fact that interests in real property falls into provincial jurisdiction, the federal government maintains jurisdiction over real property rights over aliens.

[172] [1976] 2 S.C.R. 349 at 364, 55 D.L.R. (3d) 527 at 538-39 [hereinafter *Morgan* cited to S.C.R.].

> provincial legislation. Beyond this, they are subject to competent provincial regulations in respect of businesses or activities which fall within provincial legislative power.[173]

Morgan seems to apply the same test for the aliens power as for federally incorporated companies: is the general capacity of an alien being sterilized? If not, and the provincial law is otherwise valid, subsection 91(25) will not be construed as superseding subsection 92(13).

The type of legislation in *Morgan* may have been *intra vires* the Legislature, but if it were adopted today, it might be found to violate the NAFTA principle of national treatment because it creates a distinction between Prince Edward Island residents and a foreign investor. It is for this reason that subsection 92(25) does not seem to be a very sturdy peg on which to hang a federal hat. There are too many scenarios where a court would find a provincial law that is inconsistent with Chapter 11 to be valid under section 92 and to only incidentally affect NAFTA investors. For example, if Sun Belt Water was awarded compensation by a NAFTA arbitral panel pursuant to its reported claim,[174] it would not be a very convincing argument to say that British Columbia's actions were in pith and substance related to the rights of aliens. Sun Belt Water was merely incidentally affected by a provincial ban on the export of water.

The courts have been reluctant to find provincial legislation invalid unless it is in pith and substance aimed at the status of aliens. The federal power extends to capacity and essential status, but it is doubtful whether ascribing rights of national treatment or immunizing NAFTA investors from performance requirements can be defined as affecting their essential status.

V. WHAT CAN THE FEDERAL GOVERNMENT DO: PARAMOUNTCY OR PAY?

A. *Paramountcy*

The doctrine of paramountcy applies when there is a federal law and a provincial law that are both valid but are inconsistent with each other.[175] When federal and provincial laws are found to be inconsistent, the doctrine of federal paramountcy will render the provincial law inoperative only to the extent of the inconsistency.[176] In the context of Chapter 11, however, speculating on what practical implications this might have is not very helpful in the absence of a specific issue. It would seem that in general, for paramountcy to work, a provincial law would have to be in direct conflict with a federal law that stipulated more than just a general principle.[177] A provincial law may be inoperative to the extent of the inconsistency, but Parliament cannot take away

---

[173] *Ibid.* at 364-65. See also *Lymburn* v. *Mayland*, [1932] A.C. 318 at 324, 2 D.L.R. 6 at 9-10 (P.C.).

[174] *Supra*, text accompanying note 63.

[175] Hogg, *supra* note 66 at 425. See also *Bank of Montreal* v. *Hall*, [1990] 1 S.C.R. 121, 65 D.L.R. (4th) 361.

[176] Hogg, *ibid.* at 439. See also *Re Japanese Treaty Act*, *supra* note 163.

[177] See Hogg, *ibid.* at 439-41.

a provincial power granted to it by the Constitution.[178]

In some circumstances, it might be possible for the federal government to pass paramount legislation that would nullify the effects of the provincial law, in so far as it affected the investor in question. However, real problems arise where the provincial law is otherwise valid but incidentally affects more than just one NAFTA investor, and similarly situated Canadian investors. For example, the creation of a provincial park that renders the logging licenses of Canadian and American investors worthless should not mean that the park cannot be completed if a NAFTA arbitration panel found a violation of Chapter 11. It would not make sense to render the provincial law inoperative vis-à-vis only the American investors because that would defeat the whole purpose of the legislation – the creation of the park. On the other hand, passing federal legislation preventing the creation of the provincial park would not only raise the ire of the provinces and public, it would be legally tenuous since such a law is, in pith and substance, *ultra vires* Parliament even though it is made in pursuant to the obligations of NAFTA.

More importantly, as suggested above, such a law would constitute a tremendous intervention into provincial jurisdiction. It would be very difficult to convince the court that a federal law preventing the creation of a park, or granting restitution of a licence or other affected interest, or any other action that falls squarely in provincial jurisdiction, is necessarily incidental to the implementation of Chapter 11. Indeed, the ability of a NAFTA party to pay monetary damages in lieu of restitution (Article 1135 (1)(b)) is an explicit recognition that governments need to be able to pursue objectives for the public good and restitution of property should not stand in the way of that principle.[179]

Thus, it is my conclusion that the *legal* path of least resistance for the federal government, which could be the most likely scenario if a settlement was not reached before damages were awarded by an arbitral tribunal, is to pass a law requiring the offending province to pay the damages award ordered by the NAFTA arbitral panel.[180]

B. *Payment of Compensation Award*

In the event that an arbitral tribunal makes a final award against Canada, it may award monetary damages and any applicable interest or "restitution of property, in

---

[178] See *Nova Scotia (A.G.)* v. *Canada (A.G.)*, [1951] S.C.R. 31 at 34, [1950] 4 D.L.R. 369 at 371.

[179] It is unlikely that an arbitral panel would require specific performance or restitution by a province unless the Act was blatantly contrary to international law. Indeed, Professor Rosalyn Higgins – now a judge of the International Court of Justice – has pointed out that governments need to be able to act *qua* government and in the public interest. "That fact will prevent specific performance (including restitution) from being granted against them. But that is not to liberate them from the obligation to compensate those with whom it has entered into specific arrangements": R. Higgins, "The Taking of Property by the State: Recent Developments in International Law" (1982) 176 Rec. des Cours 259 at 338.

[180] It must not forgotten that the federal power in section 90 of the *Constitution Act, 1867* is still in force, even though it has not been used since 1943. Legally, Parliament could enact legislation disallowing a provincial statute that violated Chapter 11 of NAFTA, but I find it inconceivable that this would ever be done. The Supreme Court in *Patriation Reference, supra* note 71 at 802, noted in *obiter dictum* that "reservation and disallowance of provincial legislation, although in law still open, have, to all intents and purposes, fallen into disuse."

which case the award shall provide that the disputing Party may pay monetary damages and any applicable interest in lieu of restitution".[181] The federal government would then be bound to ensure that the award is paid pursuant to its general obligation under Article 105 to take all necessary measures in order to give effect to the provisions of the Agreement by the provinces. Further, section 9 of the *NAFTA Implementation Act* provides that the federal government may enact legislation to implement any of the treaty's provisions or fulfill any obligation Canada has under the Agreement. Ultimately, it is the federal government who is liable under international law for the amount,[182] so the question here is what options it has to pass the liability to the province responsible for the breach.

It is very possible that in a case like this, the federal and provincial governments would arrive at a negotiated agreement. As a result of the *Labour Conventions* doctrine, the federal government and provinces have developed internal mechanisms, primarily informal, for implementing international treaties in domestic law. After all, as Andrew Petter has pointed out, "[t]he conventions, practices and understandings that govern the exercise of legal powers under a federal constitution are as, or more, important that the legal powers themselves."[183]

However, it is likely that in most situations, as pointed out above, monetary damages will be the remedy awarded by the tribunal or chosen by the government in lieu of restitution. Thus, the question is whether the federal government can make a provincial government pay damages for its action that, while within provincial jurisdiction, violated the terms of Chapter 11 and its valid federal implementing legislation.

C. *Crown Immunity*

As was pointed out earlier, section 5 of the *NAFTA Implementation Act* only binds "Her Majesty in right of Canada". However, section 9 reserves the right of Parliament to "enact legislation to implement any provision of the Agreement or fulfill any of the obligations of the Government of Canada under the Agreement". Thus, the first general issue that becomes immediately apparent is, if Chapter 11 falls under a federal head of power – which I have argued above that it does – then is there an argument of provincial Crown immunity to be made? That is, would the provincial Crown be immune from a federal Act requiring it – or all provinces generally– to pay the compensation ordered by an arbitral tribunal constituted under Chapter 11?

The case law in Canada confirms the principle that valid federal laws can bind the provincial Crown.[184] *Alberta Government Telephones v. Canada*[185] and *Friends of*

---

[181] NAFTA, Article 1135, *supra* note 2 at 646.

[182] As the Supreme Court pointed out in the *Offshore Minerals Reference*, *supra* note 146, "it is Canada, not the Province of British Columbia, that will have to answer the claims of other members of the international community for breach of the obligations and responsibilities imposed by the Convention."

[183] Petter, *supra* note 109 at 145.

[184] See Hogg, *supra* note 66 at 287; *Re Japanese Treaty Act*, *supra* note 163. The common law rule of statutory interpretation was expressed by Lord du Parcq of the Privy Council in *Province of Bombay* v. *City of Bombay*, [1947] A.C. 58 at 61, 62 T.L.R. 643 at 644: "The maxim of the law in early times was that no statute bound the Crown unless the Crown was expressly named therein .... But the rule so laid down is subject to at least one exception. The

the Oldman River Society v. Canada (Minister of Transport)[186] are particularly clear on this issue and lend strong support to the idea that a provincial government could not claim immunity from a federal law, adopted in accordance with its general trade and commerce power, requiring it to pay the compensation awarded to a NAFTA investor by an arbitral tribunal constituted under Chapter 11.

In *Alberta Government Telephones*, the provincial telephone and communications body (AGT)[187] challenged an application to the federal Canadian Radio-Television and Telecommunications Commission (CRTC) brought by CNCP Communications to require AGT to provide facilities for the interchange of telecommunications traffic between the system operated by CNCP and that operated by AGT. The orders were sought pursuant to the federal *Railway Act*,[188] the *Canadian Radio-Television and Telecommunications Act*,[189] and the *National Transportation Act*.[190] AGT sought a writ of prohibition against any ruling by the CRTC, arguing first that it (AGT) was not an interprovincial undertaking and thus fell under federal jurisdiction pursuant to paragraph 92(10)(a) of the *Constitution Act, 1867*, and second that as a provincial Crown agent, AGT was entitled to claim Crown immunity from the regulatory authority of the CRTC acting pursuant to the terms of sections 5 and 320 of the *Railway Act*.[191] In its judgment, the Supreme Court upheld the finding of the Federal Court of Appeal that AGT did qualify as an interprovincial undertaking within the

---

Crown may be bound, as has often been said, by 'necessary implication'. If, that is to say, it is manifest from the very terms of the statute, that it was the intention of the legislature that the Crown should be bound, then the result is the same as if the Crown had been expressly named." It is obvious that the provisions in any legislation Parliament were to pass regarding payment by a province of damages ordered by a Chapter 11 arbitration tribunal, would necessarily be expressly binding on her Majesty in right of the Province, especially since s. 5 of the *NAFTA Implementation Act*, *supra* note 55, expressly did not apply to the provinces.

[185] [1989] 2 S.C.R. 225, (*sub nom. Alberta Government Telephones* v. *Canadian Radio-Television and Telecommunications Commission*) 61 D.L.R. (4th) 193 [hereinafter *Alberta Government Telephones* cited to S.C.R.].

[186] [1992] 1 S.C.R. 3, 88 D.L.R. (4th) 1 [hereinafter *Friends of the Oldman River*].

[187] AGT operated pursuant to the provisions of the *Alberta Government Telephones Act*, S.A. 1980, c. A-23, as amended. AGT, through various federally regulated agreements with other telecommunications companies, provides telephone and telecommunications services within Alberta but is necessarily connected with the cable and microwave equipment of the other companies at the Alberta border.

[188] R.S.C. 1970, c. R-2, as amended.

[189] S.C. 1974-75-76, c. 49.

[190] R.S.C. 1970, c. N-17.

[191] Section 5 of the *Railway Act*, *supra* note 188, stated: "Subject as herein provided, this Act applies to all persons, railway companies and railways, within the legislative authority of the Parliament of Canada, whether heretofore or hereafter, and howsoever, incorporated or authorized, except Government railways, to which however it applies to such extent as is specified in any Act referring or relating thereto." Subsection 320(12) gave the CRTC jurisdiction over "all companies as in this section defined, and to all telegraph and telephone systems, lines and business of such companies within the legislative authority of the Parliament of Canada." The term "company" was defined in subsection 320(1) and included those "having authority to construct or operate a telegraph or telephone system or line" and also "telegraph and telephone companies and every company and person within the legislative authority of the Parliament of Canada having power to construct or operate a telegraph or telephone system or line and to charge telegraph or telephone tolls."

meaning of paragraph 92(10)(a) because of its involvement in the transmission and reception of electronic signals in and out of Alberta that occurred at the provincial border. More importantly for the purposes of this paper, the Supreme Court went on to find that given the lack of explicit language in the relevant provisions of the *Railway Act* binding the Crown in right of a province, AGT was in fact immune from the jurisdiction of the CRTC pursuant to sections 5 and 320 of the *Railway Act*. Dickson C.J. found that at common law and pursuant to section 16 of the *Interpretation Act*,[192] the Crown in right of a province should benefit from the principle of Crown immunity when not expressly bound by the words or by necessary implication. Notwithstanding this, however, in *obiter dicta* he explicitly rejected the argument elucidated in a 1979 article by Professor Katherine Swinton[193] that a provincial Crown should enjoy immunity from valid federal laws where core provincial interests at stake. The Chief Justice stated:

> In my view, it would be wrong to accept a theory of constitutional inter-governmental immunity. *If Parliament has the legislative power to legislate or regulate in an area, emanations of the provincial Crown should be bound if Parliament so choses* ... it should be remembered that one aspect of the pith and substance doctrine is that a law in relation to a matter within the competence of one level of government may validly affect a matter within the competence of the other. Canadian federalism has evolved in a way which tolerates overlapping federal and provincial jurisdiction in many respects, and in my view a constitutional immunity doctrine is neither desirable nor necessary to accommodate valid provincial objectives.[194]

Dickson C.J. concluded by saying that even though AGT was entitled to immunity from the provisions of the *Railway Act* because of a lack of express wording or necessary implication, "[t]here is no question, that had the *Railway Act* been expressly made to bind the Crown, AGT would be subject to its provisions as a constitutional matter."[195] He cited with approval the words of Laskin C.J. in *The Queen* v. *Canadian Transport Commission*: "It is, of course, open to the federal Parliament to embrace the provincial Crown in its competent legislation if it chooses to do so."[196]

The Supreme Court made a similarly decisive ruling in *Friends of the Oldman River*. In that case, an Alberta environmental group sought writs of *certiorari* and mandamus to compel the federal Department of Transport and the Department of Fisheries and Oceans to conduct an environmental assessment of a dam constructed by Alberta on the Oldman River. According to the federal *Environmental Assessment and Review Process Guidelines Order*,[197] which was established pursuant to section 6 of the federal *Department of the Environment Act*,[198] any federal agency with decision-making authority for any proposal that may have an environmental impact on an area within

---

[192] Section 17 of the *Interpretation Act*, R.S.C. 1970, c. I-23, as am. by R.S.C. 1985, c. I-21, stated: "No enactment is binding on Her Majesty or affects Her Majesty or Her Majesty's rights or prerogatives in any manner, except only as therein mentioned or referred to."

[193] "Federalism and Provincial Government Immunity" (1979) 29 U.T.L.J. 1.

[194] *Alberta Government Telephones*, *supra* note 185 at 275 (emphasis added).

[195] Ibid. at 301.

[196] [1978] 1 S.C.R. 61 at 72, 75 D.L.R. (3d) 257 at 265.

[197] S.O.R./84-467.

[198] R.S.C. 1985, c. E-10, s. 6, as rep. by *Canadian Environmental Protection Act* R.S.C. 1985 (4th Supp.), c. 16, s. 146.

federal jurisdiction must conduct an environmental assessment before giving approval to that proposal. The Friends of the Oldman River Society argued that even though the Minister of Transport had already given approval for the construction of the dam under section 5 of the *Navigable Waters Protection Act*[199] based only on questions of navigation, he was bound by the Guidelines Order to conduct a full environmental review before giving approval to the construction project.

After having found that the Guidelines Order was validly enacted and was mandatory in nature, the Supreme Court had to deal with the issue of whether the Crown in right of Alberta was bound by the *Navigable Waters Protection Act* by necessary implication – there were no words in the legislation which expressly bound the provincial Crown. Alberta argued that it was entitled to Crown immunity from receiving authorization from the federal government to erect a dam on the Oldman River notwithstanding that it interferes with navigation, an area of federal responsibility, but the majority of the Court (Stevenson J. dissenting) found that the whole purpose of the *Navigable Waters Protection Act* would be defeated if it were not necessarily binding on the Crown in right of Alberta.

What is important to note for the purposes of this paper is that there was no question in either case of whether or not the federal government *could* bind the provincial Crown when it acted pursuant to a valid federal law - the cases only focused on whether or not the specific federal law in question was binding by necessary implication since they were not expressly binding in words. Thus, even if a provincial government was acting fully within its sphere of constitutional competence when it took an action that resulted in a breach of Chapter 11 and a damages award against Canada, the case law supports the argument that the province would not be immune from a valid federal law enacted pursuant to its subsection 91(2) general trade and commerce power making a province liable to pay the damages for which it was the cause. If one were to follow the *dicta* by Dickson C.J. in *Alberta Government Telephones*, even an argument that core provincial powers were being affected would not allow the province to claim immunity from the federal law.

D. *Appropriation of Provincial Revenues*

While the general question of provincial Crown immunity in relation to valid federal law appears to be relatively straightforward, the more difficult issue of appropriation of provincial revenues must be resolved. Of course, since the federal spending power is independent of ordinary limits of federal legislative authority under the Constitution,[200] transfer payments could always be withheld to recoup the money owed to a NAFTA investor under a tribunal award.[201] Legally, however, section 126 of the *Constitution Act, 1867* protects the consolidated revenue fund of the provinces from appropriation. Thus, even if a provincial Crown is not immune from federal law, there

---

[199] R.S.C. 1985, c. N-22, s. 5. Subsection 5(1) provides that no work is to be built in navigable waters without prior approval of the Minister.

[200] See *Reference Re Canada Assistance Plan (B.C.)*, [1991] 2 S.C.R. 525, 83 D.L.R. (4th) 297.

[201] See generally Petter, *supra* note 109 at 144. It is difficult to deny that it would be unfair for taxpayers, from the entire country, to shoulder the monetary burden that arose as a result of a province putting the federal government in breach of its international treaty obligations. While this might be expedient, it may also be politically undesirable.

remains the interesting constitutional question of whether the federal government can pass a law requiring a province to pay the compensation awarded by an arbitral tribunal notwithstanding section 126. A close examination of the case law suggests that it can.

At first glance, several important cases give rise to the impression that the federal government cannot appropriate money from the consolidated revenue fund of a province. In *Reference Re Troops in Cape Breton*,[202] the question was whether Nova Scotia was liable to pay the federal government all expenses and costs incurred by the province when it called in the militia to quell a riot in Cape Breton in 1925 after the Attorney-General of Nova Scotia in a requisition signed an undertaking, pursuant to section 85 of the *Militia Act*,[203] that the province would pay them. The Supreme Court of Canada found that the province did not owe the federal government the money for expenses and costs because the revenues of the province were vested in His Majesty as the supreme head of the province, thus the right of appropriation of all revenues of the province belonged exclusively to the Legislature.[204]

Nova Scotia took the position, which prevailed, that the Attorney-General of the province had no authority to bind the provincial Crown by the undertaking without the Legislature's consent.[205] The Court found that the *Militia Act* placed certain powers and duties on the *person* of the Attorney-General but that "the exercise of these powers does not in any way depend upon the consent of the Lieutenant-Governor, or of the provincial Legislature .... the sections apply to every Province and go into operation independently of the scope of the Attorney-General's authority to bind the Province in respect of the expenditure of moneys for such purposes".[206]

The Supreme Court dealt with a similar issue in *Peel (Regional Municipality)* v. *Mackenzie*[207] and upheld the principle established in *Re Troops in Cape Breton* that Parliament cannot impose a duty to pay expenses on a province without its consent. At issue was subsection 20(2) of the *Juvenile Delinquents Act*,[208] which authorized a court to order municipalities to which a delinquent child belongs to contribute to the child's support. It was argued that since subsection 92(8) of the *Constitution Act, 1867* gives provinces the exclusive right to make laws in relation to "Municipal Institutions in the Province", the impugned provision was *ultra vires* Parliament. This argument was accepted by the Supreme Court.

However, what *Peel* did suggest, which is important for the discussion in this

---

[202] [1930] S.C.R. 554, (*sub. nom. Canada (Attorney General)* v. *Nova Scotia (Attorney General)*) [1930] 1 D.L.R. 82 [hereinafter *Re Troops in Cape Breton* cited to S.C.R.].

[203] R.S.C. 1906, c. 41, as am. by R.S.C. 1924, c.57.

[204] See *Constitution Act, 1867*, *supra* note 19, s. 126.

[205] The requisition of the militia was outlined in the *Militia Act*, *supra* note 203, subs. 86(2): "Moreover in every case there shall be embodied in the requisition, which shall be signed by the Attorney General, an unconditional undertaking that the province shall pay to His Majesty all expenses and costs incurred by His Majesty by reason of the militia, or any part thereof, being called out or serving in aid of the civil power as by the requisition required." Further, subsection (3) provided that "[e]very statement of fact contained in any requisition made under the provisions of this Act shall be conclusive and binding upon the province on behalf of which the requisition is made; and every undertaking or promise in any such requisition contained shall be binding upon the province and not open to any question or dispute by reason of any alleged incompetence or lack of authority on the part of the Attorney General to make the same, or for any other reason."

[206] *Re Troops in Cape Breton*, *supra* note 202 at 561-62.

[207] [1982] 2 S.C.R. 9, 139 D.L.R. (3d) 14 [hereinafter *Peel* cited to S.C.R.].

[208] R.S.C. 1970, c. J-3.

paper, is that the imposition of a requirement to pay could be justified if there is a direct link with a federal head of power and if the requirement is necessary for the effective implementation of that federal law. In his discussion of previous case law, Martland J. pointed out that in *Re Troops in Cape Breton* there was no suggestion that the impugned provisions were reasonably ancillary to the provisions of the *Militia Act* dealing with aid to the civil power, which were properly enacted pursuant to subsection 91(7) of the *British North America Act, 1867*.[209] He went on to say that in regards to the case before him, subsection 20(2) of the *Juvenile Delinquents Act* could not be enacted by Parliament in so far as it applies to municipalities because "this is not legislation in relation to criminal law or criminal procedure, and it was not truly necessary for the effective exercise of Parliament's legislative authority in these fields".[210] He argued that:

> The effect of s. 20(2) is to alter the role of municipal institutions, not necessarily limited to financial matters but also with respect to their duty toward persons found within their boundaries. This is an indirect amendment to provincial legislation respecting municipalities. *It could not be justified in the absence of a direct link with federal legislative power under s. 91(27). There is no direct link between the municipality 'to which the child belongs and the issue of the child's criminality.* The obligation sought to be imposed on the municipality arises only after the criminal proceedings have been completed and sentence has been imposed.[211]

The Supreme Court in *Reference re Goods and Services Tax*[212] accepted the *dicta* of Martland J. that the imposition on the province of an obligation to pay might be justified if there was a direct link to a federal power in that it was necessarily incidental to the exercise of that power. In that case, the Supreme Court upheld federal tax legislation that imposed an administrative duty on the provinces to collect and remit the tax. While it did not find that the GST went so far as to constitute an appropriation on the provincial consolidated revenue fund, Lamer C.J.C. said that since there was a direct link between the obligations placed on suppliers by the GST Act and the federal power over taxation under subsection 91(3) of the *Constitution Act, 1867*: "even if the GST Act imposed an obligation to pay out a sum of money for federal purposes, it might be justified."[213] La Forest J., speaking on behalf of himself and L'Heureux-Dubé J., said that although it is the essence of two sovereign levels of government that neither could appropriate funds from the other consolidated revenue fund, "it by no means follows, however, that an administrative duty reasonably placed by Parliament on a province in the course of enacting a scheme falling squarely within a federal power will be invalid because the performance of that duty will in consequence require some expenditure by the province."[214]

This position is consistent with earlier case law where the courts found it reasonable for the federal government to impose an administrative financial burden on the provinces where it was receiving a benefit for it and when it was necessary for the

---

[209] *Peel, supra* note 207 at 22. This argument seems to have been made before the Supreme Court in *Re Troops in Cape Breton, supra* note 202.

[210] *Peel, ibid.*

[211] *Ibid.* (emphasis added).

[212] [1992] 2 S.C.R. 445, 94 D.L.R. (4th) 51 [hereinafter *Re GST* cited to S.C.R.].

[213] *Ibid.* at 483.

[214] *Ibid.* at 495.

exercise of a valid federal power. In *Toronto Railway Company* v. *Corporation of the City of Toronto*,[215] the Privy Council ruled that it was *intra vires* Parliament to legislate to authorize the Board of Railway Commissioners to make an order against a provincial railway company to pay a proportional share of the cost of building a bridge over federal railway tracks. Similarly, in *A.-G. Quebec* v. *Nipissing Central Railway Co.*,[216] it was decided that federal legislation in relation to railways could authorize the compulsory taking of provincial Crown lands to the extent necessary for building railway lines. In both cases, the province received a benefit and the courts found it reasonable for them to shoulder some of the burden.

However, as Martland J. suggested in *Peel*, it is not imperative that the province is receiving a benefit. As long as the imposition of a duty or obligation is necessary for the exercise of a valid federal power, Parliament can do it: "the Dominion Parliament would only have the right to interfere with property or civil rights in so far as such interference may be necessary for the purpose of legislating generally and effectually in relation to matters confided to the Parliament of Canada".[217]

In addition to the aforementioned *dicta*, the case that provides the most direct support for the argument that the federal government can impose the burden of paying a NAFTA award is the *Johnny Walker* case.[218] At issue was whether customs duties could be imposed by the Dominion on liquor (Johnny Walker Black Label Whiskey) imported by the British Columbia government for the purpose of sale by it. British Columbia argued that section 125 of the Constitution clearly provided that "no lands or property belonging to Canada or any Province shall be liable to taxation". However, Lord Buckmaster pointed out that the overall structure of the Constitution had to be considered in light of the full authority for the federal government to legislate pursuant to its constitutional heads of power. Since the imposition of customs duties legitimately fell under federal trade and commerce – subsection 91(2) – he reasoned that the division of classes of property beginning at section 102 could not be seen as exempt from the operation of federal laws made in exercise of a section 91 head of power.[219] Thus, it was held that British Columbia was bound to pay the customs duties.

The limits of the federal power to impose administrative burdens on provinces was not examined by the Supreme Court in *Re GST*. Cases like *Toronto Railway Company* seem to indicate that Parliament could only impose a duty on a province to

---

[215] [1920] A.C. 426, 51 D.L.R. 55 (P.C.) [hereinafter *Toronto Railway Company*].

[216] [1926] A.C. 715, 3 D.L.R. 545 (P.C.).

[217] *Valin* v. *Langlois*, [1879] 3 S.C.R. 1 at 16, leave to appeal to P.C. refused [1879] 5 A.C. 115. In that case, the Dominion government imposed the duty upon provincial superior courts to try controverted elections of members of the House of Commons.

[218] *A.G. B.C.* v. *A.G. Canada (Johnny Walker)*, [1924] A.C. 222, 4 D.L.R. 669 (P.C.) [hereinafter *Johnny Walker* cited to A.C.].

[219] *Ibid.* at 225: "[t]he Dominion [has] the power to regulate trade and commerce throughout the Dominion, and, to the extent to which this power applies, there is no partiality in its operation. Sect. 125 must, therefore, be so considered as to prevent the paramount purpose thus declared from being defeated." See also *A.G. for New South Wales* v. *Collector of Customs* (1908), 5 C.L.R. 818 (H.C. Australia), cited in *Johnny Walker*. In that case, the Government of Australia sought to impose customs duties on steel railes imported by a state government for use in a state owned railway. The court considered it to be a case of competing legislative function – the Commonwealth Government's trade and commerce power versus the power of the state government as to railways. The issue was thus decided on the paramountcy of the Commonwealth power.

pay something if the province were receiving a benefit from a federal law or if there was an "administrative burden" imposed in the necessary pursuit of a valid federal law. However, cases like *Johnny Walker, Canadian Transport Commission* and *Alberta Government Telephones* suggest that the principle is not so limited. In the context of this paper, it would appear that as long as the NAFTA can be shown to fall within a federal head of power, and the provisions in Chapter 11 giving investors a right of action and compensation for violations of their rights under the treaty are necessary for the effective implementation of the treaty, the Supreme Court should allow federal legislation requiring the province to pay damages awarded by an arbitral tribunal as a result of a breach by a province.

VI. CONCLUSION

The constitutional analysis outlined in this paper suggests that Chapter 11 falls within the federal general trade and commerce power as described in *City National Leasing* but less so, if at all, in the federal power over aliens. While *City National Leasing* justifiably suggests that the applicability of an otherwise valid federal law might be limited if it crushes core provincial powers, since the investment provisions in question are of general applicability, it would be hard to argue that in all cases fundamental provincial powers are in jeopardy whenever an act of a province is impugned by a complainant-investor. Furthermore, the more specific question of whether or not the federal government could require a province to pay an arbitration award can also be resolved by a close analysis of constitutional case law. This reveals a willingness by the courts to allow a financial burden to be imposed on a province as part of legitimately enacted federal legislation, and neither Crown immunity, nor section 26 of the *Constitution Act, 1867* prohibiting appropriation of the provincial consolidated revenue fund, operates to bar a properly enacted federal statute from requiring the provinces to pay an arbitration award for which they were at fault.

The issue will arise sooner rather than later. Canada has operated for many years under the GATT with few conflicts between the federal and provincial governments largely because of the unwieldiness of the dispute resolution mechanisms under GATT, as well as the fact that members are hesitant to invoke their dispute resolution mechanisms unless it is of sufficient national interest to do so notwithstanding other diplomatic concerns – although the WTO has been much more active and effective since it came into being in 1995. Even disputes under the original Canada-United States Free Trade Agreement were muted compared to those taking place under Chapter 11 and the most contentious disputes under the FTA – like that over softwood lumber,[220] the predecessor to the NAFTA *Pope & Talbot* dispute – did directly impugn the types of provincial laws that I have been concerned with in this paper. Of course, this can be taken as a sign that the agreements are working well – states are generally following their obligations, and where conflicts do arise, traditional diplomacy is the preferred course of action.

Chapter 11 is different. Private parties are not under the same constraints as governments, and North American corporations and lawyers are increasingly

---

[220] Extraordinary Challenge Committee, *In the Matter of Certain Softwood Lumber Products From Canada,* ECC-94-1904-01USA (3 August 1994), online: NAFTA Secretariat <http://www.nafta-sec-alena.org/images/pdf/ue94010e.pdf> (date accessed: 10 November 2000).

considering arbitration under the NAFTA as a viable option to challenge federal, provincial and state laws which they feel violate investment obligations under the Agreement. Recent settlements and arbitration rulings have focused government and public attention on the potential implications of Chapter 11 and it is now regularly referred to in debates over significant issues of public policy like bulk exports of water[221] and health care.[222] Thus, it is important to re-examine the constitutional modalities of implementing and enforcing this particular subunit of the NAFTA and consider its legal ramifications. By doing this, the political ramifications of a company winning a Chapter 11 challenge will become clearer.

Just as Canada's relationship with other countries is being redefined through comprehensive trade agreements, the federal-provincial relationship will undergo an important evolution in the next few years because of the NAFTA. As investors begin to use Chapter 11 more frequently, the delicate balance between federal and provincial jurisdiction over trade and commerce will become increasingly fragile. The courts will be faced with a challenge that has no easy resolution: is the federal government to be permitted to have the wide ranging powers of implementation for the many international trade agreements it requires for effective implementation, or are provincial rights to be specially protected from excessive federal intervention in the name of maintaining the federal-provincial balance? These constitutional issues have not yet become a source of major contention since the FTA, but with the ability of private parties to initiate arbitration proceedings against governments, it is likely that provinces will be increasingly forced into situations where they will have to give serious thought to enacting legislation because of the potential for violating Chapter 11.

---

[221] See *e.g.* "Bulk Water Removal and International Trade Considerations" (Ottawa: DFAIT, 2000), online: DFAIT <http://www.dfait-maeci.gc.ca/geo/usa/water5-e.asp> (date accessed: 10 November 2000).

[222] See *e.g.* M. Janigan, "Special Report: Stretching the Medicare Envelope" *Maclean's* 113:14 (3 April 2000) 42.