

Changing Face of Canadian Foreign Direct Investment Policy

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by

Jatinder Cheema

Thesis Supervisor

Professor T.J.M. Zuijdwijk

Co-Supervisor

Professor J. Anthony Vanduzer

University of Ottawa



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Abstract

Successive Canadian governments have been criticised on the ground that they pursue investment policy that advances the interests of the United States of America and its transnational corporations. Recently the focus of such criticism has been the investment provisions of the Canada-U.S. Free Trade Agreement ("FTA") and the North American Free Trade Agreement ("NAFTA").

This dissertation attempts to rationalize the investment provisions of the above mentioned agreements. While undertaking such an analysis, this dissertation reviews the origins and evolution of the debate on foreign direct investment policy of Canada. A preview on the historical perspective of this policy in this dissertation identifies the traditional concerns vis-a-vis foreign direct investments in Canada, especially in the U.S. context and contrasts these against the investment provisions of the FTA and the NAFTA.

There has, over the last forty years, clearly been some changes in the foreign investment policy of Canada. What this policy was and how it has undergone a change is the subject matter of this dissertation. Why were the policies adopted by Canada aimed at curtailing foreign control and ownership of Canadian business enterprises? How does Canadian policy fair vis-a-vis those of other industrialised countries? What does liberalization of foreign investment mean for Canada in economic and legal terms? These are some of the other questions that this dissertation attempts to answer.

To my Father

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Introduction

Foreign direct investment [hereinafter FDI]¹ has been a source of debate in developing countries where it is viewed as an affront to national sovereignty and economic independence. Foreign investors and their investments have also been the subject of severe criticism for their policies adopted in ignorance of local market conditions. The sentiments towards FDI in most developing countries arose from the swing of economic nationalism against former imperial rulers and the economic exploitation at their hands.² Foreign investors are viewed as speculators out to exploit the natural wealth and resources at lower costs and repatriating profits to their respective countries or tax havens. The image of a foreign investor has been especially marred by bribery scandals and political interventions in the developing countries.

Since investment capital flows were largely from developed to developing

1. FDI is defined as investment made to acquire a lasting interest in an enterprise operating in a country other than that of the investor, the investors purpose being an effective voice in the enterprise, sufficient share ownership and/or effective voice in the management of an enterprise. World Bank & IMF Staff Paper, "The Role of Foreign Direct Investment in Development" (1991) 1., Submitted to the Joint Ministerial Committee of the Board of Governors of the World Bank and the International Monetary Fund on the Transfer of Real Resources to Developing Countries.

2. Countries like India, one of the largest colonies of the British empire had suffered at the hands of the East India Company, which laid the foundation of British Raj in India. India as a consequence practised protectionist policies towards foreign investors and investments over its 46 years of independence. The development of a large public sector in most developing countries took place either under governments inspired by ideological doctrines based on failures and inequities of earlier experiences with unchecked market systems, or under pragmatic governments which saw no other quick means for the industrialization and modernisation of their economies. See generally, Ibrahim S.I. Shihata, *The World Bank in a Changing World* (Dordrecht: Martinus Nijhoff Publishers, 1991) Pgs. 233-236.

countries, developed countries sought the protection of their investment in host countries. Developing countries, on the other hand, continued with their restrictive policies, and, in extreme situations, went ahead with nationalization or expropriation of particular industrial sectors or industries much to the chagrin of investors and their home states. While the debate in the developing world over permanent sovereignty over their natural wealth and resources and the possible reasons justifying nationalization, expropriation or requisition of foreign property in the early 1960-70 was raging, a similar outcry was reverberated in the heart of industrialized world-Canada.

The debate in Canada took a similar tone, to the concerns expressed and measures devised by the developing countries to balance the protection of their natural wealth and resources on the one hand and the right of economic activities on the other. Such concerns in Canada originated in the early 1960's, which was also a period of relative prosperity in Canada.

The issue of national sovereignty and economic nationalism resonated in Canada about the same time as the countries in Asia and Africa acquired their status as newly independent nations, where the issues of national sovereignty were increasingly drawing much attention. However, it would be wrong to suggest that Canada was as hostile in its policies towards FDI as most developing countries. For example, Canada did not nationalize or expropriate foreign property. But the mounting rhetoric did result in creating administrative and legislative barriers in

the process resulting in creeping expropriation of foreign investment in Canada.³ The Canadian system of foreign investment control also worked as a model for other countries, both developed and developing.⁴ The aforementioned barriers lasted for twenty years before the mood of the Parliament in Canada changed towards foreign investment. This is the starting point of this dissertation towards its logical conclusion- to gauge the change over the last forty years in the foreign investment policy of Canada.

Since the early 1960's, the all pervading concern with some quarters in Canada has been that it must withstand control and dominance of transnational corporations [hereinafter TNCs] and specially those from its immediate neighbour to the south, the United States [hereinafter the U.S.]. Some academics in the Canada of the 1990's continue to feel that the policies followed by their government are excessively friendly to the TNCs, particularly those from the U.S. The Canadian

3. Errol P. Mendes, "The Canadian National Energy Program: An Example of Assertion of Economic Sovereignty or Creeping Expropriation in International Law" (1981) 14 *Vanderbilt Journal of Transnational Law* Pgs.475-507. Introduction of new taxes by the Government of Canada in the energy sector to generate revenue to provide cash incentives to Canadian controlled companies amounted to "creeping" or "disguised" expropriation. According to Mendes: "if government is using the incentive payment scheme or direct grants in bad faith to implement a disguised discriminatory taxation regime that would make only the foreign-controlled corporation unprofitable, such measures should be regarded as creeping expropriation", *ibid.* Pgs. 477 & 507. Also see. Prof. P. Cumming, *Energy Law 1977* (Paper) (York University: Osgoode Hall Law School); Gordon H.G. McDougall & Gerald Keller, *Energy: Canadians Attitude and Reactions (1975-1980)* (Cat. No. R623-62/1981E, 1981). For restrictions in the Uranium Sector see: *Uranium in Canada: 1984 Assessment of Supply and Requirements*, Report No. EP85-3, Sept. 1985, (Ottawa: Minister of Supply and Services Canada, 1986) (Cat. No. M23-11/5-1984E); *Uranium in Canada: 1989 Assessment of Supply and Requirements*, Report No. EP89-3, Sept. 1989 (Ottawa: Minister of Supply and Services, Canada, 1989) (Cat. No. M23-11/5-1989E).

4 For example of a Canadian systems influence on a developed country, see Fisher, "Canada's Foreign Investment Review Act as a model for Foreign Investment Regulations in the United States", (1984) 7 *Canada - U.S. Law Journal* 61. For its influence on developing country, see Osunbor, "Nigeria's Investment Laws and the States Control of Multinationals" (1988) 3 *ICSID Review-FILJ* 38, 74 -75.

nationalist agenda and sentiments of those captivated with fear of corporate takeover of Canada were effectively described by Maude Barlow and Bruce Campbell:

"We as a society must guard against any future Canadian government becoming so completely captive to the corporate agenda. For there is a huge chasm between corporate interests and the fundamental priorities and values of Canadian society. A democratic government that does not give precedence to the latter forfeits its legitimacyTo take back the enormous power surrendered under free trade is clearly a precondition of national reconstruction and development, but it will not be without consequence. The U.S. government and corporate interests in the United States and Canada may well retaliate...symbolic reason for abrogating the trade deal. The free-trade deal is jeopardizing our future as a nation. Thus cancelling it is a symbol of our wish to assert Canadian sovereignty..."⁵

It is true that every democratic government elected in Canada must honor its mandate by responding to such domestic sentiments, but it is equally significant that such a government make pragmatic decisions, and balance such sentiments against the global interest of Canada in this highly competitive world.⁶

5. Maude Barlow & Bruce Campbell, *Take Back the Nation 2: Meeting the threat of NAFTA* (Toronto:Key Porter Books Limited, 1993) Pgs.121-125. Also see: Robert J. Jackson and Doreen Jackson, *Stand up for Canada-Leadership & Canadian Political Crisis* (Scarborough:Prentice Hall Canada, 1992); Jeffery Brooke, *Breaking Faith-The Mulroney Legacy of Deceit, Destruction & Disunity* (Toronto:Key Porter Books Ltd.,1992); Lawrence Martin, *Pledge of Allegiance-The Americanization of Canada in the Mulroney Years* (Toronto: McClelland & Stewart Inc. 1993); David Orchard, *The Fight for Canada-Four Centuries of Resistance to American Expansionism* (Toronto:Stoddart Publishing Co. Ltd., 1993).

6. Sylvia Ostry, *Governments and Corporations in a Shrinking World* (New York:Council of Foreign Relations, 1990) Pg.61. Also see Pgs. 15, 54, 75, 97. Sylvia Ostry reflecting on the intervention by the governments: "Whether it is the 'power' of the ideas or simply the fact that they provide intellectually respectable backing for policies that governments and others want to undertake on their own grounds, a number of recent developments in economics have led to new arguments for government intervention in both trade and industrial policy. In the history of economic doctrine and economic policy, the role of the state has moved from the prescribed "night watchman" of Adam Smith, to the "nanny" of the postwar cradle-to grave welfare state, to the "nemesis" of Ronald-Thatcherism in the 1980's. Today, in the context of the debate over the sources of long-run competitiveness, the climate of ideas about the role of government seems to be shifting once again. or at least becoming more nuanced."

Some Canadians have intensely felt that the investment by corporate giants from the U.S erodes the sovereignty and economic independence of Canada. This view must however be contrasted against the fact that both the Canadian and U.S. economies rely heavily on each other's trade and investment for their economic prosperity. Governments in both countries consider this trade so important that they have in the recent past concluded comprehensive free trade agreements to improve barrier free access for both trade and investment. i.e. the Canada-U.S Free Trade Agreement and the North American Free Trade Agreement.

These agreements have often been branded as symbols of "Americanization of Canada". An attempt has been made in this dissertation to rationalize the investment provisions of these agreements against Canadian interest and determine, whether calls for "taking back the nation" and "de americanization" are really well founded.

Successive Canadian governments have had to face the criticism on the grounds that Canadian government pursues investment policy that advances the interests of U.S. government and its transnational corporations. This dissertation will attempt to assess the validity of these assertions. More specifically, this dissertation will:

- a) trace the evolution of Canadian investment policy over past 40 years

culminating in the FTA/NAFTA;

- b) identify the motivations and rationale underlying such policies;
- c) compare investment policies in Canada with those of other OECD countries and in particular Mexico and the U.S;
- d) analyze the provisions of the FTA/NAFTA in contrast with traditional and existing policies of the Canadian government;
- e) assess the change in policy undertaken by the Canadian government by concluding binding investment obligations under FTA/NAFTA, especially focussing on achievements, prospects and failures of these agreements.

In concluding this analysis this dissertation will touch upon such milestone events as:

- i) Reports of the Gordon Commission (1958), the Watkins report (1968), the Gray report (1972) and the MacDonald report (1985);
- ii) The various legislative and policy measure undertaken by the successive governments in Canada, in particular the Foreign Investment Review Act (1973), Investment Canada Act (1985) and the National Energy Policy.
- iii) The provisions of the comprehensive trade agreements between Canada, the U.S. and Mexico, especially the Canada-U.S. Free Trade Agreement (1985) and the North American Free Trade Agreement

(1992);

The analysis undertaken in this dissertation will hopefully demonstrate that Canada has pursued a transparent review mechanism based on economic benefit to Canada; although accepting binding obligations under the FTA/NAFTA, Canada continues to protect its traditional policy and initiatives.

Chapter two of this dissertation is a historical perspective on Canadian foreign investment policy. That chapter will trace the evolution of this policy. The purpose of that chapter is to present the reader with the background on Canadian foreign investment policy for two reasons. Firstly, to determine the changes in the Canadian foreign investment policy in the last 40 years; and secondly, to analyze whether such policies have been in any manner discontinued by successive governments of Canada, first in the FTA negotiations with the U.S., and later in the NAFTA with the U.S. and Mexico.

Chapter three of the dissertation will address briefly investment provisions of both U.S. and Mexico to understand their policies on the investment issues and determine and highlight the contrast in the investment policies of the three NAFTA Parties. This is being done to determine whether Canada's review process of foreign investments is far more restrictive than that of other countries, as is the general perception. An attempt will be made in that chapter to demonstrate that the U.S. policies towards foreign investment are far less liberal as they are most

commonly perceived. Then, chapter three will discuss the investment provisions of FTA. The analysis undertaken in that chapter is to present a broader view of the investment provisions against the backdrop of pre-existing investment policies of Canada.

Chapter four of the dissertation focuses on the NAFTA. Chapter Four provides a commentary on the substantive investment provisions in the NAFTA and begins with the identification of the objectives of the various parties in the negotiations. The chapter then goes on to identify the amendments expected of Parties to the agreement with regard to their existing legislation. It is also argued in that chapter that Canada stands in a vulnerable position vis-a-vis the United States because of its national security exception, which will be explained in detail in Chapter three.

NAFTA stands out for its binding dispute settlement mechanism in the investment chapter and this is an improvement over dispute resolution under the FTA. The binding investor-state dispute resolution (under ICSID, ICSID Additional Facility and the UNCITRAL Arbitration Rules) is the key feature of dispute resolution under NAFTA. Chapter five will therefore describe briefly the positions of Canada, Mexico and the U.S. on the investor-state dispute settlement mechanism. The Investor-state dispute settlement process represents a major change in Canada's foreign investment policy and its international obligations. Chapter five will present a general overview on the investor-state dispute settlement provisions of

the NAFTA investment chapter. It is compelling to ask why Canada resisted from investor-state dispute and ICSID in particular for the past twenty five years. This is significant because there is no foreign investment protection treaty between the U.S and Canada despite the significant presence and, capital flows between the two countries. Investor-state dispute mechanism has also been seen as an affront to national dignity and sovereignty in many Latin American countries including Mexico, which has been under the influence of the Calvo Doctrine. The Calvo Doctrine has also been addressed to in detail in relation to Mexico and the United States.

This dissertation is not about political rhetoric. It is about the legal regimes that Canada has been able to achieve through bilateral and trilateral agreements in North America. It seeks to demonstrate Canada's ability to manage, control and regulate FDI to the level desired by it. The negotiators of the FTA and the NAFTA made significant changes in the Canadian foreign investment policy without derailing the traditional concerns of Canadians towards foreign investment. It may be noteworthy at the outset that this dissertation is in no manner an attempt to analyze whether FDI should or should not be controlled. This is a policy question which falls outside the scope of this dissertation.

HISTORICAL PERSPECTIVE

1. General

This chapter will explore the background of Canadian policy towards foreign investment. The purposes of this chapter are to: bring out clearly the different phases of the Canadian experience with its foreign investment policy; identify the various regimes which have persisted; and examine how government has reacted to the public sentiment towards establishing any regime to control or scrutinize foreign investment. Between 1960 and 1984, Canada created an ambitious legal regime to regulate foreign investment within its borders. Inspired by widespread public concern over the high level of foreign ownership of Canadian industry, this regime sought to encourage the extension of control by Canadian persons over the economy and to ensure that the activities of foreign owned businesses would benefit the country. These goals were to be attained through two main regulatory instruments: the reservation of certain "key sectors" of the economy for Canadian investors and the operation of a control agency to screen individual foreign direct investments.⁷

⁷ The various legislative barriers to increase proportion of the resident Canadians representation in large corporations and financial institutions are reflected in Canada Business Corporations Act R.S.C. 1985, c. C-44, as amended, s. 105(3), and Banks and Banking Law Revision Act S.C.1980-81-82-83, c.40 as amended, s.36. Certain tax preferences exist for some Canadian controlled companies, see Income Tax Act R.S.C.1952. c 148, as amended by S.C 1970-71-72, c.63, and as subsequently amended in s.125. One of the most ambitious regulatory change recommended by Melville Watkins (See *infra* note. 33) was the Canada Development Corporation [hereinafter CDC]. The CDC was established in 1971 under the Canada Development Corporation Act S.C. 1970-71-72. c.49, to be a holding company owned jointly by the federal government and private investors for the purpose of increasing the proportion of Canadian ownership of large industries.

The vociferous campaign mounted against foreign investment in the 1960s-70s, which will be analyzed later in this chapter, was calmed with the change in the Canadian government's perspective towards foreign capital in the mid 1980s. The Conservative federal government in Ottawa elected in 1984 signalled change through dismantling the regimes put in place by the successive Liberal governments in the 1960-70s. In particular, the Conservative government forged ahead with signing of the Free Trade Agreement with the U.S. in 1988 and subsequently with Mexico and the U.S in 1992.

The change in Canadian perspective came with two significant policy changes made by the government, i.e. the abolition of the Foreign Investment Review Act⁸ and the subsequent signing of the Canada-U.S Free Trade Agreement⁹ [hereinafter the FTA]. The progress towards a less interventionist outlook was further complemented with the signing of the North-American Free Trade Agreement.¹⁰ But before we delve into the specifics of these agreements which are dealt with in chapters three, four and five of this dissertation, it is important to analyze the

⁸ Foreign Investment Review Act S.C. 1973-74, c.46 amended by S.C. 1976-77, c.52, s.128(2), S.C. 1980-81-82, c.107, s.63 and S.C. 1984, c.31, s.14 (hereinafter FIR Act)

⁹ Canada-U.S Free Trade Agreement, 22 Dec.1987 and 2 Jan.1988. (1988) 27 International Legal Material 281. Part Four, chapter 16, deals specifically with investment. See Canada-United States Free Trade Agreement Implementation Act S.C. 1988, c.65.

¹⁰ North American Free Trade Agreement - Preliminary Text. (Canada: CCH Canadian limited, 1992) [hereinafter the NAFTA] NAFTA is between the governments of Canada, the United States of America and the United Mexican States. Part five, chapter Eleven of the agreement deals specifically with investment. North American Free Trade Agreement Implementation Act S.C. 1993, c.44.

evolution of the foreign investment policy in Canada. Any worthwhile discussion of the change of the investment policy can only be engaged in against the backdrop of the traditional Canadian viewpoint on the issue of foreign investment. Apart from tracing the historical background of the Canadian foreign investment policy, this chapter will also show the increasing pace of Canadian outward investment.

2. The Early Debate and Measures

With its small population, vast and untapped natural resources and relatively young economy which had depended on foreign capital to energise and sustain its economic development and growth, Canada has always been a "debtor nation".¹¹ In four decades after confederation in 1867 when British colonies conglomerated to form federation of Canada, foreign investment came rather as debt than in the form of "equities". It was in the 1920s that equity investments outpaced debt and Canada saw a new trend towards foreign owned Canadian subsidiary companies, mostly from the U.S., replacing the capital input from the United Kingdom as the primary source.¹² In 1926, the total direct investment in Canada from the U.S. stood at \$1,403 million and for the same year direct

¹¹ Royal Commission on Canada's Economic Prospects, Final Report 1957, (Ottawa; Queens Printer, 1957) 380. The report is also known as the Gordon report after the name of its chairperson -- Walter Lockhart Gordon. The commission was constituted to study the long term economic prospects of Canada. The Commission was constituted by Order in Council on 17 June 1955 and submitted its report in November 1957. At Pg. 380 the commission observed that " the growth of the country at any stage in its history, would have been much slower without large supplies of capital from foreign countries, principally from the United kingdom and the United States".

¹² *Ibid.* Pgs. 380-81.

investment from U.K. was \$336 million, whereas the total direct investment in Canada for the same year was \$1,782 million.¹³ During the same period Canada's foreign assets, including long-term investments in other countries, were also slowly increasing. Total Canadian direct investment abroad (by industry) stood at \$397 million out of which \$250 million was invested in the U.S. and \$7 million in the U.K.¹⁴ A large part of foreign investment in Canada was concentrated in subsidiaries controlled by non-residents in the resource and manufacturing industries, the majority of them from the U.S.¹⁵ This was of principal concern to the members of the Gordon Commission.¹⁶ The Commission expressed its concern over massive non-resident ownership and control over some industries like the oil and gas industry, mining, smelting and refining and the pulp and paper industry. Of the \$2,559 million foreign investment in the petroleum and natural gas industry investment, the U.S. singularly contributed \$2,380 million. Although sounding the

¹³ Canada's International Investment Position-Historical Statistics 1926 to 1992 (Ottawa: Statistics Canada 1993), (Catalogue number 67-202). Refer to Tables 29, 31, 32 at Pg. 106, 109 and 111 respectively.

¹⁴ *Ibid.* Tables 10, 11, 12, at Pg. 73-74, 75-76, 76-77, respectively. Other countries in which Canada had invested were Bahamas, Mexico, Brazil, Venezuela, Germany, France, Spain, Italy, Norway, Australia, Japan, Malaysia, India and other South and Central American countries and Pacific Rim countries.

¹⁵ *Ibid.* Table 30, Pg. 107. In 1957, FDI in Canada in manufacturing sector was \$ 4,704 million of which \$3,883 million were from the U.S., Investments in petroleum and natural gas was \$2559 million and for mining and smelting was \$1125 million for the same year. The manufacturing sector mainly included vegetable produce's, animal products, textiles, wood and paper products, iron and products, non-ferrous metals, non-metallic minerals, chemical allied products.

¹⁶ *Supra* note 11, Gordon report, Pg. 383. "In many of the Canada's fastest growing industries the principal companies, the ones which hold the dominating positions, are controlled by non-residents. This concentration in key industries and in large companies wielding extensive influence is the most important factor to be considered in connection with foreign investment in Canada."

alarm of "foreign" presence in the core economy sectors, the Commission conceded that:

"Canada has always welcomed the investment of foreign capital because without it our rate of growth would necessarily have been much slower. One of the principal detriments of growth of the Canadian economy has been the development of our resource industries including forest products, mining, smelting and refining, oil, gas and hydro electric power. These industries have all required larger amounts of capital than Canadians have been able to provide themselves"¹⁷.

The Gordon Commission concerns appear similar to those of developing countries in those years.¹⁸ The global operation of the oil industry in Canada was also a factor, where the interest of Canada was expected to be undermined by foreign parent companies in control of the situation in case a deficiency arose in future in a non-replenishable resource like oil.¹⁹ It was considered difficult to police the activities of Canadian subsidiaries vis-a-vis their operation with parent companies.²⁰ The Gordon Commission recommendations²¹ on the issues were

¹⁷ *Ibid.* Pg.385.

¹⁸ *Ibid.* Pg.390. The Gordon report suggests: "At the root of Canadian concern about foreign investment is undoubtedly a basic, traditional sense of insecurity vis-a-vis our friendly, albeit much larger and more powerful neighbour, the United States. There is concern that as the position of the American capital in the dynamic resource and manufacturing sector becomes even more dominant, our economy will inevitably become more and more integrated with that of the United States. Behind this is the fear that continuing integration might lead to economic domination by the United States and eventually to the loss of our political independence. This fear of domination by the United States affects to some extent the political climate of life in Canada today. Therefore it is a factor which has some bearing upon the probable economic development of Canada and the problems to which such developments appear likely to give rise"

¹⁹ *Ibid.* Pg. 390.

²⁰ For example, a subsidiary might be required to pay too higher price for materials, equipment and other goods purchased from there foreign parent companies or high charges for administration, research and other services. *ibid.* Gordon report, Pg. 391, the purchasing policy of machinery and

relatively modest, and as a result they had no real impact on the community which was still largely committed to gains and prosperity as a result of rapid industrialization in the Canada of the 1950s-60s.

After Conservative government's apparent tough posturing towards the U.S. from the years 1957 to 1963, the liberals headed by Lester B. Pearson returned to power, but with Walter Gordon as Finance Minister and his deep concern over large foreign investment in Canada. Gordon's moves,²² i.e. proposal to levy a thirty percent takeover tax on the sale of publicly held Canadian companies to foreign investors, were, however forestalled due to the backlash from within and outside of Canada. Although Gordon had to abandon his measures, his antipathy towards foreign investment continued.²³

equipment has "strong bias in favour of United States suppliers in real and should not be underestimated".

21. *Ibid.* Pg.392. The Commission recommended three things.

"1) to see a larger share of foreign capital invested in the form of bonds and mortgages, which do not involve control of large sectors of the economy;

2) to see that the part of foreign investment which is invested in the resource and manufacturing industry is associated in some degree with Canadian capital and Canadian interests; and

3) to ensure that control of the Canadian banks and other financial institutions is retained in Canada."

Regarding operation of the report, Gordon commission recommended following measures: i) more Canadians in top management and technical positions-could influence purchasing. ii) full disclosure and transparency, make public financial statements. iii) more representation of Canadians on Board of Directors (say 20-25% of equity stock).

22. Gordon proposed to levy a thirty percent takeover tax on the sale of publicly held Canadian companies to foreign investors among other measures.

23. Walter L. Gordon, *A Choice for Canada* (Toronto:McClelland and Stewart, 1966), Pg.XIX. Gordon states: "During the two and half years I held that office/finance/, the influence that financial and business interests in the U.S. had on Canadian policy and opinion was continually brought home to me. On occasions, this influence was reinforced by representations from the state department and the American administration as a whole. It was pressed by those who direct american businesses in

Gordon was not alone in his anti-American sentiments, some in academia also reflected his contempt for American "imperialism" over Canada.²⁴ In the face of growing economic nationalism, the Pearson government responded in a more pragmatic way and allowed its finance minister (Walter Gordon resigned in 1965 and re-entered the cabinet in 1967) to establish a special task force on the structure of Canadian industry. Melville H. Watkins, a University of Toronto economist, headed the task force which submitted its report in 1968 entitled "Foreign Ownership and the Structure of Canadian Industry".²⁵ [hereinafter the Watkins report]. The Watkins report clearly stated its concerns about foreign investments, particularly those from the U.S. investors and instances of U.S extraterritoriality.²⁶ Watkins report shared the concerns expressed earlier in the Gordon report with regard to limitations which should be imposed on subsidiaries of multinational enterprises to import or undertake research and development and problems of transfer pricing

Canada, by their professional advisers, by Canadian financiers whose interests were identified directly or indirectly with American investment in Canada, by influential members of the Canadian civil service, by some representatives of the university community, by some sections of the press."

²⁴. George Parkin Grant, *Lament For A Nation; the Defeat of Canadian Nationalism* (Toronto:McClelland and Stewart Ltd 1966). Also see, Levitt Kari, *Silent Surrender; the Multinational Corporation in Canada* (Toronto:MacMillan of Canada 1970)., Purdy Al, *The New Romans; Candid Canadian Opinions of the U.S.* (Edmonton: M.G.Hurtig 1968)., Ian Lumsden. *Close the 49th Parallel etc; the Americanization of Canada* (Toronto:University of Toronto Press 1970)., Timothy E.Reid, *Foreign Ownership:Villain or Scapegoat?* (Toronto:Hold, Rinehart and Winston of Canada 1972).

²⁵ Foreign ownership and the Structure of Canadian Industry, Report of the Task Force on the Structure of Canadian Industry (Ottawa; Privy Council Office, 1968). The report came to be known as Watkins report after the name of its Head Melville H. Watkins)

²⁶ *Ibid.* Pg. 384.

and taxation.²⁷ Despite the growing concern²⁸ with regard to political independence and sovereignty of Canada, a consensus emerged among members of the Commission about placing an "upper limit" on foreign dominance. The report further states that there was no "consensus" on "what that limit" should be.²⁹ However the Watkins report concluded with the following suggestions:

- "1) a "special agency" be created to co-ordinate mandatory policies with respect to multinational enterprise, collection and dissemination of information to keep surveillance of foreign owned enterprises.³⁰
- 2) collection of information on activities of corporations particularly large corporations both Canadian owned and foreign owned. This proposal reflects the non-discriminatory attitude of the Watkins report and suggested amendments to various legislation to bring this proposal in effect.³¹
- 3) the "public interest" and the maximization of the "net economic benefits for Canadians" in revision of any legislation and maintenance of competition.³²
- 4) the Canada Development Corporation be created to increase Canadian participation in Canadian economic activity. The proposal also stated that the CDC should finance industrial rationalisation in a manner that would provide "Canadian presence in those cases where industry is largely foreign-controlled".³³
- 5) in order that Canada exercises complete sovereignty over its decisions, efforts be made to block any U.S. policy applicable to American owned subsidiaries operating extraterritorially with respect to freedom to export to communist countries; that Canada must have freedom to oversee its conformity with its own law and foreign policy. The Watkins report also recommended that American balance of payment guidelines, controls and surveillance machinery in so far they operate extraterritorially must be replaced by Canadian

²⁷ *Ibid.* Pg. 386 and Pg. 390.

²⁸ *Ibid.* Pg. 363 and Pg. 390.

²⁹ *Ibid.* Pg. 363.

³⁰ *Ibid.* Pg. 395.

³¹ *Ibid.* Pg. 398.

³² *Ibid.* Pg. 401.

³³ *Ibid.* Pg. 404. Also see, *supra* note 7, CDC.

guidelines to foreign-owned subsidiaries.³⁴

- 6) that Canadian participation be ensured in the decision making process of multinational enterprise, that incentives be considered to encourage large corporation to offer its equities to Canadians³⁵ and finally the Watkins report recommended complete overhaul of national policy.³⁶

The protagonist of economic nationalism emerged across Canada each attempting to champion the cause and concern of Canadians who viewed themselves being influenced by American culture and "imperialism"³⁷

The federal government elected in 1968, headed by Pierre Elliot Trudeau, perturbed over the high presence of U.S. ownership and control of Canadian industry was nevertheless uncertain over the introduction of any measures recommended by the Watkins report, presented the report to its Minister Herb Gray to conduct a study. The Gray report: "Foreign Direct Investment in Canada", was

³⁴ *Ibid.* Pg. 407-410.

³⁵ *Ibid.* Pg. 411-413.

³⁶ *Ibid.* Pg. 415, "The old national policy served Canada in its day, as an investment of nation-building and a means of facilitating economic growth. The challenge have changed and a new national policy is required. The nation has been built, but its sovereignty must be protected and its independence maintained. A diversified economy has been created, but its efficiency must be improved and its capacity for autonomous growth increased."

³⁷ John English and Ian Drummond, *Canada Since 1945* (Toronto:University of Toronto Press, 1981). *ibid.* Pg. 416, "It was not businessman who pushed the government from the foreign acquiescence of the late sixties to the systematic screening and interventions of 1971 and thereafter. The credit-if that is the word-belongs to three groups; nationalist sectarians among the intelligentsia and their echoes in the media; like minded people within the liberal party and caucus; and eager officials, anxious to 'regulate' foreign owned firms in the national interest....In the background was an ever increasing but unacknowledged echoing of American populist opinion, Which held that large business is bad, multinational business is worse, and, after 1973, oil companies are worst of all."

presented in 1972.³⁸ The Gray report described the maintenance of "national sovereignty" and "independence" as foremost national objectives of Canada.³⁹ The Gray report asserted that foreign direct investment weakens domestic control over Canadian economy and overexposes "Canadian economy to decisions taken outside of Canada."⁴⁰ The Gray report, besides expressing enormous concern about FDI, did eventually acknowledge the benefits that come with foreign capital to Canada and recommended against any "sweeping" changes because it would result in high "economic price".⁴¹ In fact the Gray report suggested that a reasonable balance be struck between the investors interest in maximising return on investment and those of the Canadian economy.⁴² But a reasonably balanced approach was not what the Gray report was to conclude; the report made conclusions which were to drastically change the foreign investment policy of Canada, the Gray report concluded:

³⁸ Foreign Direct Investment in Canada, (Ottawa; Information Canada 1972).The reports also called Gray Report, named after the head of working group Herb Gray.

³⁹ *Ibid.* Pg. 426.

⁴⁰ *Ibid.* Pg. 426-427. The argument advanced in the report was that Canada's vulnerability to external were different in matters of trade and investment, whereas Canada was protected against trade distortions arising from sudden decisions of its trading partners, because of regime under GATT. This was not the case under foreign direct investment where Canada was not only vulnerable to decisions of foreign government but also those of transnational corporations [Hereinafter TNCS], it was also felt that TNCS with multiple jurisdictions and production facilities could use most countries as pawns to further their objectives, more so in case of Canada where one province could be pitted against another. Also See, Pauline Couture, "A Bit More and Quebec Could Dictate Washington's Policy", The Globe and Mail, 15 July 1993, Pg. A-17.

⁴¹ *Ibid.* Pg. 430.

⁴² *Ibid.*

- (vi) a more effective means of dealing with remaining problems of foreign direct investment would be through flexible administrative intervention on a case by case basis;
- (vii) such intervention can justifiably be restricted to foreign controlled firms;
- (viii) administrative intervention would be most effective if carried out within the framework of well defined industrial strategy."⁴³

The kind of administrative intervention⁴⁴ and justifications for singling out only the foreign controlled enterprises⁴⁵ resulted in acceptance of a recommendation that a review agency be established to review case-by-case both the

⁴³ *Ibid.* Pg. 432 and 439.

⁴⁴ *Ibid.* Pg. 440. The purpose of administrative process were; "to negotiate with the foreign firm, where this was practicable, to improve the net benefits from proposed foreign direct investment; to block foreign direct investments where this was desirable for economic or non economic reasons; to seek through negotiations to secure for the economy, where feasible, the distinctive and valuable inputs of the foreigner by other means than direct investment-under licence, for example. This would amount to "untying" the tied investment package and obtaining the foreigner's distinctiveness (say, obtaining his technology on licence or his management ability by contract) without being obliged to accept and pay for other parts of the package which had no particular contribution to make the economy."

⁴⁵ *Ibid.* Pg. 441. The Gray report differentiated between Canadian controlled enterprises and foreign controlled enterprises on five accounts namely:

- (1) possible public policy intervention on behalf of Canadian society to a Canadian controlled would accrue less cost to Canadian economy than foreign controlled enterprise which may result in unnecessarily accruing high cost for the economy because of the economic power of the proprietor;
- (2) likelihood of Canadian controlled firms being more sensitive to Canadian interests compared to foreign controlled firms;
- (3) capacity of foreign controlled firms to frustrate Canadian policy than Canadian controlled firms;
- (4) non-economic costs like extraterritorial application of foreign law which create both political and cultural problems; and
- (5) governments review of foreign controlled firms would involve only a unit of its entire global set up, but if government were to review Canadian "based" multinational that would involve review of entire global activities thus Canadian based MNE in all likelihood would relatively be more prone to government intervention.

new foreign investments and the acquisition of existing Canadian owned corporations. In 1972, Trudeau government introduced a legislation to establish a process of reviewing foreign takeovers. The bill was still pending, when parliament was dissolved for a general election. In 1973, the government, now dependent for survival on parliamentary support from the left wing and nationalist New Democratic Party, introduced a revised bill which would extend the review process to new investments in Canada as well as the takeovers.⁴⁶ The new Act established the Foreign Investment Review Agency [hereinafter FIRA] to advise and assist the Minister of Trade and Commerce in administration of the Act. Bill C-132, established FIRA, a reviewing agency for all takeovers of existing business and new foreign investment made except those related to the expansion of existing businesses. Foreign investment Review Act [hereinafter FIR Act] became law on 12 December 1973.⁴⁷

Bill C-132 had its own share of criticism on the issue of leaving provinces with an option to opt-out from the operation of the Act. Provinces like Ontario and

⁴⁶ House of Commons Debates, 29th Parliament, 1st Session, Vol.III, 30 March 1973, Pg. 2776-77. The sentiments that resonated in the backdrop of this bill can be captured from the introductory speech delivered by Mr. Alastair Gillespie, then Minister of Industry, Trade and Commerce: "... the Canadian future is not something that just happens. Our future does not need to be merely a response to external factors, however important they may be. We, as Canadians, can determine in large measure what that future-will be that Mr. Speaker, is the underlying philosophy of this bill". Minister also explained the objectives of FIR Act as."In short, we have four objectives, one, to support the development of strong, Canadian-held business enterprises; two, to ensure that future foreign takeovers and the establishment of new foreign held businesses will be of significant benefit to Canada; three, to help arrest and reverse the increasing degree of foreign control of our economy; four, to contribute to the development of distinctive Canadian identity." Also see, Pgs. 2781-82.

⁴⁷ *Supra* note 8.

parts of British Columbia, which had developed into large urban centres would have adhered to the federal legislation, while most other less economically developed provinces would have opted for suspension of its operation in their respective provinces. Paul Helleger, M.P. participating in the debate in Canadian parliament over introduction of FIRA legislation described the situation as follows:

"The fact that the problem now exists is accepted by most thoughtful people in Canada. Not every one agrees to the course, and there are strong regional differences of opinion. It is understandable if those areas of Canada where high chronic unemployment exists place a higher priority on the creation of new job opportunities than the nationality of the capital which make them possible...."⁴⁸

Had the suspension of federal legislation been allowed in certain provinces it would have resulted in the "mockery" of the federal legislation.⁴⁹ That reason defeated the "option" situation for provinces.

The Gray recommendation which had fathered FIRA, is usually read as more nationalist document than those contained in its predecessor (the Watkin and the Gordon reports). Although the thrust of the Gray report was in general direction of new protectionism, it was still realised that firm judgements on the costs versus benefits of any fixed foreign investment policy were next to impossible. The key

⁴⁸. House of Commons Debates, 29th Parliament, 1st Session, Vol. III, 30 March 1973, Pg. 2783.

⁴⁹ John Saywell, ed; *Canadian Annual Review of Politics and Public Affairs*.1973 (Toronto; University of Toronto Press,1974) Pg. 337.

underlying objective echoing through FIR Act was "flexibility".⁵⁰ Therefore, it should be noted that the FIR Act, in spite of its conception and creation in the climate of economic nationalism, was nevertheless a relatively modest compromise proposal.

The FIR Act provided "significant benefit to Canada" as the litmus test for the acquisition or establishment of new business in Canada keeping in view the various factors enumerated in section 2(2) of the Act.⁵¹ The purpose of the FIR Act was not

⁵⁰ *Supra* note 38, Gray report, Pg. 453-54, "A review process would be flexible, It could concentrate on that relatively small proportion of foreign investments which are of greatest concern to Canada at any point in time. It could focus on the key variable (e.g., research and development, industrial structure for economies of scale and so on), which differs from industry to industry and from case to case. It could adapt to different industries and changing conditions overtime, in light of government's industrial strategy, and in light of increased efficiency and new technology which a particular investor might bring to Canada. As general economic policies and specific remedial measures involving capital market, technology and management result in strengthening of indigenous capability in a particular industry, the need for foreign investment could decline. A review mechanism, as opposed to a policy based solely on the designation of key sectors or the introduction of across-the-board ownership rules, would be flexible enough to take account of such changes in its negotiations.

A review process can and ought to be used as an economically rational instrument. Unlike some of the alternatives policies described below, it could avoid the cost to the economy which would result from protecting Canadian owners through blocking all foreign direct investment; blocking all direct investment in a particular industry regardless of its terms or accompanying benefit such as new technology; or establishing fixed percentages or standards for export, procurement etc, without regard for the economics of individual industries or cases. The delineation of key sectors to be protected from foreign investment or the introduction of precise formulae covering such things as the extent of exports and the procurement of components would necessarily be arbitrary and thus potentially economically costly."

⁵¹ *Supra* note 8, FIR Act, Section 2(2):

" In assessing, for the purpose of this act whether any acquisition of control of Canadian business enterprise or the establishment of any new business is or is likely to be significant benefit to Canada, the factors to be taken into account are as follows;

- (a) the effect of the acquisition or establishment on the level and nature of economic activity in Canada, including, without limiting the generality of the foregoing, the effect on employment, on resource processing, on the utilization of parts, components and services produced in Canada, and on exports from Canada;
- (b) the degree and significance of participation by Canadians in the business enterprise or new business and in any industry or industries in Canada of which the business enterprise or new business forms or would form a part;
- (c) the effect of the acquisition or establishment on productivity, industrial efficiency, technological development, product innovation and product variety in Canada;

to reduce foreign ownership in Canada, but rather, to push foreign firms to alter their behaviour and thereby increase the package of benefits the country obtained through foreign investment.

In practice, FIRA, as an agency and the FIR Act were never a great obstacle to foreign investment in Canada. To begin with, there were major loopholes in what the FIR Act covered. Excluded from the Act's ambit was the expansion of existing foreign controlled businesses. In addition, foreign investors who already had a business in Canada could establish a new but "related business" without review.⁵² The concept of relatedness remained completely undefined in the FIR Act. It had little impact on the largest source of foreign investment-the reinvestment by foreign corporations of their Canadian earnings.⁵³ Moreover, by interpreting the concept of

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- (d) the effect of the acquisition or establishment on competition within any industry or industries in Canada; and
 - (e) the compatibility of the acquisition or establishment with national industrial and economic policies, taking into consideration industrial and economic policy objectives enunciated by the government or legislature of any province likely to be significantly affected by the acquisition or establishment.

⁵² *Ibid.* Section 8(2)(b).

⁵³ House of Commons Debates, 29th Parliament, 1st Session, 30 March 1973, Pg. 2782. Mr. Alastair Gillespie, then Minister of Industry, Trade and Commerce, explained the government position like this:

"One of the criticism of the bill with which I would like to deal is the fact that it does not cover the expansion of existing foreign controlled firms, unless of course, they propose to establish unrelated new businesses. We have refrained from proposing this type of review for a number of reasons. Given the large number of firms, that are already foreign controlled in Canada, a Review of normal expansion would call for an enormous amount of intervention. I am not prepared to argue that the state should have such sweeping authority over normal private decision making. In addition, I think there is a difference in kind between the normal growth which takes place as a business prospers and expands its activity on the one hand, and the opening of unrelated businesses on the other. It seems to me that there is almost an element of retroactivity in intervening in the process of normal growth."

Conservative M.P., Mr. Paul Helleoyer, although joined the liberals in criticizing high U.S. investment in Canada, but also criticised the liberal government for excluding expansion of existing business from

a "related business" in a way that favoured investors, the administrators of FIRA deliberately narrowed the scope of the Act even further.⁵⁴ If FIRA was a serious barrier to investment, its impact should have been dramatic in 1981, when the number of disallowances and the profile of the agency itself was at its height.⁵⁵

FIRA was only part of a wide range of legislation initiatives which together resulted in a revolutionary change in Canadian investment policy. These initiatives include early key sector legislation,⁵⁶ the ad-hoc review of specific transactions to

the screening mechanism. Mr. Hellyer stated: "While Bill C-132, unlike its predecessor, extends the screening process to include new investment as well as takeovers, it pays no heed to the expansion of existing foreign-owned companies in Canada except in respect of entry into new and unrelated business. As the Gray report cited 1965 statistics showing that of the three ways in which foreign ownership in Canada had increased the most important was the expansion of existing foreign-controlled enterprises, one must conclude that the intent of the bill is largely cosmetic."

⁵⁴ Office Consolidation of Foreign Investment Review Act, S.C., 1973-74, c.46 (Ottawa; Minister of Supply and Services Canada, 1978). Guidelines concerning related business in Canada Gazette part I, dated 2 Aug. 1978 and 19 March 1977) in office consolidation at Pg. 73. The guidelines laid down that "where the additional business activity of the non eligible person (Section 3(1) of the FIR Act) does not constitute the establishment of a new business, but is simply an expansion of an already established business, the notice requirement of sub-section 8(2) and the assessment procedures under the act have no application." The related business guidelines set out six guidelines and if non eligible person met any of the criteria under six guidelines framed, business of such a person was exempted from operation of the assessment procedures. Guidelines were broad and therefore, narrowed the scope of the FIR Act. Also see, Peter R. Hayden & Jeffery H. Burns, *The Regulation of Foreign Investment in Canada* (Scarborough: Prentice Hall of Canada, 1976).

⁵⁵ Annual Report under Foreign Investment Review Act, Fiscal year 1982-83, (Ottawa: Statistical Tables 1982-83)., there were 739 reviewable applications in 1981-82 of which 81 were disallowed. In the Year 82-83 there were 887 reviewable applications and only 60 were disallowed. Also see, *supra* note 13, Statistics Canada-Historical Statistics, Table 31, Pg. 109., Total U.S investment in Canada in 1973 was U.S \$26,919 million and it was U.S \$66,013 million in 1985, which means that investment almost doubled during FIRA's operation. D. Mac Dowall in *A Fit Place for Investment? Study No.81*, (Ottawa; Conference Board of Canada, 1984) found that only 11% of the respondents to survey claimed to have been deterred from investing in Canada.

⁵⁶ Aeronautics Act, R.S.C. 1970, c. A-3; Air Regulations, C.R.C. 1978, c.2, s.200; Broadcasting Act, R.S.C. 1970, c. B-11, s.3(b); Banks and Banking Law Revision Act, S.C. 1980-81-82, c.40, s.2; Canada Mining Regulations, C.R.C. 1978, c.1516, s.58(10); Canada Oil and Gas Act, S.C. 1980-81, c.81, s.27(2), s.23 and s.19(1); Petroleum Incentives Program Act, S.C. 1980-81-82, c.107, ss.2-33; Canadian ownership

prevent takeover in key sectors of the Canadian economy, the National Energy Program [hereinafter NEP] and guidelines for mega projects. In addition, on 18 July 1975, the Minister of Industry, Trade and Commerce tabled the "New Principles of International Business Conduct."⁵⁷ Fourteen new principles were introduced to reflect the "broad government policy" regarding the activities and responsibilities of foreign controlled business enterprises in Canada. The New Principles, while not law, evidence a further governmental initiative in the de-americanization process.

These initiatives have been dealt with the purpose of understanding the sectoral approach which Canadian investment policy took and these initiatives were especially in the areas of natural wealth and resources.

On 28 October 1980, the federal government introduced the NEP.⁵⁸ The NEP had three specific goals:

- (1) at least 50 percent Canadian ownership of oil and gas production by 1990;
- (2) Canadian control of a significant number of the larger oil and gas firms; and
- (3) an early increase in the share of the oil and gas sector owned by the

and Control Determination Act, S.C. 1980-81-82, c.107, ss.34-62. Also see, Graeme C.Hughes, *Foreign Investment Law in Canada* (The Carswell Company Limited, 1983).

⁵⁷ Parliament Debates, House of Commons, 18 July 1975, Pg. 7712, Presented by Mr. Alastair Gillespie, then Minister of Industry, Trade & Commerce.

⁵⁸ National Energy Program (Ottawa; Published under the Authority of the Minister of Energy, Mines and Resources, Canada, 1980) (Catalogue No. M 23-12/80-4E)

government of Canada.⁵⁹

The NEP contained a number of major initiatives including potentially significant exploration and development incentive payments to Canadian companies. The NEP was designed to place foreign investors in the petroleum industry at a competitive disadvantage and to provide a strong incentive for the sale, in whole or in part, of existing interest to Canadians. U.S direct investment in the petroleum and natural gas sector was \$2,885 million in 1960 and when FIRA came in operation in 1974 it was \$7,150 million, In 1985 it was \$16,504 million but dropped to \$13,786 million by 1991.⁶⁰ The U.S investment in energy sector accounted for 17% of total U.S direct investment in Canada (down from 20% in 1987).⁶¹ The objective of 50% Canadian ownership of oil and gas product by 1990 and higher incentive grants to Canadian-owned companies were to hit hardest U.S investment in the energy sector.⁶² The process of issuing grants to corporations with a 65% of

⁵⁹ *Ibid.*

⁶⁰ *Supra* note 13, Statistics Canada-Historical Statistics, Table 31, Pg 109.

⁶¹ *Ibid.* Pg. 24.

⁶² For example, to receive approval for an acquisition, a U.S. Company was at times forced to sell its holdings; Occidental petroleum Canada-cities services in 1983, (the assets of Canada-cities services and Canadian Occidental were combined into a new corporation). Whose share were later issued to the public. This diluted the parent company's ownership to less than 50%. See generally. Jack Hanna, *Financial Times*, 31 October 1983, Pg. 6. Mobil Corporation on the other hand, got approval to buy the Canadian assets of General Crude oil by agreeing to sell half of the proven gas reserves it had acquired to Canadians. Dunnery Best, "FIRA-Less Canada-First Bite", *Financial Post*, 25 Sept. 1982, Pg. 1; Also see Hyman Solomon, "N.E.P and FIRA at the Top of Reagan's Hit List", *Financial Post* (Special Report) 3 July 1982, Pg. 53.

Canadian ownership were considered as injurious to United States corporations.⁶³ In some respects these policies were trade distorting and anti-competitive. Both FIRA and NEP were being used as a framework to increase Canadian ownership.

The coalition of American labour-business lobby groups, Labour-Industry Coalitions for International Trade [hereinafter LICIT] which include giants in business and labor like United Steelworkers of America, the Boeing Corporation, the International Brotherhood of Electrical workers and St. Joe Minerals Corporation pointed out to American politicians that performance requirements such as commitments to export a fixed percentage of production, to source locally and to transfer technology, would lead to undesirable consequences for U.S.⁶⁴ LICIT also described the government of Canada as "probably the most assertive advocate of the benefits of performance requirements".⁶⁵ Perhaps the concerns were expressed in Washington, regarding Canada being a bad example for the rest of the world and the likelihood of Canadian policies being followed in several other countries if the

⁶³. *Supra* note 58, National Energy Program, Pg. 39-44. The government of Canada announced it would change the NEP to allow corporations at 65% Canadian-owned to qualify for the highest level of incentive payments available.

⁶⁴ The labour Industry Coalition for International Trade "LICIT" Performance Requirements; a Study of the Incidence and Impact of Trade-Related Performance Requirements and an Analysis of International Law, Pg. V111 published in March 1981, Washington: D.C reprinted in U.S Policy Toward International Investment; Hearing's before the Sub Committee on International Economic Policy 97th Cong., 1st Sess. (1981); n.24, at 49.

⁶⁵ *Ibid.* Pg. 8.

same remained "unchallenged"⁶⁶.

The concerns south of the Canadian border were soon finding voice in domestic critics, who were portraying FIRA as being responsible for almost everything that was wrong with Canadian economy:

"The two biggest economic problems in this country- why people don't have jobs- are FIRA and the NEP., Which have been an absolute disaster. Basically both policies should be scrapped"⁶⁷

The cycle was at this point complete. The FIRA constituted out of denunciation for foreign investment was itself being criticized by some Canadians. Perhaps it was also time for a change of perception towards foreign investment in Canada. At least, that is reflected in the following discussion on the legislative measures undertaken by the Conservative government upon coming to power in 1985.

⁶⁶ Statement of Robert D.Hormats, Assistant Secretary of State, Bureau of Economic and Business Affairs, Department of State, before the Sub Committee on Oversight and Investigations of the Committee on Energy and Commerce, House of Representatives, Washington D.C., 9 July 1981, p.5.

⁶⁷ Stu Eagles, Chairman of Marathon Realty as reported in The Toronto Star, 19 June 1982, Pg. A3.

3. The MacDonald Report: A New Perspective to the Canadian Foreign Investment Policy

The Royal Commission on the Economic Union and Development Prospects for Canada [hereinafter the MacDonald report] submitted its report in 1985, had considered the past policies on the issue of investment.⁶⁸ The MacDonald report found that Canada's share of global direct foreign investment had fallen from 16% in 1960 to 3% in late 1970s to a negative figure in the early 1980s. The MacDonald report observed that: "The National Energy Program alone resulted in an out-flow of direct foreign investment of about \$6 billion as a result of the purchase of foreign-owned companies by Canadian interests".⁶⁹ The report also confirmed that by virtue of reinvestment of profits by foreign controlled enterprises the percentage of foreign ownership in Canada had kept its steady pace. This fact could be largely attributed to the wide interpretation assigned to "Related Business" under the FIRA guidelines, which resulted in a situation where net flows of FDI continued to decline and then even turn negative, but foreign ownership continued to rise. The MacDonald Report found foreign control of capital in Canadian industry to be high by international standards.⁷⁰

⁶⁸ Report of the Royal Commission on the Economic Union and Development Prospects for Canada (Ottawa; Minister of Supply and Services 1985) Vol. 2, Pg. 232. Under the Chairmanship of Donald MacDonald.

⁶⁹ *Ibid.* Pg.233.

⁷⁰ *Ibid.*

The MacDonald report also added new perspective to foreign investment policy of Canada by stating that from a balance-of-payments perspective, due to increasing Canadian direct investments abroad, "Canada will soon become a significant exporter of capital" and that

"this tread toward increasing Canadian investment abroad suggests that our policy toward inward investment must take into account our national interests in securing equitable reciprocal treatment for Canadians investing abroad."⁷¹

The MacDonald report recommended unhindered foreign ownership in equity.⁷² It also strongly suggested that in order to meet the challenge posed to the U.S. owned Canadian subsidiaries as a result of competing policy requirement⁷³ placed by both Canada and the U.S., a regulatory machinery be created.

⁷¹ *Ibid.* Pg. 234.

⁷² *Ibid.* Pg. 235, "our policies toward foreign controlled enterprises must avoid restrictions that impede the importation of these elements (technology, managerial know-how and entrepreneurship). In particular, equity ownership of an enterprise may give foreign investors more incentive to apply fully their ideas and processes and to enhance the quality of their products."

⁷³ *Ibid.* Pg. 236. MacDonald report observed: "American tax and regulatory policies affect the business decisions of U.S. owned multinationals operating in Canada. During the past two decades, many foreign-usually U.S. owned-multinationals in Canada have had to choose between the competing policy demands of two national governments. Disputes have involved trade restrictions imposed by the U.S. government on the trade of U.S.-owned subsidiaries in Canada for national security reasons; the attempted extraterritorial application of U.S. antitrust and other regulatory law; and American tax laws that encourage multinationals to repatriate their foreign-source income and to expand their production in the United States, rather than increase the size of their operations in this country. While it is easy to exaggerate the economic significance of these bilateral conflicts, their relative frequency and their potential for causing serious friction in Canada-U.S. relations suggest the need to establish regulatory machinery to manage these disputes in future."

The MacDonald report also recommended an across-the-board reporting requirements for all large firms, both foreign and domestic to achieve precision in making comparisons between the overall performances of foreign controlled and domestic corporation.⁷⁴ The MacDonald report further recommended that national treatment in taxation and regulatory policies vis-a-vis foreign-controlled firms be provided, except in sectors where cultural and national security interests predominate.⁷⁵ The MacDonald report further expressed its dissatisfaction with the practice of non-disclosure both of FIRA's recommendations to the cabinet and that of cabinets final reasons in disposition of cases under review. Although general policy guidelines were issued by the Canadian government periodically, but those statements of general policy considerations were a poor substitute for disclosure of cabinet's reason for a particular decision. As a result, the MacDonald report recommended creation of a quasi-judicial tribunal to replace the existing FIRA and to undertake the decision-making process then assigned to the Minister responsible for the agency and to the cabinet.⁷⁶

Preceding the release of the MacDonald report, on 7 December 1984, the

⁷⁴ *Ibid.* Pg. 242.

⁷⁵ *Ibid.* Pg. 236. MacDonald report recognised the importance of principle of national treatment or non-discrimination because Canada had formally assented to 1976 Organization for Economic Cooperation and Development's Declaration on International Investment and Multinational Enterprises. This was particularly relevant in Canadian context because the OECD guidelines authorised the prior screening of foreign investors and the imposition of special condition such as performance requirements by the foreign controlled firm taking over an existing firm or selling up a new business. These provisions of the OECD guidelines were in conjunction with Canadian practises in the matter.

⁷⁶ *Ibid.* Pgs. 239-40.

Conservative government in Ottawa, soon after assuming power, introduced Bill C-15. This bill introduced significant changes in the Canadian policy towards foreign-controlled enterprises.⁷⁷ Sinclair Stevens, then Minister of Regional Industrial Expansion, introducing the Bill in the House of Commons emphasized the need to welcome both non-Canadians and Canadians to invest in Canada.⁷⁸ The Investment Canada Bill finally became law on 20 June 1985.⁷⁹ The Investment Canada Act [hereinafter ICA] established Investment Canada as the reviewing agency, with the Minister as the sole decision maker, replacing the hierarchical steps in the FIRA review process (the minister in-charge and finally the federal cabinet).⁸⁰

The MacDonald report approved Bill C-15 as a step in the "right direction"⁸¹ because it laid down thresholds for review of direct and indirect acquisitions. These

⁷⁷ Parliament Debates, House of Commons, 7 December 1984, 33rd parliament, 1st Session, Vol.1, Pg. 1010.

⁷⁸ *Ibid.* December 11, 1984, Pg. 1089. "By changing the name of the agency, we will be sending a positive signal, changing from that hostile-sounding terminology of Foreign Investment Review Agency, to one of: we are open for business once again. I suggest that in changing the mandate from one of Foreign Investment Review to Investment Canada we will demonstrate that indeed there is a strong positive signal once again from Canada with respect to our investment potential and that those who have money to invest, be they Canadian or non-Canadians, are once again welcome to this country".

⁷⁹ Investment Canada Act R.S.1985, c.28 (1st supplement). The purpose of Act stated in Section 2 was much same as one presented by Sinclair Stevens while presenting Bill C-15.

⁸⁰ *Supra* note 77, House of Commons Debates, Pg. 1090. Mr Stevens, Minister of Regional Industrial Expansion, while introducing the Bill C-15 criticised the abuse of over 20 percent liberal governments cabinet agenda in reviewing non-Canadians investors involved in establishing a hair stylist shop, a hamburger stand, or a popcorn stand. The Minister suggested that the Investment Canada will not review 90 percent of the type of cases that previous regime were indulging in and reserved the right to review direct acquisition of \$5 Million or more and indirect acquisitions by non-Canadian of \$50 million or more. Also see. *supra* note 79, ICA, Sections 14(3) and Section 14(4) and Section 14(1).

⁸¹ *Supra* note 68, MacDonald Report, Pg. 240.

thresholds are:

- a) direct acquisition of control of a Canadian business with assets value Can. \$ 5 million or more;⁸²
- b) indirect acquisition of control of Canadian business where the assets value in Can.\$5 million or more;⁸³ and
- c) indirect acquisition of control of a Canadian business with assets of Can.\$ 5 million or more, where the Canadian assets acquired represent more than 50 percent of the aggregate gross asset value of all domestic and international business acquired, directly or indirectly, in connection with the transaction.⁸⁴

The MacDonald report expressed its dissatisfaction with confining the final decision on foreign takeovers to a single Minister because of the risk of arbitrary decision making⁸⁵ (when the Cabinet made decisions under FIRA, other federal government departments and agencies were also able to present their views on issue of public policy). The MacDonald report expressed its preference for a quasi judicial tribunal to review foreign investment, primarily for its preference to public proceedings and full public disclosure of the decision-making process.

⁸². *Supra* note 79, ICA, Sections 14(1)(a) and (b), Sec. 14(3) and Sec. 28(1).

⁸³. *Ibid.* Sections 14(1)(d), 14(4) and 28(1)(d)(ii).

⁸⁴. *Ibid.* Sections 14(1)(c), 14(2), 14(3) and 28(1)(d)(ii).

⁸⁵ *Ibid.* Pg. 240. Also see: House of Commons Debates, 6 June 1985, 33rd Parliament, 1st Session, Vol.IV, 5467.(Lloyd Axworthy). Mr. Axworthy opposing the government's move to provide a single Minister to make a decision in the proposed review mechanism under Bill C-15 said:
" Aside from the basic flaw in the economic reasoning of the government, we object strongly to the way in which the bill arrogates star chamber powers to the Minister. I defy any member of this house to come forward with a piece of legislation which concentrates so much power and control in the hands of one Minister. Without any form of accountability. The Minister does not report to Cabinet, nor does he report to Parliament, yet he will be making decisions which will be worth billions of dollars and will effect every region of Canada without any cognizance except his own."

The test of "significant benefit to Canada" in the review process under FIRA, was also changed to "net benefit to Canada" test.⁸⁶ The factors to be considered to reach any decision upon a review of application for investment remained the same in the ICA,⁸⁷ except for an added consideration of "the contribution of the investment to Canada's ability to compete in world markets".⁸⁸ Investment Canada presented a more future oriented, "open" and positive attitude towards foreign investment.⁸⁹ The ICA not only sought to provide a mechanism for reviewing foreign acquisitions and new investments under Investment Canada, but also a future information source for Canadian investors and businesses intending to export capital from Canada. However, tougher procedures⁹⁰ were introduced for non-Canadian

⁸⁶. *Supra* note 79, ICA, Section 16 and Section 21.

⁸⁷. *Ibid.* Section 20 and also see *supra* note 8, FIR Act, Section 2.

⁸⁸ *Ibid.* ICA, Section 20(f).

⁸⁹ *Ibid.* Section 5 of the Act sets out some of the positive aspects of the Investment Canada. Section 5(1) The Minister shall;

- (a) encourage business investment by such means and in such manner as the Minister deems appropriate
- (b) assist Canadian business to export opportunities for investment and technological advancement
- (c) carry out research and analysis relating to domestic and international investment
- (d) provide investment information services and other investment services to facilitate economic growth in Canada
- (e) assist in the development of industries and economic policies that affect investment in Canada
- (f) ensure that the notification and review of investments are carried out in accordance with this Act.

⁹⁰. *Ibid.* Sections 15, 13(1)(b).

investment in cultural businesses.⁹¹

ICA raised its own share of contentious issues. Herb Gray, whose recommendations in 1972 had initiated the idea of the restrictive agency like FIRA, vehemently criticized the ICA:

"Dismantling FIRA, replacing it with a truncated remnant called Investment Canada, will do nothing to respond to this essential point. This bill does nothing to create real opportunities for profit by investors"⁹²

Gray contended that if no direct takeover of a firm in Canada worth less than Can.\$5 million and no indirect takeover where the control of the parent changes abroad worth less than Can.\$50 million will be subject to review by the government. Hence, there will be doors open for smaller firms be taken over by foreigners leading to further loss of jobs in Canada.⁹³

⁹¹ *Ibid.* According to Section 14.1(9) of ICA "cultural business" means a Canadian business that carries on any of the following activities, namely:

- (a) the publication, distribution or sale of books, magazines, periodicals or newspapers in print or machine readable form, other than the sole activity of printing or type setting of books, magazines, periodicals or newspapers
- (b) the production, distribution, sale or exhibition of film or video recordings
- (c) the production, distribution, sale or exhibition of audio or video music recordings
- (d) the publication, distribution or sale of music in print or machine readable form, or
- (e) Radio communications in which the transmission are intended for direct reception by the general public, any radio, television and cable television broadcasting undertakings and any satellite programming and broadcast network services.

⁹² Parliament Debates, House of Commons, 17 December 1984, Pg. 1300.

⁹³ *Ibid.* Pg. 1301.

The Conservative government not only brought changes, in 1985, through dismantling the hurdles for foreign investors, it also brought in a broader international perspective to Canadian enterprises. The demands of "global markets" and continental pull of the U.S. caused a marked shift towards the welcoming of foreign investment into Canada. Most of the industries in the key sectors were opened up, in varying degrees, to foreigners. Investment Canada focusses on the promotion rather than the deterrence of investment.⁹⁴ The next step in this process occurred on 2 January 1988, President Ronald Reagan of the U.S. and Prime Minister Brian Mulroney of Canada signed the landmark comprehensive Canada-U.S. Free Trade Agreement between the two countries that already enjoyed the largest bilateral trade relationship in the world. Numerous commentators within and outside Canadian parliament have attacked the investment provisions of FTA as unilateral concessions by Canada to its giant neighbour.⁹⁵ Much of the concerns expressed in 1988 with regard to the FTA are being voiced again regarding NAFTA and distrust in the American corporate agenda continues to date.⁹⁶

⁹⁴ Foreign investments which acquire controlling interests in Canadian enterprises also have now to meet the provisions of the Competition Act R.S.C 1985, c. C-34, as amended.

⁹⁵ Parliament Debates, House of Commons, 33rd Parliament, 2nd Session, Vol. VIII, October 5, 1987, 9637. Edward Broadbent reacting to the Prime Minister Mulroney's Statement stated: "I can tell you that for the first time in the history of Canada, we have a man who is Prime Minister (Mr. Mulroney) who has, without even being asked, volunteered Canada to be the 51st State of the United States, we reject that perspective of this country". The then leader of the opposition Right Honourable John N. Turner (Pg. 9634) also sharply criticised Brian Mulroney initiative to Free Trade Agreement and remarked: "One of the first things our Prime Minister (Mr Mulroney) did when he was sworn in as a leader of the country was to go to the United States and tell our American friends "Canada is open for business again". Today, the Prime Minister has put Canada up for Sale."

⁹⁶ See Generally. NDP leader Audrey McLaughlin voicing concern over NAFTA: "I would ask you to think back in history to Central America and the hold that the United Fruit Co. had over Central America. They ran the government, and when they didn't like it the American army came

As observed from the discussion in this chapter, some academics, parliamentarians, and members of the public at large have consistently expressed their concern over the high presence of FDI. However, the Canadian policy response overtime has been somewhat conflicting. Policies have ranged from encouragement of foreign investment to efforts to limit it or to direct it in certain ways.

in....It was company that ran those countries....." The Globe and Mail, "NAFTA will Turn Canada into Banana Republic; NDP says", June 19, 1993, A3. Also Liberal leader Jean Chretien's Statement: "we will be back as proud nation,....we will not be any more the 51st state of America." The Globe and Mail, "Rediscover Pride, Chretien urges Canada", June 17, 1993, A6., The Globe and Mail, "NAFTA and FTA Flawed, Not Beneficial", June 16, 1993, A-21, suggests that liberal party will "renegotiate NAFTA in five specific areas-subsidies, labour and environment provisions, dumping and control over energy resources. On that last point, the Mexican negotiators affirmed their country's control over their energy resources under NAFTA, but Canada, having given away such control in Canada-U.S. Free Trade Agreement, did not."

Is Canada really Closed to FDI?

It has been earlier argued in Chapter one and two of this dissertation that any government initiative to liberalize its policy towards foreign investment has been the source of considerable political debate. Canadian foreign investment policy has also been branded over protectionist because it is based on the economic security of Canada. The purpose of this chapter is not restricted only to demonstrate that Canada, does nothing extraordinary vis-a-vis its contemporaries in North America and other industrialised countries, when it reviews foreign investment based on an economic criteria, but also to present a detailed overview on the initiatives taken by the U.S. Congress to protect American high-tech industry from foreign takeover. This is done to demonstrate that although there exists no mechanism for reviewing foreign investments based on the economic criteria similar to the ICA, there exists an important "national security" exception for screening foreign investment. An attempt has been made to show that the "national security" exception has been used in the recent past to protect American technology and business enterprises. By first analyzing the investment provisions of both Mexico and the U.S., an attempt is made to lay foundation to understand the provisions of NAFTA discussed in chapter four of this dissertation. The second half of this chapter has been devoted to study the investment provisions of the FTA. An attempt has been made to provide a rational analysis of various provisions in the FTA investment chapter. The investment policy of the U.S. has also been dealt with to highlight the fact that how, as a result of the FTA, Canada stands shielded against the aggressive and often

politically influenced policies of the U.S.

1. CHANGES IN THE MEXICAN FOREIGN INVESTMENT POLICY

Like most economies of the developing world, the Mexican economy had been characterised by a high degree of protection from foreign competition, strict controls on foreign investment, and government control over the domestic production of goods and services (including government ownership of numerous state owned manufacturing and service enterprises).

In order to secure greater and assured access to U.S. markets through NAFTA, Mexico has made conscious attempts to reform its law and in the process the U.S. has attempted to influence change Mexican law to conform to the approach undertaken in the U.S.⁹⁷ This process of gradually opening the economy to foreign competition and enhancing the role of the private sector at the expense of government control-known as the *apertura* (opening)-began with Mexican accession to the GATT in 1986.⁹⁸

There is a certain degree of similarity between the Mexican and Canadian interests which have prompted both countries to keep a check on foreign investors.

⁹⁷. Stephen Zamora, "The Americanization of Mexico Law:Non-Trade Issues in the North American Free Trade Agreement" (1993) 24 Law and Policy in International Business 391, Pg. 405.

⁹⁸. See generally, Richard D. English, "The Mexican Accession to the General Agreement on Tariffs and Trade" (1988) 23 Texas International Law Journal 339.

Both Canada and Mexico have commonly shared fear of "American" takeover of their cultural industries, energy, resource and mining sectors. It is feared in Mexico that the adoption of rules covering non-trade (like investment), may have greater impact on the domestic legal system because it attempts to influence society in ways that the circulation of goods through trade may not.⁹⁹ It is more than a coincidence that two neighbours of the U.S. have had commonality of concerns regarding the real intentions of their giant neighbour. There has always been that extra degree of caution exercised by both Canada and the Mexico, yet it is noteworthy that Canada has certainly been less restrictive towards FDI as compared to Mexico.

At the outset, it should be noted that cultural differences between U.S. and Mexico have not earned much attention in the NAFTA debate, at least within the U.S. The U.S. International Trade Commission, in its extensive consideration of all viewpoints relevant to the NAFTA negotiations, down-played the relevance of cultural differences in NAFTA:

"The majority of participants [in public hearing] said that, because of the close proximity and cultural integration that exists between the United States and Mexico, cultural differences should not hinder development of a United States-Mexican FTA. Many people regarded that impact of different languages, traditions, history, and customs of the neighbours as negligible on FTA negotiations. A few participants noted that during the United States-Canadian FTA talks, Canada, being so similar to the United States, was perhaps rightly concerned about U.S. cultural domination on its society, but since Mexico's "culture is so strong and distinctive", its fear of U.S. domination should be minimal. As one U.S. government official asserted, "Mexico is much

⁹⁹. *Supra* note 97, Stephen Zamora, Pg. 404.

more self-confident than Canada."¹⁰⁰

As the quote suggests Canada unlike Mexico, has been greatly concerned about U.S. cultural domination. Canadian sensitivities on cultural issues caused the exclusion of cultural industries from the U.S.-Canada FTA.¹⁰¹ The Canadians were successful in maintaining certain exceptions in the NAFTA for their cultural industries. For example, NAFTA, Annex-I, Schedule of Canada, specifies reservations regarding investment that allows review by Investment Canada of acquisitions or new business related to Canada's cultural heritage or national identity and sets out as one of the criteria for determining "net benefit to Canada"_"the compatibility of the investment with national industrial, economic and cultural policies".¹⁰² Canada has also excluded certain cultural products from the intellectual property provisions of Chapter Seventeen of NAFTA. Further, investors dealing with the export and import of cultural property, patent agents, and trade mark agents all are required to be residents of Canada, or institutions of Canada.¹⁰³

It is also interesting to note that the nationalistic attitude towards foreign investment manifested itself approximately at the same periods in both Canada and

¹⁰⁰. U.S. International Trade Commission Publication No.2275, Review of Trade and Investment liberalisation measures by Mexico and prospects for future United States-Mexico Relations 41 (1990), at Pg.I-6.

¹⁰¹. See generally, Debra P. Steger, A Concise Guide to the Canada-United States Free Trade Agreement 49 (1988).

¹⁰². *Supra* note 10, NAFTA, ANNEX-I, Schedule of Canada, Para.3 & Para.4(e), Pg. I-C-3.

¹⁰³. *Ibid.*

Mexico.¹⁰⁴ For instance, in 1867, Canada was not a high-tariff country, at least in the context of trade relations inside the British empire. The system of exchange between Britain and Canada was that of mercantilism: Canada traded fish, lumber, and other raw material for finished goods from Britain. As Britain shifted towards free trade, Canada furtively sought other arrangements with the U.S., ultimately in terms of protectionist policies of Sir John A. MacDonald's National Policy. Although the National Policy was publicized as a revenue measure, its real immediate purpose was to protect Canadian manufacturers from foreign competition.¹⁰⁵ Similarly, the Mexican constitution¹⁰⁶ promulgated in 1917, as a result of the Mexican Revolution placed restraints on economic activities of foreigners and their ownership of land in Mexico. These constitutional restrictions were and continue to be despite NAFTA, a major barrier to foreign capital.

¹⁰⁴. A strong sense of Canadian nationalism did develop in the years immediately following the creation (Confederation) of the modern dominion of Canada in 1867. It took the form of a neo mercantilism or protectionist desire to foster secondary manufacturing through the manipulation of tariff barriers. In 1879 the conservative government of Sir John A. Macdonald responded to this sentiment by a substantial upward revision to turn a large revenue tariff into an instrument to protect Canadian manufacturing. The new policy of tariff protection was labelled Canada's "National Policy". Although Great Britain was still Canada's largest trading partner, much of the protectionist rhetoric of the time focused on the perceived ill-effects of imports of cheap American manufactured goods. In Mexico, Diaz took control of the government in 1876 and launched a successful program of economic growth, but the Diaz program, was also believed to have inspired fear that increasing foreign influence would exploit Mexico's natural resources and labour. See Generally, Sandra F. Maviglia, "Mexico's Guidelines for Foreign Investment: The Selective Promotion of Necessary Industries" (1986) 80 *American Journal of International Law* 283, at Pg. 283. This economic nationalism exacerbated during the Mexican Revolution (1910-1917). one of the salient objectives to emerge during the country's revolution was the goal to recover Mexico's economic destiny. This goal was an essential tenet of every piece of legislation pertaining to foreign investment that was enacted subsequently in Mexico.

¹⁰⁵. Charles C. Tansill, *Canadian-American Relations, 1875-1911* (New Haven: Yale University Press, 1943), Chapter 11. Also see, Robert C. Brown, *Canada's National Policy, 1883-1900: A Study in Canadian-American Relations* (Princeton: Princeton University Press, 1964).

¹⁰⁶. Constitution of Mexico (As Amended), *Constitutions of the Countries of the World*, Vol. 11 (Dobbs Ferry, New York: Oceana Publications 1988).

The various investment provisions of Mexico will be explained in this section in order to appreciate the context within which negotiating teams both from the U.S. and Canada had to operate at the NAFTA negotiations. The Mexican Constitutional and legislative barriers to foreign investment are also discussed in this section to give an appreciation of the numerous annexes assigned to NAFTA Investment Chapter, saving certain sectors of Mexican economy completely from any foreign control. These sectors were considered non-negotiable by the Mexicans and were accepted in their entirety by the negotiating teams from both the U.S. and Canada.

Due to the economic crises involving a devaluation of the Peso, the Constitution was amended in 1983.¹⁰⁷ The amended Constitution listed "strategic" areas reserved exclusively to the state mentioned in the constitution¹⁰⁸ and in other legislative enactments of Mexico.¹⁰⁹ Later in May 1983, the Mexican Government announced the National Development Program 1983-1988 [hereinafter PND].¹¹⁰ The

¹⁰⁷. Amendments to Articles 16, 24, 26, 27-XIX and XX, 28, 73, 29 D, E and F of the Constitutions of the Mexican United States, approved 2 February 1983 and Published in the Federal Official Gazette (Diario Oficial. Feb 3. 1983).

¹⁰⁸. *Supra* note 106, Constitution of Mexico, Article 25, 27 and 28.

¹⁰⁹. For Example, Regulatory Law of Constitutional Article 27 with Regard to Mining of 11 December 1975 (D.O. 22 December 1975), and Law on Inventions and Trademarks of 30 December 1975 (D.O. Feb.1976).

¹¹⁰. National Development Program 1983-1988, Federal Chief Executive (May 1983), also see, Julio C. Trevino, "Mexico: The Present Status of Legislation and Governmental Policies on Direct Foreign Investments" 18 (1984) International Lawyer 297, at Pg. 300.

PND constitutes the governing principles for development policies.¹¹¹ The Constitution describes the economic system as "mixed economy". In order to properly assess these changes, it is important to note that for over 40 years Mexico has been a closed economy and the economy is still largely state-planned.¹¹² The natural resources and energy sectors still remain largely under state control by virtue of the Constitution.¹¹³

111. *Ibid.* PND is a 430 Page Document. The chapter on Development financing analyses the participation of private capital, with an emphasis on industrial development and foreign trade. Finally this document discusses the ties of the national economy with the international economy and distinctively states the role of foreign investment policy.

112. *Supra* note 106, Mexican Constitution, Article 25, Para.2-"The State shall plan, conduct, coordinate and orient the national economic activity, and shall bring forth the regulation and implementation[formento] of activities of general interest within the scope [marco] of liberties set forth in this constitution", Para. 4 confines the strategic sectors to Mexican ownership and control, they now form exceptions in the NAFTA. But the amended constitution also attempts to define its hybrid outlook through Art.25, Para.8,"The Law shall encourage and protect economic activity by private individuals and shall provide conditions for the growth of the private sector and its contribution to the national economic development, within the terms set forth in this constitution."

113. *Ibid.* Article 27, Para.6 ".....In the case of petroleum, and solid, liquid, or gaseous hydrocarbons or radioactive minerals, no concessions or contracts will be granted nor may those that have been granted continue, and the products, in accordance with the provisions indicated in the respective regulatory law. It is exclusively a function of the nation to general conduct, transform, distribute, and supply electric power which is to be used for public service. No concessions for this purpose will be granted to private persons and the nation will make use of the property and natural resources which are required for these ends.....The use of nuclear fuel for the generation of nuclear energy and the regulation of its application to other purposes is also a function of the nation". No foreigner can acquire ownership of land but the state can grant such a right if foreign acquirees agree "before the Ministry of Foreign Affairs to consider themselves as nationals in respect to such property, and bind themselves not to invoke the protection of their governments in matters relating thereto; under penalty, in case of non-compliance with this agreement, of forfeiture of the acquired property to the nation"(Art.27-I). The 1983 Amendment of Art.28 provides that although there shall be no monopolies or restrictions to free competition, but para.4 of Art.28 states:"The functions exercised exclusively by the state in the strategic areas referred herein shall not constitute monopolies; the coinage of money; the postal system; the issuance of money by a single bank to be controlled by the federal government; petroleum and other hydrocarbons; basic petroleum chemistry; radioactive minerals and nuclear power production; electricity; rail roads; and the activities expressly provided for in the laws issued by the Congress of the Union"(Article 28, para.4 is to be read with Article 25, para.4). Art.28, Para.5 also exempts "the provisions of the first part of the first paragraph of this article are the banking and credit institution services. This service shall be rendered exclusively by the state through institutions under the terms established by the respective regulating law.....".

According to Article 25, para 4, the federal government exercises exclusive ownership and control over public sector enterprises engaged in: the coinage of money; the postal system; telegraph; radiotelegraphy and communications via satellites; the issuance of money by a single bank to be controlled by the federal government; petroleum and other hydrocarbons; basic petroleum chemistry; radioactive minerals and nuclear power production; electricity; railroads and activities expressly provided for in the laws issued by the Mexican Congress. The above-mentioned economic activities are reserved exclusively to Mexican state according to Annex-III of the NAFTA.¹¹⁴

Important dimension of the Mexican constitution which restricts foreign ownership of lands, waters and natural resources is stated in Article 27. Article 27 vests originally ownership of all lands, waters (both territorial and inland) and natural resources in the nation.¹¹⁵ As a result federal executive alone can, according to the law of Mexico allow exploitation and use of these resources. Sectors like petroleum, electricity generation and operation of nuclear energy are also exclusive functions of the Mexican state,¹¹⁶ as a result, foreign investors are prohibited to

¹¹⁴. *Supra* note 10, NAFTA, Annex-III, Pg.III-M-3 to III-M-5. According to Section-B of Annex-III, no private equity investment is permissible in these sectors under Mexican law. In case Mexico allows private equity participation through service contracts or concessions, such participation shall not be construed to affect the state's reservations to those activities.

¹¹⁵. *Supra* note 106, Constitution of Mexico, Article 27, para.4.

¹¹⁶. *Ibid.* Article 27, para.6.

invest in these sectors. Some of the other sectors like the fisheries and water transportation continue to be within the exclusive ownership of the Mexicans and these sectors are reserved (MFN) under NAFTA.¹¹⁷

As mentioned earlier that only Mexicans enjoy the right to own lands, waters and exploitation of mines and minerals, therefore foreign investors may only attain such a right, if they agree before the Ministry of Foreign Affairs that they will consider themselves as nationals of Mexico and agree not to invoke the protection of their home states in any matter (including expropriation) related to such a right. Such clauses in an agreement between foreign investors and the host governments are also called the Calvo Clause. Calvo Clause is discussed in detail in chapter five of this dissertation.

It is important to emphasize the expropriation power of the Mexican constitution because Mexico has a history of expropriating foreign owned industries.¹¹⁸

^{117.} *Supra* note 10, NAFTA, Pg. I-M-29 & I-M-30, Also see Annex-IV, Schedule of Mexico, Pg. IV-M-1.

^{118.} There have been four major efforts to expropriate or to displace foreign- owned industries to Mexicans. Major act of expropriation in recent past was in 1982. Fifty three private banks were expropriated. These banks managed 55.6 percent of the entire banking resources of Mexico, which was approximately 40 percent of the Mexican GDP. These banks held shares of non-banking businesses operating in Mexico, by way of long term investments. Corporate giants like Texaco, Hooker Chemicals, British American Tobacco, Union Carbide, Celanese and Toshiba, in order to maintain there operations (To fulfil the 51/49% ownership ratio, in order to operate in Mexico, foreign investors entered joint ventures with private Mexican banks) in Mexico, often allowed private banks to be their investing partners. By virtue of an expropriation decree, on 1 september 1982, private banks were expropriated. It also resulted in a surprise for multinationals that its majority Mexican partner had become the Mexican government. See generally, Ewell E.Murphy,Jr., "Expropriation and Aftermath:The prospects for Foreign Enterprise in the Mexico of Miguel De La Madrid" (1983) 18 Texas International Law Journal 431.

The Mexican constitution grants to the legislature the power to prescribe laws regulating foreign investment. In 1973, Mexico legislated "The Law to Promote Mexican Investment and Regulate Foreign Investment" [hereinafter FIL],¹¹⁹ this is the same year FIRA was created in Canada. The FIL contains numerous defensive and regulatory measures pertaining to foreign investment.¹²⁰ Mexico's impetus for liberalization of foreign investment stems, among other things from the economic crisis in 1982. After continual economic growth from 1960 to 1980, the sudden drop in world oil prices precipitated a dramatic decline in the Mexican economy.¹²¹

In 1989, recognising the importance of attracting foreign investment, the Mexican government proposed amendments to the FIL.¹²² However, significant obstacles stood in the way because of the division on the issue in the Mexican House of Representatives. This dissension in the Mexican legislature raised questions as to

¹¹⁹. Law to Promote Mexican Investment and Regulate Foreign Investment of 6 February 1973 (D.O. 9 May 1973), in force since 8 May 1973.

¹²⁰ *Ibid.* Article V states 51-49% general rule for Mexican and foreign-capital investment, which was designed to stimulate joint ventures at the point of incorporation, Article IV exclusively reserves certain industries to the Mexican government and domestic investors. Article VIII requires approval from National Foreign Investment Commission [hereinafter FIC] it was established under the FIL it decides whether the foreign investment is acceptable for the country, and the formalities and requirements to which it should submit are determined. Article XII grants the commission discretionary authority to decide on the expansion of existing foreign investment. New Foreign Investment Regulations, Art 4, 5, 8, 12, D.O., 16 May 1986 translated in *DOING BUSINESS IN MEXICO* pt IV, App.4 (Michael W.Gordon ed.1992). Article 13 of the FIL provides the requirement that need to be met to determine whether foreign investment is in the "best interest of the country".

¹²¹. David B.Hodgins, "Comment, Mexico's 1989 Foreign Investment Regulations: A Significant Step forward, But is it Enough?" (1990) 12 *Houston Journal of International Law* 361, at 361-362.

¹²². New Foreign Investment Regulations (D.O. 16 May 1989), Translated in *DOING BUSINESS IN MEXICO* pt.IV. app.4 (Michael W.Gordon ed.,1992).

the success of any legislative attempt to liberalize foreign investment restrictions.¹²³ Circumventing the divisiveness in Mexican legislature, the President issued new regulations under Article 89, Para.1 of the Mexican Constitution.¹²⁴

The scope of any regulations issued under a law by the executive in Mexico, is necessarily limited to the law enacted by the Mexican legislature. The President as chief executive has to administer laws through "exact enforcement" of the law as issued by the Mexican legislature¹²⁵ and any measures taken by the executive in contravention of this principle would be ultra-vires under the constitution. What this means is that regulations under the law enacted by the Mexican Congress cannot contravene the provision of the law issued by the Congress. Notwithstanding the "deregulation"¹²⁶ permitting 100% ownership under the new

¹²³. Ignacio Gomez-Palacio, "Mexico: A Different Task", (1990) 12 Houston Journal of International Law 253, at 259.

¹²⁴ *Supra* note 106, Mexican Constitution, Article 89 reads powers and duties of the President as the following: "To promulgate and execute the laws enacted by the Congress of the Union, providing for the exact enforcement in the administrative sphere".

¹²⁵. *Supra* note 123, Ignacio Gomez, Pg. 259.

¹²⁶. The new FIL regulations does not grant incentives like abatements, tax breaks, or cost reduction. Only Article 5 of the FIL Regulation provides that upon incorporation foreign investors may hold any proportionate interest in the capital stock of Mexican business enterprises without FICs approval if it complies with following six requirements: 1) Investment must be made in fixed assets used to conduct company's economic activities in amounts up to that periodically set by the Commerce and Industrial Development Ministry (from 1989 through 1992 this amount was one hundred million dollars); 2) Investments must be funded by outside sources; 3) industrial establishment must carry out industrial or manufacturing activities of the growth controlled geographical zones (The term "growth controlled geographical zones" refers to Mexico City, the surrounding suburbs of the state of Mexico, Guadalajara, and Monterrey); 4) Incorporated companies shall maintain, as a minimum, a balanced accumulated-foreign currency budget during their first three years of operation; 5) Investors must create permanent jobs and establish worker training and development programs; and 6) Investors must employ adequate technology and meet environmental requirements. Provisions for automatic approval is devised if the activities by the company are not included in the catalog of classified activities. The

regulations, Article 5 of the FIL Regulations directly contravenes Article IV & V of the FIL Act.¹²⁷ However no constitutional challenge is believed to have been made against the 1989 regulations.¹²⁸ Mexico is expected to introduce new foreign investment legislation in the Mexican Congress to bring its foreign investment law in conformity with its commitments under the NAFTA investment chapter.¹²⁹

Annex-I, Schedule of Mexico, Pg. I-M-4 of the NAFTA shows how Mexico continues to maintain a review mechanism for both direct and indirect acquisitions in the unrestricted sector according to the thresholds set out in that Annex and discussed later in chapter four of this dissertation. The aforesaid review mechanism remains in place beside the complete exclusion of foreign investments from certain sectors of the Mexican economy.¹³⁰ Nevertheless the foreign investment targets envisioned by the Salinas administration has certainly proved to be "a Win-Win-

regulations now permit upto 100 percent foreign ownership of new corporations in "unclassified" sectors of the economy. Unclassified sectors have been substantially broadened to include the previously restricted glass, cement, iron, steel and cellulose industries. As a result unclassified sectors now cover approximately two-thirds of Mexico's GDP. New Foreign Investment Regulations, Article 5. D.O. 16 May 1989, Translated in *DOING BUSINESS IN MEXICO* pt.IV, app.4 (Michael W. Gordon ed., 1992).

127. *Supra* note 123, Ignacio Gomez Palacio, Pg. 259, noting that one hundred percent rule contravenes FIL Act.

128. Recorded Conversation on 5 July 1993 with Mr. Jorge A. Juraidini, Assistant Representative, Representative Office for NAFTA Negotiations, Embassy of Mexico, Ottawa, Canada

129. *Ibid.*

130. *Supra* note 10, NAFTA, Annex-I, Pg. I-M-4, and Annex-III, Pg. III-M-1 to III-M-5. Those sectors which are exclusively reserved for the Mexican state are: Petroleum, other hydrocarbons and basic petrochemicals; electricity; nuclear power and treatment of radioactive minerals; satellite communications; telegraph services; radiotelegraph services; postal services; railroads; issuance of bills(currency) and minting of coinage; control, inspection and surveillance of maritime and inland ports; control, inspection and surveillance of airports and heliports.

Win Situation".¹³¹ On putting a query to the Mexican official in Ottawa as to the reason for high inflow of foreign investment in Mexico, despite protectionist investment regime still in place, the official replied that it was the sign that legal regime has nothing to do with the inflow of investment and their legal framework was "ok".¹³² According to the official at Investment Canada the high inflow of foreign investment in Mexico could be attributed to returning capital.¹³³ It is hard to accept that everything was fine with the Mexican foreign investment Law. Certainly the Mexican accession to GATT and the subsequent introduction of new regulations has gone a long way in restoring the confidence among the foreign investors and businesses to venture-out in Mexico.¹³⁴ Certainly introduction of the new legislation on foreign investment in the near future should provide added incentives for foreign investors to invest in Mexico.

¹³¹. Time. 7 June 1993, Pg.43, Interview; "A Win-Win-Win Situation-President Salinas speaks out on Free Trade, Drugs and Democracy". In replying to a question as to what has been the benefit of the free market reforms in Mexico, President Salinas said: "Foreign investment continues very strong. Last year the flow of foreign capital into Mexico was about \$20 billion. One plus for us has been our capacity to reduce our debt, both foreign and domestic. When I took office, total debt was 70% of gross domestic product. Then we went privatization, and we got more than \$22 billion from sales of banks, telephone companies, state industries, mines. Now we are going into ports and airports.[As a result], in Mexico domestic debt is 10% of GDP. We have a budget."

¹³². *Supra* note 128, Conversation with Mr. Juraidini, According to Mr. Juraidini: "But we see our legal framework... as it is now, we will see that the amount of foreign investment, we are receiving is amazing... that means our legal framework is o.k."

¹³³. Conversation with Ms. Emmy Verdun, Director of Policy, Investment Canada, Ottawa, Canada, on 18 June 1993. According to Ms. Verdun, higher rate of inflow of foreign capital vis-a-vis Canada is because the present inflow is the returning capital of Mexican businesses which had in the past outflow from Mexico because of expropriations and restrictive regimes.

¹³⁴. Arturo Carrillo, "The New Mexican Revolution:Economic Reform and the 1989 Regulations of the Law for the Promotion of Mexican Investment and Regulation of Foreign Investment" (1991) 24 George Washington Journal of International Law and Economics, Pgs.647-690. Also see, Miguel Jauregui-Rojas, "Liberalisation of Foreign Investment in Mexico:Present and Future Challenges" (1992) Private Investors Abroad-Problems and Solutions in International Business, Pgs. 2-1(21).

2. Review Mechanisms Practised in the Industrialized World

The characterization that the Canadian review mechanism is overly protectionist is a "false accusation" given that a majority Organization of Economic Co-Operation and Development [hereinafter OECD] countries¹³⁵ have either implemented review mechanisms for all types of investment or require prior authorization when a non-resident investor invests in a specific sector of the economy.

Among the OECD countries, Australia,¹³⁶ Austria, France¹³⁷ and Spain are

¹³⁵ The OECD constitutes of 24 nation states: Austria; Belgium; Canada; Denmark; France; Germany; Greece; Iceland; Ireland; Italy; Luxembourg; the Netherlands; Norway; Portugal; Spain; Sweden; Switzerland; Turkey; The U.K and the U.S. (Original Members of the OECD), Japan; Finland; Australia; New Zealand (Subsequently became Members of the OECD), Yugoslavia also takes part in some of the work of the OECD. The OECD Convention was signed in Paris on 14 December 1960 and it came into force on 30 September 1961.

¹³⁶ Controls and Impediments Affecting Inward Direct Investment in OECD Member Countries, OECD Document, 1987, Pg. 17. In Australia: "Prior Authorization is required for certain types of inward investment in Australia, Authorization is required for:

- Proposals by foreign interests that should result in the ownership of a substantial interest" (i.e. share holding of 15% or more by a single foreign interest or associates, or 40% or more by two or more unrelated foreign interests) in an Australian Corporation;
- All investments in those sectors subject to special restrictions;
- Proposals to establish new businesses in other sectors of the economy where the total amount of the investment is A\$ 10 million or more;
- Certain proposals to acquire real estate and real estate development projects.

Foreign investment proposals are examined on a case to case basis against sectoral policy guidelines....

Additional investments in Australia established foreign controlled enterprises are accorded the same treatment under foreign investment policy as that accorded to non-resident companies investing for the first time...The diversification of the business of a foreign-controlled enterprise into

countries besides Canada which require prior authorization pertaining to certain sectors or maintain thresholds for foreign investment review like Canada. Six countries: Finland, New Zealand, Norway, Sweden and Turkey require prior authorization for all kinds of foreign investments. For example, In New Zealand, prior authorization is required when non-resident investors acquire 25% or more of any class of shares in a New Zealand company or acquire the assets of a business exceeding NZ.\$500,000 or intend to commence business in New Zealand. All applications are reviewed on a case-by-case basis taking into account the benefits to New Zealand. The above-stated requirements also apply to an already continuing operation of a foreign corporation. Prior authorization is required for any subsequent takeover of 25% or more of a New Zealand corporation or the expansion of activity into an area unrelated to that consented to originally.¹³⁸

Japan which is one of the leading industrialised nations also has a prior authorization procedure for certain sectors like: primary industry related to agriculture; forestry and fisheries; mining; oil; leather and leather products manufacturing and other sub-sectors falling under the aforesaid sectors where the

an activity previously undertaken by the enterprise is regarded as investment in a new business."

In Australia prior authorization in case of all proposals irrespective of the size, falling within the scope of Foreign Takeovers Act 1975 (including proposals for the acquisition of businesses by the purchase of shares or assets) and proposals to establish new business where total amount of investment is A\$ 10 million or more is required.

¹³⁷ *Ibid.* Pgs. 19-20. In France investment from the non-E.C. countries are subjected to prior authorization procedures for: Investments taking the form of the creation of a new enterprise or a participation of not less than FF.10 million in an existing enterprise not under foreign control.

¹³⁸ *Ibid.* Pg. 22.

Minister of Finance and other competent Ministers consider that Japanese interests might be adversely affected.¹³⁹

¹³⁹. *Ibid.* Pg. 22.

3. U.S. FOREIGN INVESTMENT POLICY

To enhance the argument that Canada does what most other industrialised nations do to safeguard against the problems associated with FDI, including the U.S. Although, the movement of FDI, has been a principal stimulus of U.S. economic development in the nineteenth century and continues to be at the core of U.S. commercial policy towards other countries in the twentieth century, recently, there appears to be emerging duality in its treatment towards inward foreign investment, particularly in the high-technology industries. This can be best described in the difference in the U.S. national policy vis-a-vis some of the states in the U.S. which has created some interesting situations. Whereas some states in the U.S. have offered incentives to locate industries, others have also tried to fend off unwanted foreign takeovers.¹⁴⁰

The U.S. national policy towards foreign investment remained unrestricted till 1973 when inward investment in the U.S. surged by 24% in 1972 and led to a Congressional re-examination of the traditional "open door" policy.¹⁴¹ The concerns

¹⁴⁰For example: the Wisconsin legislature tried to stop Alan Bond from acquiring G. Heileman Brewing; the Ohio legislature passed a law thwart Campeau (Canada) from acquiring Federated Department Stores; and the Kentucky legislature attempted to halt Belzberg (Canada) from taking over Ashland Oil. In case of Ohio, legislation was deemed unconstitutional. Earl H. Fry, "Foreign Direct Investment in the U.S.: The Differing Perspectives of Washington D.C. and the State Capitals" (1989) 2 Brigham Young University Law Review, Pgs. 373-391.

¹⁴¹ Mina Gerowin, "U.S. Regulation of Foreign Direct Investment: Current Developments and the Congressional Response" (1975) 15 Virginia Journal of International Law 611. Also see, Jay Laurence Lenrow, "Foreign Direct Investment in the United States: Possible Restrictions at Home and a New Climate for American Investment Abroad" (1976) 26 American University Law Review 109. Number of Bills were proposed in the 93rd Congress, the most restrictive being the 1973 Dent-Gaydos Bill. This

of the Congress were synonymous to that of Canada.¹⁴² But despite pressures from the Congress, the U.S. administration felt that since it had a long record of leading the fight to remove incentives and impediments to international investment flows, that policy should be continued to be followed. The U.S. administration feared that any shift in policy might violate bilateral treaties, and more importantly there was the threat of retaliation from abroad to U.S. transnational corporations [hereinafter TNCs] located there. As the U.S. had more investment abroad than there was foreign investment in the U.S., it was argued that the U.S. stood to lose the most in the process.¹⁴³ Due to mounting pressure on the U.S. administration, however, it gave in to a number of measures intended to restrict foreign investment in the mid- to late 1970's.¹⁴⁴

Bill aimed at restricting foreign control of U.S. industry by limiting foreign firms to not more than 5% of the voting shares of a U.S. public company. The Roe Bill, The Gunter Bill, The Metzemaum Bill. All these bills proposed Cabinet-level commission or regulatory commissions to monitor, control and ownership of inward investment.

¹⁴². The 1973 oil price rise and increase in petrodollars available for investment raised different concerns: a fear of political manipulation and economic blackmail from the use of government-controlled investments. The concern was whether government (namely the OPEC) investors would act as "private economically rational investors" or if they would rather forgo maximum profits in pursuit of other goals, such as gaining control of firms for political purposes and to gain leverage to influence domestic and foreign policy, as a result the Treasury Department published guidelines in OPEC investments in 1975.

¹⁴³. Roger Sugden, *The Warm Welcome for Foreign-Owned Transnational from Recent British Governments*, in Chick (ed.), 1990, op.cit.

¹⁴⁴. Foreign Investment Review Agency, 1982: *Barriers to Foreign Investment in Canada*. The various measures among other were: i) the creation of the Committee on Foreign Investments in the United States [hereinafter CFIUS] in May 1975; ii) the passing of Inouye's Bill as the 1976 Foreign Investment Survey Act, which sought to conduct on going, Comprehensive surveys of direct and portfolio inward and outward investment; iii) the 1978 Agricultural Foreign Investment Disclosure Act, which required notification by foreign investors if they purchased agricultural land, forestry and timber industries. Both Treasury and State Departments were always opposed to any restrictive legislation on inward investment and CFIUS being under the supervision of the Treasury went to great lengths to scale down the ideas of Inouye Bill (Inouye Bill initially required Commerce Department to undertake

In addition, the Office of Foreign Investment in the United States [hereinafter OFIUS] was created to support the Committee on Foreign Investment in the United States [hereinafter CFIUS].¹⁴⁵ Mina Gerowin at least hints at Congressional proposals being influenced by moves in other countries at the same time to regulate inward investment (for example, Canada, Mexico).¹⁴⁶ In some measure CFIUS/OFIUS was a U.S. parallel to the FIRA, at least that was FIRA's view defending its own position on the issue. FIRA's view was that not only had CFIUS reviewed a number of foreign investments over the years, it also engaged in much more activity than that it actually disclosed.¹⁴⁷ Nevertheless the barrage of criticism from the Congress

analysis covering trade, financing, technology transfer, employment, concentration and anti-competitive behaviour, the effects of state investment incentives on economic development and impact of taxes on investment patterns. But Inouye Bill in its final form only sought Federal Agencies to analyze only net employment, tax payments and R&D expenses of foreign TNCs, and only when "necessary and feasible". For Details see: U.S. Committee on Government Operations 1980: The Adequacy of the Federal Response to Foreign Investment in the U.S., House Report No 96-1216, Washington D.C., U.S. Government Printing Office, 1980.

¹⁴⁵. CFIUS had been set up in May 1975 by President Ford under Executive Order 11585. This inter-agency committee includes permanent representatives of the departments of State, Treasury, Defence and Commerce at a level no lower than Assistant Secretary. CFIUS was charged to: arrange for the preparation of analyses of trends and significant developments in foreign investment in the U.S.; provide guidance on arrangements with foreign governments for advance consultation on prospective major foreign governmental investments in the U.S.; review investments in the U.S. which, in the judgement of the Committee, might have major implications for U.S. national interests; and consider proposals for new legislation or regulations relating to foreign investments as may appear necessary. OFIUS is assigned responsibility to monitor and analyze impact of inward investment. OFIUS operation includes study of: the concentration and distribution of inward investment by industry, area and so on; the impact of inward investment on national security, energy, natural resources, agriculture, environment, real estate, employment, balance of payments and trade; the methods used for the inward investment. OFIUS also undertakes preparation of studies and analyses for the U.S. Congress on the effect of inward investment trends and transactions. *Ibid.* U.S. Committee on Government Operations (1980).

¹⁴⁶. *Supra* note 141, Mina Gerowin.

¹⁴⁷. U.S. House of Representatives, The Operations of Federal Agencies in Monitoring, Reporting on and analyzing Foreign Investments in the United States, Hearing before a Subcommittee of the Committee on Government Operations, Ninety-fifth Congress, Second Session, 19, 20 and 21 September 1978. Washington D.C, U.S. Government Printing Press. Bergsten, then U.S. Treasury

continued because it felt that Administration was not being hard enough on foreign investors. The U.S. Committee on Government Operations¹⁴⁸ in 1980 called for a policy reassessment, arguing that:

"most other industrial countries manage foreign investment in a way that benefits their economies and minimises the harmful effect of such investment. There is no valid reason why the United States cannot manage its foreign investments with the same objectives."

Among other things the Committee recommended a screening agency, like Canada's FIRA or Australia's Foreign Investment Review Board [hereinafter FIRB], with the aim not of excluding foreign investment, but gaining from it "substantial benefit" for the U.S. economy.¹⁴⁹ In 1980-83, pressure from the U.S. Congress led to CFIUS to review twenty five cases under its executive authority.¹⁵⁰ While debate over FDI was raging in the U.S., then came the famous Fujitsu's proposed takeover of Fairchild Semiconductors in 1986, which CFIUS investigated.¹⁵¹ The

Assistant-Secretary for International Affairs, Stated at the aforementioned hearing:

"One should not, I think, view the formal meetings of the committee as the only activities of the committee. Like most committees in government and elsewhere, the formal meetings are usually the tip of the iceberg and a great deal goes on in informal meetings and discussions within the agencies and between the agencies. That is the way business is done."

¹⁴⁸. U.S. Committee on Government Operations, 1980: The Adequacy of the Federal Response to Foreign Investment in the U.S., House Report No.96-1216, Washington D.C., U.S. Government Printing Office.

¹⁴⁹. *Ibid.* Pg.160.

¹⁵⁰. For Details see: Harvey E. Bale Jr., The U.S. Federal Government's Policy Towards Foreign Direct Investment, in Fry and Radebaugh (eds) 1983, op.cit. A.E. Safarian, Governments and Multinationals; Policies in the Developed Countries (Washington D.C.:British/North American Committee, 1983).

¹⁵¹. There was concern over the possible increased dependency of the U.S. military on foreign suppliers (although Fairchild was already French-owned), the large share of semi-customised chip market that Fujitsu would hold, and that Fairchild's advanced semiconductor technology would pass to the Japanese control. Jane Sneddon Little, "Foreign Investment in the United States: A Cause for

semiconductor industry was particularly vulnerable¹⁵² and the number of foreign takeovers was raising concerns. Foreigners were involved in four hundred and forty-six acquisitions in 1988, against three hundred and sixty-three in 1987. Hostile takeovers were also becoming more common.¹⁵³

The rising concern¹⁵⁴ led to number of amendments to the Omnibus Trade Bill, later Omnibus Trade and Competitiveness Act of 1988¹⁵⁵ and the most significant was the Exon-Florio Amendment [hereinafter EXFA]. The original House Bill was designed to empower the Secretary of Commerce to examine foreign acquisitions if they affected "national security" and "essential commerce" but the U.S. administration was opposed to this bill because it felt that the same would undermine the traditional open policy of the U.S. towards international investment. The final version of the Bill that was approved by the House, authorised the President to block or divest acquisitions of a U.S. juridical person by foreign corporations if such acquisitions would threaten to impair the "national

Concern?" (1988) New England Economic Review, Pgs.53/58.

¹⁵² Donald J. Goldstein and Charles L.Fishman, "Foreign Direct Investment in the United States and National Security Policy" (1988) 7 Comparative Strategy, Pgs. 143-158.

¹⁵³ Margaret Ayers and Joseph Chubb, "Exon-Florio: US Power to Block Foreign Acquisitions", (1989) 8 International Financial Law Review, Pgs.19-22. Debate was fuelled in particular by the \$ 2.6 billion Bridgestone (Japanese) acquisition of Firestone in 1988, which heightened Congressional and public concern in the U.S.

¹⁵⁴ D.Heleniak & T. Farrell, Developments in the Law of Mergers and Acquisitions: Cross Border Transactions (Corporate Law and Practice Course Handbook Series No. 620, 1988), 143.

¹⁵⁵ Omnibus Trade and Competitiveness Act of 1988, Pub.L.No.100-418, 5021, 102 Stat. 1107, 1425 (Codified as 721 of the Defence Production Act of 1950, at U.S.C.A. App. 2170(West Supp.1989).

security".¹⁵⁶ Though the EXFA provides factors to be considered by the U.S. President, the language of the provision is open ended and ambiguous. Although the factors to be considered by the President are laid down by the legislation, there may be undefined reasons extraneous to these factors which may persuade the U.S. President to take action to prohibit or suspend any foreign acquisition, merger, or takeover. National security is a nebulous term and may be used at wider discretion by the U.S. Administration. No legally defined parameters of national security have been provided under EXFA to contain any discriminatory and discretionary U.S. Administration action may take under the garb of national security.

¹⁵⁶ *Ibid.* 2170. Authority to review certain mergers, acquisitions, and takeovers. 2170(a) states:

"The President or the President's designee may make an investigation to determine the effects on national security of mergers, acquisitions, and takeovers proposed or pending on or after the date of enactment of this section [August 23, 1988] by or with foreign persons which could result in foreign control of persons engaged in interstate commerce in the United States. If it is determined that an investigation should be undertaken it shall commence no later than 30 days after receipt by the President or the President designee of written notification of the proposed or pending merger, acquisition, or takeover as prescribed by regulations promulgated pursuant to this section. Such investigation shall be completed no later than 45 days after determination...

(c) Subject to Sub section(d) of this section, the President may take such action for such time as the President considers appropriate to suspend or prohibit any acquisition, merger, or takeover, of a person engaged in interstate commerce in the United States proposed or pending on or after the date of enactment of this Section [August 23, 1988] by or with foreign persons so that such control will not threaten to impair the national security"

Canada's growing FDI in the U.S.¹⁵⁷ makes it imperative that Canada must seek exemption from EXFA to secure its outward investment into the U.S. Although Canadian investors have not suffered on account of EXFA, the increasing number of divestitures and control of acquisitions for reasons of national security should increase Canadian sensitivity to the issue,¹⁵⁸ especially when U.S. has a record of abuse of "national security" against its allies.¹⁵⁹

^{157.} *Supra* note 13, Statistics Canada-Historical Statistics, Table 11, Pg.76, "Canadian direct investment in the U.S. by Industry". Total Canadian direct investment in the U.S. in 1991 stood at \$ 54.6 billion. According to a 1989 Survey conducted by the U.S. Department of Commerce, total FDI from all countries in U.S. was \$400.8 Billion(100%), European Community was largest investor in the U.S. \$234.8(58.6%), followed by Japan \$ 69.7 Billion (17.4%) and Canada \$31.5 Billion (7.9%). In the same survey U.S. FDI in all countries was \$ 373.4 Billion (100%), largest receiver of this outflow was European Community at \$150 Billion (40.2%), followed by Canada \$66.8 Billion (17.9%) and Japan \$ 19.3 Billion (5.2%). Source: Russell Scholl, The International Investment Position: Component Detail for 1989, Survey of Current Business, U.S. Department of Commerce, Bureau of Economic Analysis, Vol.7, No.6, June 1990.

^{158.} Jim Mendenhall, "United States: Executive Authority to Divest Acquisitions under Exon-Florio Amendment-The MAMCO Divestiture" (1991) 32 Harvard International Law Journal 286. See Generally. Eastin, "Foreign Investment Facing Hurdle: Domestic Politics Could Chill Foreign Investment in U.S." .Defence News, April 2, 1990, at Pg.20. President Bush in MAMCO Case, ordered the China National Aero-Technology Import and Export Corporation (CATIC), a Chinese government agency, to divest (\$5 Million) holding in MAMCO, a U.S. manufacturers of aircraft components. It was difficult to justify the divestiture on the grounds that MAMCO's production facilities provided technology and goods necessary to maintaining the integrity of the domestic defensive industry. MAMCO produced metal brackets and other relatively simple components for civilian aircraft. None of the components that MAMCO produced were on the list of goods prohibited for export to China. In fact, even CFIUS recognized that MAMCO produced nothing of a sensitive nature. Also See. Rosenthal, "Bush Urged to Void Sales of Airplane Parts Maker to Chinese", The New York Times, 2 February 1990, at A9, Col.1. MAMCO divestiture can be viewed as device to pursue foreign policy objectives than for economic (\$5 Million) or national security concerns of the U.S. Exon, sponsor of the original proposals hoped that the action "would send a very signal to all foreign buyers that the Exon-Florio is meaningful" The Financial Times, "Bush Orders Peking to Sell Back US Aircraft Parts Manufacturers" 3 February 1990, Pg.24.

^{159.} Lawrence Fullerton and Jonathan Knee, Running For Cover Under the Flag, Legal Times, 6 Jan. 1992, Vol. XIV, No.33, Pgs 20-21. The possibility of triggering a formal investigation-whether it is warranted or not-so that the target enterprise of foreign takeover may have as much 90 days to bolster its defense's or encourage a bid from a more "congenial suitor". Under Exon-Florio, the inter-agency Committee on Foreign Investment in the United States has 30 days from the time it is notified of a transaction to decide whether to launch a formal 45 days investigation, the President of the U.S. has 15 days to decide what action to take based on CFIUS recommendation. The misuse of Exon-Florio has a

The House conference report on EXFA expresses irreconcilable congressional policies. It states that the Congress sought to grant the President broad authority to interpret the term national security. But, it also expressed a desire to avoid any chilling effect on foreign investment "outside the realm of national security". Some of the conclusions of the conference report are rather far reaching.¹⁶⁰

The argument advanced by those who consider the Canadian review process as being overly protectionist and one which would negatively affect the inflow of FDI in Canada, should consider the behaviour of the neighbour south of the border. The U.S. has been successful in protecting its corporations from foreign takeover

practical example in BTR PLC., a British conglomerates, hostile bid to takeover of Norton Co., a Worcester, Massachusetts based maker of abrasives, ceramics, and engineering materials that held several classified U.S. Defense Department contracts. Norton's management sought the help of the Massachusetts Governor, state legislature (Massachusetts state legislature rushed through legislation specially aimed at stopping BTR's bid, restricting the number of Norton Boardroom seats that could be contested at its annual meeting) and over 120 members of the U.S. Congress asked President Bush of the U.S., to block the deal on national security grounds. CFIUS officials reluctant over any move to launch formal investigation, but subsequently succumbed to political pressure and initiated an investigation. Although President Bush, ultimately decided against intervention in the BTR acquisition of Norton, anyway BTR had already withdrawn its bid and Norton eventually agreed to \$2.6 billion counter bid from the French based firm Compagnie de Saint Gobain. Saint Gobain is France's seventh largest company and its bid besides being slightly higher, offered five year employment contracts for 12 Norton executives and seven year contract for Norton's chairman, John Nelson, who "quickly disavowed any national security concerns based on french ownership of the company." The strategy employed in the BTR and other cases where takeover targets have grounds of national security to thwart takeover are also known as the "Pentagon Ploy". Also See, "Government Concern over Pressure to Stop BTR Bid", Financial Times, 16 May 1990, Pg.30.

¹⁶⁰. House Conference Report, No. 100-576. 100th Cong., 2nd Session, 926 (1988), U.S.Code Congressional and Administrative News, Vol. 5, Pg.1959. The report states: "the standard of review in this section is "national security".The conferees recognize that the term "national security" is not a defined term in the Defence Production Act. The term "national security is intended to be interpreted broadly without limitation to particular industries"

either through completely excluding or restricting an acquisition or by placing an investment through a review mechanism under the garb of national security.¹⁶¹

In December 1991, the Department of Treasury (U.S.) issued its final regulations regarding the implementation of the EXFA.¹⁶² But the regulations did not clarify or provide any parameters on the scope of national security. Another controversy centred on the extent of Presidential powers over firms that did not submit notification of takeovers and whether the U.S. Administration should have the authority to investigate once such a takeover has been made. Government

¹⁶¹. For example. Tokuyama Soda's proposed acquisition of General Ceramics., *The Financial Times*, The Task of Matching Sense and Sensibilities, September 15, 1989, Pg.22. Also see. Joel Davidow and Paul Schott Stevens "Antitrust Merger Control and National Security Review of Foreign Acquisitions in the United States" 24 (1990) *Journal of World Trade Law*, Pgs.39-56. Some other examples of U.S. review process to block takeovers are: (i) Heuls AG (German) acquisition of Monsanto, a subsidiary of the Veba AG Group. Monsanto was the only major U.S. producer of silicon wafers (used in the production of Computer Chips). CFIUS though allowed the deal to go ahead but only after Heuls reportedly made specific commitments over technology transfer and the operation of U.S. facilities-in a sense similar to performance requirements transnational have had to abide by when locating in certain countries. Ayers and Chubb, "Exon-Florio: US Power to Block Foreign Acquisitions", (1989) 8 *International Financial Law Review* Pgs.19-22. See Generally.(ii) BTR bid for Norton; See Generally, *The Financial Times*, BTR Comes Under Fire in Massachusetts, March 22,1990, at Pg.32, also see, *The Financial Times*, White House May Toughen Stand Against Acquisitive Foreigners, Jan.2 1991. at pg.2. (iii). Nippon Bid for Semi Gas Systems. Nippon-Sanso's acquisition of Semi Gas Systems, which produces gas delivery and purification system used in the production of semi conductors created furore in the U.S. Congress. Vice President Al Gore, then Senator and Chairman of the Commerce Sub Committee, criticized CFIUS for not having undertaken any technical analysis of the sale to Nippon-Sanso or of assessing the cumulative effect of such sales on the U.S. industrial base. See Generally: *The Financial Times*, U.S. Senators Hint at a Tighter Rules on Sales to Overseas Groups, October 11,1990, at Pg.4. (iv) U.S. government intervened when Nikon announced its intention to acquire Perkin-Elmer, a semiconductor manufacturer. Government talks with U.S.business, resulted in consortium between IBM and other U.S.firms taking over Perkin," thus a key corporation received the new funds it needed to keep its products competitive and the firm in american hands" Linda Spencer, *Foreign Investment in the United States: Unencumbered Access* (Washington D.C.: Economic Strategy Institute, 1991) at Pg.12

¹⁶². *Federal Register*; 21 Nov.1991:Part V.31 CFR Part 800. Regulations Pertaining to Mergers, Acquisitions and Takeovers by Foreign Persons:Final Rule, (Washington D.C: Deptt. of the Treasury, Office of International Investment 1991).

agencies compromised on this issue by accepting a period of up to three years after the investment takes place to initiate a review process under the EXFA. However, the EXFA Regulations remains a highly topical issue.¹⁶³

There has been persistent effort by the U.S. congress to block foreign investment by CFIUS in the high-tech industries. For example, the Technology Preservation Bill (H.R.2624) was introduced in the House of Representatives in June 1991 by Rep. Cardiss Collins, and supported by the House majority leader Rep. Richard Gephardt. Rep. Gephardt made the following statement to the committee hearing the Technology Preservation Bill:

"This legislation addresses the administrations persistent failure to respond to the increasing number of foreign acquisitions of U.S. critical technology companies. Over the last 3 years, control of 540 companies, many of them crown jewels of America's technological accomplishments, have been sold to foreign buyers without a single objection lodged by the Bush administration. The Committee on Foreign Investment in the United States (CFIUS) track record of approving such sales must be reversed. This Committee need to be more closely judged on the steps it takes to enhance our national and economic security."¹⁶⁴

This bill called for a new criteria to block an acquisition if it impaired the "industrial and technological base of the United States" and would have enabled the

¹⁶³. The Financial Times, U.S. Foreign Investment Regulations, 12 December 1991, Pg.27.

¹⁶⁴. Document on National Security: Exceptions, Courtesy: Department of External Affairs, Ottawa, Canada.

President to call for written assurances from the foreign investor of its "plans and intentions".¹⁶⁵

Another concrete measure to protect U.S. technology comes with introduction of the National Defense Authorization Act 1993 [hereinafter the Authorization Act].¹⁶⁶ Section 837 of this Act, amends section 721(f) of the Defence Production Act, 1950,¹⁶⁷ and now provides additional factors for consideration by the President and the CFIUS when scrutinizing transactions under EXFA. Hence the President must evaluate the potential effects of the transaction under review on:

- a) Sales of military goods, equipment, or technology to any country that either supports terrorism or may encourage the proliferation of missiles or nuclear/chemical/biological weapons; and
- b) U.S. international technological leadership in areas affecting national security.

Section 838 of the Authorization Act also requires technology risk assessment to be undertaken by the U.S. Department of Defence if a proposed or a pending merger, acquisitions, or takeover involves a firm engaged in the development of critical defense technology or is otherwise important to the defense industrial and technological base. Section 835 of this act also prohibits acquisition, merger or

¹⁶⁵. The Economist, "Good For You", 29 June 1991, Pg.43.

¹⁶⁶. National Defense Authorization Act for Fiscal Year 1993, Public Law No.102-484 [H.R.5006], 106 STAT. 2315.

¹⁶⁷. *Supra* note 155, Defence Production Act.

takeover of any U.S. corporation performing Department of Defence or Department of Energy contracts.

This emerging trend in the U.S. towards devising legislative and administrative barriers on FDI based on the grounds of national security and technology preservation provides some indication on the possible introduction of screening mechanism based on the grounds of economic security. Therefore, the suggestion by the U.S. and other countries that the Canadian mechanism to review foreign investment is based on economic criteria and therefore protectionist does not hold ground since both the U.S. and other developed countries themselves practice a non-transparent screening mechanism for FDI.

4. CANADA-US FREE TRADE AGREEMENT

No bilateral treaty for promotion and protection of foreign investment exists between Canada and the US. However, in 1988 Canada entered into the free trade agreement with the U.S. One of the important agenda items in the negotiations was investment, which resulted in a full fledged chapter on this issue in the Canada-U.S. Free Trade Agreement.¹⁶⁸ The FTA is significant because the agreement creates the largest bilateral investment area in the world. This section of the chapter will briefly deal with the agenda of the two parties-Canada and the U.S. the for negotiation of the FTA. Thereafter the section will address the negotiations stage of the agreement to understand the stakes and importance of the investment issues between the two countries and finally the substantive provisions of the FTA and their implications for Canada.

The Canadian Position

Canadian exports represent more than 39% of the Gross Domestic Product [hereinafter GDP], and more than 75% of those exports are absorbed by the U.S. market. The growing protectionist mood in the U.S. Congress and the arbitrary application of the trade remedy laws to Canadian exports in the 1980s made Canada conscious of its sole agenda- to secure barrier free access to American market for its

¹⁶⁸ *Supra* note 9, Canada-United States Free Trade Agreement. See generally, International Trade, (1988) 29 Harvard International Law Journal 572.

products.¹⁶⁹ Investment was not foremost on the Canadian agenda. Perhaps Canada was comfortable with the status quo on the issue because of a relatively open U.S. regime for FDI.¹⁷⁰ Investment was a secondary issue for Canada but was considered as a bargaining chip for securing better access by Canada to the U.S. market.¹⁷¹

The U.S. Agenda

The significance of investment in the Canada-U.S. economic relations can be judged from the fact that besides Canada and the U.S. being the largest bilateral trading partners, they between themselves are also major (nation to nation) capital exporting and importing countries.¹⁷² The FTA negotiations provided a timely

¹⁶⁹. The Macdonald Report made similar conclusions and suggestions that: "The First and most important, concern is for Canadian producers to obtain barrier-free market access under a negotiated arrangement which assures that access is dependable and secure from future political and legal challenges". See *supra* note 68, Macdonald Report, Pg.382-83 and 302.

¹⁷⁰. Aronson, "A Proposed Legal Framework for a Comprehensive Free Trade And Investment Agreement Between Canada and the United States" (1984-85) 8 Fordham International Law Journal 161, Pg.180.

¹⁷¹. Department of External Affairs, Canadian Negotiations, Reprinted in D. Cameron. The Free Trade Paper (1986), Pg. 14-15. "The Quid Pro Quo that the United States is likely to seek in return for securing and enhancing Canadian access to its market is freer and more secure access to the Canadian market. The U.S. Administration has indicated it is prepared to consider our key concerns.... as long as we are prepared to consider their key objectives (such as mutual elimination of tariffs, and new discipline on investment and services).

¹⁷². E.Fry, Foreign Investment in the United States and Canada: The Setting: In Regulation of Foreign Direct Investment in Canada and in the United States, (E. Fry and L. Radebaugh eds. 1984), Pg. 1. Also see *supra* note 13, Canada's International Investment Position: Historical Statistics 1926-1992, Pg.15-17.

opportunity for the U.S. government to advance its policy of liberalization of international investment.¹⁷³ This specially was true in its economic relations with Canada because of serious setbacks to its investment policy during Trudeau regime and divestments as a result to the NEP.¹⁷⁴ Besides dismantling the restrictive provisions of the ICA, especially in the culture and the energy sectors, the U.S. also sought national treatment for U.S. investors. The U.S. had complained to the GATT against Canada's review process under FIRA requiring mandatory local sourcing of goods, minimum export levels and import substitution; a negative finding was made by the panel only with respect to mandatory local sourcing.¹⁷⁵ Therefore, this was also premier issue for the U.S. to be resolved at the negotiations. This was also seen by the Americans as an appropriate opportunity to achieve considerable gains on investment.¹⁷⁶

¹⁷³. Harvey E.Bale, Investment Frictions and Opportunities in Bilateral Trade Relations, in Canada/United States Trade and Investment Issues (D.Fretz et al. eds. 1985)165, at pg.169-71. Clayton Yeutter claimed U.S. objective with regarded to FDI "to produce a Canadian policy environment as open to inflows of foreign direct investment as our own". See. Negotiations of United States-Canada Free Trade Agreement:Hearing Before the Senate Committee on Finance, 99th Congress., 2nd Session (1986), Pgs. 28-39.

¹⁷⁴. J.Schott, United States-Canada Free Trade:An Evaluation of the Agreement (1988), Pgs. 24-25. Also see. *supra* note 58, NEP and the accompanying text.

¹⁷⁵. GATT Report No. CL/5504 (Feb.7, 1984), reprinted in Law and Practice Under Gatt,pt.II, (K.Simmonds and B.Hill 1989) at Pg.47. Until 1983, foreign investors often gave commitments to purchase (a certain percentage or amount of) Canadian-made goods, provided the price and quality were competitive. The U.S. objected and complained to the GATT Council. A Panel appointed under the GATT ruled that the practice of approving investors to purchase goods from Canadian sources or goods of Canadian origin was inconsistent with Article III.4 of the GATT.

¹⁷⁶. Peter Murphy;U.S. Chief Negotiator at the FTA negotiations in hearing before the House Sub-Committees on International Economic Policy and Foreign Affairs stated that "all we are trying to do is to seek an investment climate in Canada equivalent to what we have in the United States". United States-Canada Relations:Hearings Before the Sub Committee on International Economic Policy

Negotiations

Besides the specific issues regarding investment, both Canada and the U.S. were in conflict over the increasing use of trade remedy laws by the U.S. firms and industry. As a result Canadians pressed in negotiations for a bipartisan body to resolve trade disputes, whereas U.S. wanted liberalisation on investment.¹⁷⁷ Due to the political sensitivity of investment issues in Canada the Conservative government denied having given a mandate to negotiators to discuss investment with the U.S.¹⁷⁸ Subsequently Pat Carney, the then Minister for International Trade (Canada) acknowledged having agreed to negotiate investment with the U.S.¹⁷⁹ Finally, on 3 October 1987, five minutes before the deadline set by the U.S. Congress for an amendment free confirmation¹⁸⁰ the deal was clinched.¹⁸¹ Investment was

and Trade and on Western Hemisphere Affairs of the House Committee on Foreign Affairs 99th Congress., 3rd Session (1986), at Pgs. 5-6.

¹⁷⁷. G. Bruce & B.W. Tomlin, *Faith and Fear: The Free Trade Story* (Toronto: Stoddart Publishing Co. Ltd., 1991), Pg. 190.

¹⁷⁸. Parliamentary Debates, H.C., 33rd Parl., 2nd Sess. 4104, 4178 & 6200 (Statement of Pat Carney, Minister of International Trade). Also see Pat Carney's previous statement expressing that U.S. wished to pursue issues of investment, (6202). Refer to Prime Minister Mulroney's Statement at 6238-41.

¹⁷⁹. *Ibid.* at 6199 (statement of Minister Pat Carney). Also see 6330 (Statement of Joe Clark, Secretary of State for External Affairs).

¹⁸⁰. Amendment free confirmation is also called the "Fast Track Authority". Under the Constitution of the United States, the Congress enjoys the authority to regulate inter-state and foreign commerce, as a result if the President of the U.S. entered into an international agreement it could not be implemented without a legislation being enacted by the Congress (U.S.) on the substance of the agreement. To bring about accommodation between the President and the U.S. Congress to facilitate negotiations on Trade.

The Fast Track Authority mechanism was created in the Trade Act of 1974. The accommodation

used by Canadians as a bargaining chip and brought major U.S. concession on dispute settlement.¹⁸²

Investment Provisions of the Canada-U.S. Free Trade Agreement.

National Treatment

The single most important feature of the FTA is its endorsement of national treatment.¹⁸³ Keeping in view the traditional Canadian foreign investment policy, Canada's agreement to offer to U.S. investors, treatment equivalent to what Canada gives to its Canadian owned and controlled enterprises, something that could not be envisaged in the Canada of the 1970s. National treatment means that American investment in Canada and Canadian investment in the U.S. are to be treated no less

is rather simple. The President goes through certain routes that Congress has set out-consults regularly, notifies of his intent to enter into negotiations- and then at the end of the process, when the agreement has been completed, he agrees to put forward his own proposed implementing legislation; Congress then agrees to two important things; not to amend the implementing legislation and to act within ninety legislative session days.

¹⁸¹. *Supra* note 177, Faith and Fear, Pg.199.

¹⁸². Lewington and Waddell, Late Push by Baker Shows Reagan Wish For Canadian Pact, *Globe and Mail* (Toronto), October 5, 1987, at Pg.A5. See Generally. Lloyd Axworthy's statement in 1986-87, *Parliament Debates*, H.C., 33rd Parliament, 2nd Sess. 6240. referring to statement of Peter Murphy, U.S. Chief Negotiator. "Investment is another critical component for any agreement....The Canadians are finally getting the message but are holding out as bait to get some progress on their key issue, such as contingency protection."

¹⁸³ *Supra* note 9, FTA, Art.1602. Art.1602 provides that "except as otherwise provided in this chapter, each party shall accord to investors of the other party treatment no less favourable than that accorded in like circumstances to its own investors"

favourably than domestic investment in like circumstances. National treatment governs the establishment, acquisition, conduct and operation and sale of business enterprises.¹⁸⁴ Furthermore, no maximum domestic ownership requirements, other than nominal participation by directors, may be imposed on a business belonging to an investor of another party.¹⁸⁵ It also mandates that neither party may force divestiture of another party's investment by reason of nationality alone.¹⁸⁶

Article 1601(4) of the FTA¹⁸⁷ provides that a province or state of the either Contracting Parties to the FTA, is obliged to grant treatment to U.S. investors investing in such a province of Canada or a Canadian investor investing in such a state in the U.S., treatment that such a province or a state will grant to investors of other provinces and states within the territory of the Contracting Parties. This is also known as most-favoured nation treatment.¹⁸⁸

If national treatment was a victory for the U.S. at the negotiations, Canada

¹⁸⁴ *Ibid.* Para.1.

¹⁸⁵ *Ibid.* Para.2.

¹⁸⁶ *Ibid.* Para.3.

¹⁸⁷ *Ibid.* Article 1601(4) states: "treatment no less favourable than the most favourable treatment accorded by such province or state in like circumstances to investors of the party of which it forms a part."

¹⁸⁸ *Ibid.*

was also able to safeguard any existing non conforming measures.¹⁸⁹ As a result ICA was amended¹⁹⁰ but its existing procedures of review mechanism were left intact except for modifications of the thresholds for review of investments by the U.S. investors.¹⁹¹ Other significant amendments to guidelines and regulations were to conform with the prohibition of minimum domestic ownership and performance requirements set out in Article 1602, paragraph 2 and 3.¹⁹² Since non conforming measures also include existing policies of the Canadian government as a result, the policy in oil and gas and uranium mining industries as followed by Investment Canada remained unchanged.¹⁹³ The exclusion of these sectors means that traditional thresholds of Can.\$5/50 million under ICA and requirements of

¹⁸⁹ *Ibid.* Article 1611 defines "Measure" as any law, regulation, procedure, requirements, actual practice or published policy.

¹⁹⁰ *Ibid.* Art.1607, at Pg. 376. It was agreed under Art.1607(3), that the existing guidelines and regulations in the Investment Canada Act would be amended. See, *supra* note 79, ICA.

¹⁹¹ *Ibid.* Article 1607, Para.3, and Annexure 1607.3. The Threshold for review of direct acquisition of a Canadian business was increased from Can.\$ 5 million to Can.\$ 150 million (over a period of 3 years till 1992. Similarly review of indirect acquisition were increased from Can.\$ 50 million to Can.\$ 500 million also over a period of three years. The review of indirect investment under this provision completely ceased on 1 January 1992. See *supra* note 79, ICA, Sections 14.1(5) & (7).

¹⁹² *Ibid.* Annexure 1607.3, Para.3.

¹⁹³ *Ibid.* Annexure 1607.3, Para.4:

The Amendments described in paragraph 2 and 3 and provisions of paragraph 2 of Article 1602 and of Article 1603 shall not apply in respect of oil and gas and uranium-mining industries. These industries are subject to published policies that are implemented through the review process set out in the Investment Canada Act. The Parties shall by exchange of letters, prior to introduction of legislation to implement this agreement by either party in its respective legislature, set out the aforementioned policies, which policies shall be no more restrictive than those in effect on October 4, 1987.

Letter from Michael Wilson to James Baker III, May 12, 1988; The Canadian Policy limits foreign investments of Uranium to 49%. Non Resident ownership may exceed 49% if it is proven that the business is Canadian controlled, or if it is clear that no Canadian partners can be found.

minimum domestic ownership and performance requirements still prevail and information can be demanded of by Investment Canada in these sectors.¹⁹⁴ Though the thresholds at Can.\$500 million for indirect acquisitions ceased to operate as of 1 January 1992, but indirect acquisition continues to be reviewed at the same threshold as the direct acquisition (Can.\$150 million), if the asset value of the Canadian portion of a transborder transaction is more than 50% of the asset value of the total international transaction.¹⁹⁵

Another traditional concern in Canada has been with regard to Crown Corporations which have occupied a place of historic importance in the Canadian state. The FTA provides that existing businesses carried on by a Canadian federal or Provincial government or by Crown corporations are exempted as to their prospective ownership from the application of the national treatment.¹⁹⁶ However, there is a qualification to this exceptional treatment of crown corporations: once measures derogating from the national treatment have been adopted, Canada is prohibited from amending them or introducing other measures that would render the original measures more inconsistent with the concept of national treatment.¹⁹⁷

^{194.} *Ibid.* Section 14.1(8), Exceptions: There are five exceptions. The higher thresholds do not affect Canada's cultural businesses, the oil and gas, uranium, transportation and financial services.

^{195.} *Ibid.* Section 14(1)(c).

^{196.} *Ibid.* Article 1602, Para.5.

^{197.} *Ibid.* Article 1602, Para.6(a).

Similarly, if ongoing ownership restrictions have been imposed on the business, Canada is not allowed to increase them later. The crown corporations established or acquired after January 1, 1989 also enjoy the exemptions of a crown corporation established prior to such date, with only one modification, i.e. on the first disposition of such a corporation, the distribution of shares can be restricted to Canadian investors. But this restriction on distribution of shares to Canadian investors will cease to operate on second disposition of shares of such a crown corporation.¹⁹⁸

Sectors Exclusively for Canadians

Investments related to financial services and government procurement, the transportation¹⁹⁹ and cultural industries have been excluded in their entirety from the application of the investment chapter of the FTA.²⁰⁰ However in case of cultural industries, the scope of exclusion was restricted through defining cultural industry

¹⁹⁸. *Ibid.* Article 1602, Para.7.

¹⁹⁹. Transportation services were excluded from the FTA being a high sensitivity sector in both U.S. and Canada. U.S. shipping industry, feared that granting national treatment to Canada would mean the end of the protectionist regime it enjoys under the Jones Act 46 U.S.C 883 (1982). Numerous representations by the shipping industry opposing any change in the U.S. Maritime policy were made to Congress. for details see; Senate Committee on Finance, 100th Congress, 1st Session, Data and Materials related to United States-Canada Free Trade negotiations (Committee Print 1987)74-198.

²⁰⁰. *Supra* note 9, FTA, Article 1601, Para.2 and Articles 2005. Chapter 14 type of services are the ones that demand national treatment under FTA.

under Article 2012 of the FTA.²⁰¹ Cultural industries continue to be subject to review procedure under ICA even after FTA. Consequently both parties can adopt measures that would increase discrimination against respective parties investor in this area. Both Canada and the U.S. also reserve their right to retaliate if discriminated against.²⁰²

Performance Requirements

Performance requirements²⁰³ have always been a contentious issue between U.S. and Canada, and one, which escalated the GATT proceedings against Canada.²⁰⁴ The restriction on imposing performance requirements under FTA are with regard to trade related requirements.²⁰⁵ This means that Investment Canada can still

²⁰¹. *Ibid.* Article 2012. Also refer to *supra* note 91, ICA, cultural industry under ICA is defined therein. printing and typesetting any publication, distribution, or sale of books, magazines, periodicals, or newspaper in print or machine readable form under para.a is deleted in the FTA definition; recordings is deleted from para.b of the ICA definition; radio communication in which the transmissions are intended for direct reception by the general public and all radio, television and cable television broadcasting undertaking and satellite programming and broadcast network services in para.e is excluded from ICA definition of cultural industry under FTA.

²⁰². Retaliation by the U.S. could take the form of Presidential Action under Section 301 of the Trade Act of 1974, 30, 19 U.S.C 2411, Pub.L.No 93-618, 8 Stat 1978 (January 3, 1975). See Generally: Fisher and Steinhardt, "Section 301 of the Trade Act of 1974: Protection for U.S. Exporters of Goods, Services and Capital" (1982) 14 Law and Policy in International Business 569.

²⁰³ *Supra* note 9, FTA, Art.1603.

²⁰⁴. *Supra* note 175, GATT proceedings and the accompanying text.

²⁰⁵. *Supra* note 203, FTA, Article 1603. For U.S. investors there are four types of performance requirements that cannot be undertaken except when investment is in the oil and gas sector, uranium mining, financial services, transportation sector or cultural industry. These trade related performance requirements are:

require undertakings by U.S. investors regarding local employment, technology transfer, research and development, new investment, improvements in productivity, etc. Trade related performance requirements can also be imposed in the five key sectors: oil and gas; uranium mining; financial services; transportation; and cultural businesses.

Dispute Settlement

Disputes arising out of those disagreements which are related to the application of Chapter 16 are to be dealt with under panel procedure set out in Chapter 18 of the FTA. But the panel procedure does not provide a mechanism to an aggrieved investor over the decision taken through the review mechanism of Investment Canada.²⁰⁶ This exception was essential because it left intact the discretionary authority of the Minister concerned to determine whether any future acquisitions stood the test of "net benefit to Canada". This power of the Minister has been maintained under dispute settlement procedure established under NAFTA. Dispute settlement mechanism under the FTA operates on a government-to-

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- a) export commitments: to export a given quantity or percentage of their Canadian production of goods and services;
 - b) import substitution commitments: to substitute Canadian goods or services for imported goods and services;
 - c) sourcing commitments: to purchase Canadian goods and services instead of imports or to accord a preference to Canadian goods and services; and
 - d) domestic content commitment: to achieve a given level or percentage of Canadian content in the final value of a product by purchasing Canadian produced goods and services.

206. *Ibid.* Article 1608, Para.1, Para. 4.

government basis. Investors have no rights. For example, in case a U.S. corporation is angry over Canada's refusal to categorize it as an "American" under section 14.1(9) of the ICA, it must petition the U.S. government (under Section 301 of the Trade Act of 1974) to commence an inquiry against Canada. The investor-state dispute settlement mechanism has been designed under NAFTA to facilitate resolution of investment disputes between and investors and the government of each Party. This issue is studied at a greater length in chapter five of this dissertation.

The only aspect of the FTA dispute settlement mechanism that pertains specifically to investment is that the parties undertake to make every attempt to name panellists who are experienced in international investment, and that the investment disputes should be dealt with by giving due consideration to internationally recognized rules of commercial arbitration.²⁰⁷

Taxation and Subsidies

Both subsidies and new taxation measures are excluded from the national treatment principle; provided they do not constitute a means of arbitrary or unjustifiable discrimination between investors of the two countries or disguised

²⁰⁷. *Ibid.* Article 1608. Para. 4.

restrictions on the benefits conferred by Chapter 16.²⁰⁸ However this exclusion is subject to Article 2011, which deals with claims of nullification or impairment of benefits granted under the FTA.

Monitoring

Section 25 of the ICA gives Investment Canada, a statutory authority to perform monitoring function over non-Canadian investors. This is done by Investment Canada by requiring a submission from time to time by non-Canadian investors, to determine whether the investment operation is proceeding in accordance with the original proposal and any commitment made thereunder.

Each party under Article 1604 reduced the requirements of submitting routine information on its investment to one only for statistical and informational purposes. The information provided must remain confidential²⁰⁹

Expropriation and Transfer of Profits

Direct and indirect expropriation or nationalization of investment of the other party is allowed under FTA, provided it is for a public purpose, and done in

²⁰⁸. *Ibid.* Article 1609.

²⁰⁹. *Ibid.* Article 1604.

accordance with due process of the law, on a non discriminatory basis, and upon payment of prompt, adequate and effective compensation at fair market value.²¹⁰

According to Article 1606, both Canadian and the U.S. investors can transfer any profits from investments out of the country; dividends; royalties or fees earned from an investment; proceeds from sale of any investment and proceed from partial or complete liquidation of investment.²¹¹ Such transfer can only be prevented by Canada or the U.S. if made in violation of any measure related to: rights of creditors; criminal or penal offence; violation of taxation regime; violation of the securities law and satisfaction of a claim in adjudicatory proceeding.²¹²

²¹⁰. *Ibid.* Article 1605. The New International Economic Order, proposed by the developing countries in early 1970s, as contained in three U.N. General Assembly Resolutions. These resolutions were: (1) G.A. Res. 3201 (S-VI), (1 May 1974)-Deceleration on the Establishment of a New International Order; (2) G.A. Res. 3201 (S-VII), (1 May 1974)-Programme of Action on the Establishment of a New International Economic Order; and (3) G.A. Res. 3281 (XXX), Charter of Economic Rights and Duties of States [hereinafter CERDS]. These resolutions sought to introduce payment of "appropriate compensation" as standard for payment of compensation for expropriation and nationalization of alien foreign property. This was in contradistinction to the requirements of payment of "prompt", "adequate" and "effective" compensation advocated by the U.S. and other capital exporting countries. It is interesting to note that Canada abstained from roll call vote on G.A. Res. 3281 (XXX). See generally, Yearbook of the United Nations, 1974, Vol. 28, U.N. Publication Sales No. E.76.I.1., Pgs. 386-403. Also see, U.N. Centre on Transnational Corporations, Bilateral Investment Treaties, U.N. Doc. ST/CTC/65, U.N. Sales No. 88.11.A.1 (1988), at Pgs. 90-91. C.F. Amerasinghe, "Issues of Compensation for the Taking of Alien Property in the Light of Recent Cases and Practice" (1992) 41 International and Comparative Law Quarterly 22.

²¹¹. *Supra* note 9, FTA, Article 1606(1).

²¹². *Ibid.* Article 1606(2).

5. Analysis of the FTA Investment Provisions

This an attempt to provide rational answers to concerns of those Canadians, who feel that Canada has been put on "sale" because of its commitments under the FTA.²¹³

Changing Review Mechanism and Thresholds.

New Investments under FTA are excluded from review.²¹⁴ They were not subject to review under ICA either. The MacDonald commission also recommended

²¹³. Parliament, House of Commons., Minutes of Proceedings and Evidence of the Standing Committee of the House of Common External affairs and International Trade, No.31, at 32, 1986-87. ("the agreement has yielded Canada's rights to control investment"); Bill Lesich, (M.P. and Member of the Committee), No. 38, at 8 ("we are not open to business...we are clearly up for sale"); Mel Hurtig, (President of Hurtig Publishers), No.49, at 52 ("almost all remaining screening of U.S. investment is to be dropped"); Dixon Bailey, Saskatchewan Pro Canada Network), No.50, at 21 ("it is the conquest of Canada" because here is no more screening of new investments, and the prohibition of performance requirements "effectively bars public control over the economic life of this country").

²¹⁴. House of Commons Debates, 33rd Parliament, 2nd Session, 5 October 1987, Pg. 9635. Right Hon. John N.Turner, then leader of the Opposition, criticising the FTA as total sell-out expressed his concerns over exclusion of new investments from the review process in the following manner: "The principle we have before us- and that is all we have we do not have the document-are a minefield for Canada. Let's look at some of the items. Let us take a look at investment. Let us Call it "takeover unlimited". All of Canada is now open to American proprietorship. Takeover fever will go northward. This country will be a satellite of the United States. We will become the number one takeover target of American business. The Americans already own too much of us, now it is "open sesame". It is "open doors", come on, we are ready, "come and take us". That is what the government has done." He continued: "We ought to look at the nature of what has happened to the sovereignty of this House of Commons. In the Yeutter document-we get most of our information traditionally from the American side- here is what Mr. Yeutter says "Under this agreement, Canada commits to make permanent its recent policy of not screening new business investments". In other words, it will be a permanent deal. There is no way a future parliament can play around with it, modify it or amend it. No, Mr. Speaker, we have yielded on the floor of this House of Commons the sovereignty of our nation to control investment."

against the review of new investments.²¹⁵ But, review of direct and indirect acquisitions of existing businesses in Canada are in place with new thresholds. An argument can be advanced in light of a latest Report on Business.²¹⁶ Out of the top 1000 corporations in Canada, 211 corporations have assets above \$500 million (threshold for indirect acquisition) and over 135 more corporations have assets above \$150 million (threshold for direct acquisitions).²¹⁷ Among the top 300 corporations in Canada,²¹⁸ 118 are Canadian owned, of which 53 have assets above \$500 million and 24 have assets worth \$150 million or above but less than \$500 million.²¹⁹ That means that most Canadian owned corporations are still under the review process of Investment Canada. Besides these corporations there are Crown corporations that remain untouched by the FTA.²²⁰ One must add all the business

²¹⁵. *Supra* note 68, MacDonald Report, Vol.2, Pgs. 232-35, 241, 226; also see Vol.3, at 430, Competition policy was also considered important in allowing new business in Canadian economy to increase the degree of competition, which may otherwise be distorted upon acquisition of existing businesses.

²¹⁶. The Globe and Mail, Report on Business, The Top 1000: The Definitive Report on Corporate Canada, July 1993, (10th Anniversary Issue).

²¹⁷. *Ibid.* Pg. 58-97.

²¹⁸. These are private companies, which do not issue publicly traded shares, are a significant part of Canadian economy. *Ibid.* Pgs. 99-108.

²¹⁹. *Ibid.* Assets of many family owned corporations have not been mentioned in the listing.

²²⁰. *Ibid.* Pg.111. Crown Corporations both Federal and Provincial holds assets of almost \$ 212 billion under exclusive Canadian control.

involved in the transport,²²¹ cultural industry,²²² communications,²²³ energy²²⁴ and financial services industries,²²⁵ which are the key sectors of the Canadian economy and are either excluded by virtue of existing policies or through complete exclusions by virtue of grandfathering existing legislation in the FTA.

Performance Requirements

The prohibition on trade related investment requirements and minimum equity ownership brought sharp criticism from Canada's premier economic province-Ontario.²²⁶ In fact, both the Gordon²²⁷ and the Watkins²²⁸ reports had

²²¹. *Ibid.* Pg 124.

²²². *Ibid.* Pgs.123 & 134.

²²³. *Ibid.* Pg.126.

²²⁴. *Ibid.* Pg. 117.

²²⁵. *Ibid.* Pgs. 113-115.

²²⁶. Lavelle, Barrows & Traficante, The Ontario Government's Perspective on the Canada-U.S.Free Trade Agreement, (1988) 53 Business Quarterly, Pg. 12. "Canada would no longer be able to request best efforts to source domestically or other measures to encourage foreign investors to contribute to Canadian industrial development....There is evidence to suggest that Canadian and foreign-controlled companies behave differently with respect to research and development expenditures, the extent of local sourcing and export orientation. The investment provisions of the Free Trade Agreement represent a departure from past Canadian policies aimed at ensuring that direct foreign investments is in the best interest of Canada".

²²⁷. *Supra* note 11, Gordon Report, Pg. 391.

²²⁸ *Supra* note 25, Watkins Report, Pgs. 386 & 390.

previously expressed its serious concerns over the issue of foreign subsidiaries avoiding local sourcing and research and development, but interestingly the Gray report had a different view on the subject: it considered these requirements as "arbitrary" and "potentially economically costly" for Canada.²²⁹ But to suggest that Canada gave up entirely on the issue because the only prohibition against performance requirements are those that are trade-related is not true, because Canada can still negotiate on research and development, technology transfer etc. This means that Canada's traditional concern vis-a-vis research and development is well taken care off.

Exempted Sectors

Once again, traditional Canadian concerns with regard to sensitive sectors: energy, transportation, cultural industries, banking were excluded from investment provisions of the FTA. Canadian interest in maintaining its control over financial institutions²³⁰ continues to hold good with regard to U.S.investments to some

²²⁹. *Supra* note 38, Gray Report, Pgs.453-54.

²³⁰. *Supra* note 11, Gordon Report, Pg.392.

degree.²³¹ If there have been any changes they are the voluntary makings of Canadian government.

One can assess from the aforesaid discussion that Canada more or less maintained its existing measures and powers in its foreign investment policy. If one weighs these against the gains achieved by Canada in securing its own FDI in the U.S., which has vastly increased in the past²³² Canada has been able to secure national treatment for its corporations specially in the face of mounting Congressional pressure to forestall foreign takeovers of American businesses, discussed earlier in this chapter.

²³¹The Bank Act, S.C.1991, c.46, Although financial services are exempted from the investment chapter of the FTA, they are governed by a separate chapter which effects similar results, (Chapter 17 of the FTA). Chapter 14 of the NAFTA deals with financial services under NAFTA. Under the Bank Act a non-resident can own up to 10% of any class of shares of a Schedule I bank [Canadian held]. As is the case for residents, no individual non-resident or associated group of non-residents may own more than 10% of any class of shares of a Schedule I bank. Non-U.S. non-residents cannot own, collectively, more than 25 % of the shares of a Schedule I bank. Non-U.S. foreign bank subsidiaries cannot have assets exceeding 12% of the total domestic assets of all banks in Canada. Foreign banks may apply to establish a subsidiary to operate in Canada, a Schedule II bank [Closely held foreign bank. The 10/25 rule continues to apply to Canadian controlled banks. The Finance Minister must satisfy before allowing a foreign bank to operate in Canada its "potential to make a contribution to competitive banking in Canada". The FTA expressly exempts "United States controlled Canadian Bank subsidiaries" from the 16% ceiling and U.S. persons from ownership restrictions not applicable to Canadians. Subsidiaries of U.S. banks are therefore now put on almost at the same footing as the Canadian banks and are in position more favourable than that of subsidiaries of other foreign banks.

²³². *Supra* note 13, Statistics Canada-Historical Statistics, Table 11, Pg.76, (1993).

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NORTH AMERICAN FREE TRADE AGREEMENT

1. General

"Each new US agreement would undercut the value of concessions obtained by partner countries in previous FTAs because the preferences in the US market would be shared, and thus diluted, by the new FTA partners."²³³

That U.S.-Mexico free trade negotiations began within two years of the FTA took Canada by surprise.²³⁴ Canada responded to the negotiation process set in motion on 11 June 1990 by the Governments of the U.S and Mexico by requesting that it be included in the negotiations, in order to avoid any watering down of the FTA. Exactly one year after its inception as a bilateral negotiation between Mexico and the U.S., Canada joined the negotiations to ensure equal access to Mexican economy, although the Canadian-Mexican economic nexus is of limited character both in terms of trade and investment.²³⁵

²³³. Jeffery J.Schott, *More Free Trade Areas?* (Washington:Institute for International Economics, May 1989), No.27, Pg.25.

²³⁴. Jennifer Hosten-Craig, *The Effect of A North American Free Trade Agreement on the Commonwealth Caribbean*, (Lewistin, New York:The Edwin Mellen Press, 1992) pg.19. Although Canada and Mexico did increase their formal economic contacts at the end of 1980's, Canada neither wanted nor encouraged Mexico to approach the U.S. to open trade talks. Canada completely focussed on the FTA and was rather surprised at the U.S. move to consolidate their economic interests through other bilateral arrangements, compelled Canada to the NAFTA negotiations. See generally: Ronald J. Wonnacott, "US Hub and Spoke Bilateral and Multilateral Trading System", C.D. Howe Commentary (Toronto:C.D.Howe Institute, 1990)., Maureen Appel Molot, "What We Need Are More Answers", (1990) XI:3 Policy Options 14-18.

²³⁵. Merchandise trade flows for the year 1992 between Canada-Mexico and the United States were: Canada trade flow to Mexico was Can.\$ 771 million and Can.\$125.5 billion to the U.S. Mexican exported merchandise worth Can.\$2.8 billion to Canada. and Can.\$42 billion to the U.S.,U.S exported Merchandise worth Can.\$ 96.6 billion to Canada and Can.\$ 48.6 billion to Mexico. The North American Free Trade Agreement-At a Glance, Government of Canada Publication, Catalogue # E74-56/1-1993E.

Canada's participation in the negotiations was supported by Canadian TNCs, the Chamber of Commerce, the Canadian Manufacturers Association and the automotive manufacturers, all of whom believed that Canada could not permit others to determine the North American trade regime.²³⁶

One of the arguments made by Canada in favour of trilateral negotiations with the U.S. and Mexico is that a three-way deal precludes the possibility of a situation in which the U.S. has the upper hand and overall advantages in NAFTA negotiations. Had trilateral negotiations not been agreed to, the U.S. would have been the only country with free access to both the Canadian and Mexican economies, a situation which would have enhanced the investment and trade climate in the U.S. at the expense of Canada.

Canadian sovereignty is once again the issue raised by the critics of NAFTA.²³⁷ Concerns about economic adjustment and weak economic links as well

Canadian direct investment as of 1991 was Can.\$ 54,639 million in the U.S. and \$188 million in Mexico (Table 9, Pg.67)., U.S and Mexican Direct investment in Canada as of 1991 was \$83,775 million and \$1 million respectively (Table 29, Pg.101).

236. A survey of Canadian manufacturers association members showed that almost 90% favoured Canadian participation in the NAFTA talks. About 46% viewed trade liberalisation with Mexico as an opportunity and 29% it as a threat. Of the latter, 75% still felt that Canada should participate in the talks. House of Commons, Standing Committee on External Affairs and International Trade, Hearing on Canada-US-Mexico Trade Negotiations (Ottawa:House of Commons, 1990) Pgs. 23-24.

237. House of Commons Debates, 34th Parliament, 3rd Session, May 25, 1993, Volume 132, n 254B, Pg.19705 (Chris Axworthy). "It is worth remembering that we in the New Democratic Party talked about the threat to our social programs, our health care system and our economy....."
"If we are close to markets and have a large market we can benefit more effectively from more open barriers. After all, we will recall that Britain was a big advocate of free trade when it had the upper

as constraints on sovereignty, made the NAFTA choice for Mexico and Canada more complex. Due to the shared economic dependence of both countries on the U.S. there are certain parallels in the way they decided free trade with the U.S. was essential for their long term economic prosperity. The U.S. is the most important trading partner of both Canada and the Mexico, absorbing some 72% of Canadian²³⁸ and approximately 70% of Mexican exports.²³⁹ Therefore securing and expanding access to the U.S. market was paramount for both countries.²⁴⁰ This may also mean big business opportunities for U.S corporations²⁴¹ but the important consideration is what does the agreement translate into in legal and economic terms for Canada

hand. However countries that do not have upper hand, the market benefits or the industries developed to take advantage of the breakdown of national interests must take matters into their own hands. Here we have an agreement that is giving up more sovereignty rather than claiming back sovereignty.....What we need in this country is not to give up power to multinational corporations and to other countries."(19706).

238. Department of Finance, "The North American Free Trade Agreement: An Economic Assessment From a Canadian Perspective", November 1992. 30% of Canadian GAP comes from exports.

239. "Survey: Mexico-Free Trade's Virtues" The Economist, 13 February 1993, Pg. 6. Mexico is America's third largest trading partner after Japan and Canada. Total bilateral trade in 1991 between the U.S. and Mexico was worth \$62 billion, or 10.4% of Mexico's GAP but only 0.5% of the U.S. Mexico's imports from the U.S were \$33.3 billion, or 11.9% of Mexico's GAP and only 0.6% of the U.S.

240. "He Wants Your Job", The Economist, 12 June 1993, Pg.15. "Another expression of economic neurosis-and another bad policy-is America's evolving approach to trade with Japan. On June 11th America's negotiators were expected to ask Japan to set targets for imports of certain goods and (a new bench mark for fatuous demands) to reduce its current-account surplus by some given amount. Some Americans will welcome this for the plausible(though incorrect) reason that Japan's markets are unfairly closed to outsiders, and such targets are the only way to open them. More will welcome them simply because they regard liberal trade with Japan or any other highly competitive producer as a threat to their prosperity."

241. Many U.S. corporations foresee that Mexico offer opportunities similar to those which Eastern Europe provides the European community. Companies under pressure to keep costs down may do all of their manufacturing work in Mexico, rather than just assemble components. Increased operation in Mexico could benefit U.S. corporations that supply parts and equipment, including plastics, dyes and packing used in Mexican factories. The New York Times, 11 November 1990, Pg. F.12.

aside from its relationship to any broader social or political objectives of politicians.²⁴²

Supporters fear being left out from any potential market of 360 million people for Canada.²⁴³ Besides the market potential for trade, NAFTA also provides a lead in formulating rules for FDI. The preamble to the NAFTA resolves among other things to "ensure a predictable commercial framework for business planning and investment".²⁴⁴ NAFTA is unique in terms of investment not only because of it

²⁴². House of Commons Debates, 34th Parl., 3rd Session, 25 May 1993, Pg.19707 (Mr. John E.Cole): "The fact is that Mexico is a developing country. Its demands have increased very substantially in the last three or four years. Its market is expanding very rapidly. It has some 80 million or 85 million people who are learning to become more productive in a developing country..". Also see *Ibid.* Pg.19710, "We are dealing with a third world country that has struggled but now seems to be moving in the right direction. I think it is to its advantage and Canada's advantage to work with this country. I think it is also incumbent upon us to set the stage for further development in the southern hemisphere. If Canada can make this kind of arrangement work with Mexico effectively it is certainly going to be to everyone's advantage."

²⁴³. According to 1992 U.N. estimates, total population of Mexico is 88,153 (thousands), Canadian and U.S. population under the same survey is shown at 27,367 (thousands) and 255,159 (thousands)., Source: Department of Economic and Social Development, Population Division, World Population 1992, (United Nations New York:1992). NAFTA creates a North American market of some 360 million people. Mexico has an abundance of inexpensive labour, roughly one-tenth the cost of that in the U.S. The combined economy of all three countries would approximate \$6 trillion a year. This compared with the European Common Market in 1992 of 336 million people and an economy of about \$4.4 trillion a year. See generally: Les Whittington and Anne McLory, "The Flipside of Boom", The Ottawa Citizen, Ottawa, 5 May 1991, Pg. E.7.

²⁴⁴ North American Free Trade Agreement Between the Government of Canada, The Government of the United Mexican States and The Government of the United States of America. 1992. Official Publication, Ottawa, Canada. Part Five of the agreement deals with investment specifically. Canada was first to ratify the treaty. Under the Agreement, all tariff barriers between the three contracting states will be eliminated over a maximum of 15 years. Bill C-115 implementing NAFTA agreement received Royal assent from the Governor General of Canada, But by virtue of Section 247 of the North American Free Trade Agreement Implementation Act, S.C. 1993. c. 44, this legislation will only operate as a law in Canada once both the U.S. and Mexico have ratified and completed all requirements for the implementation of this agreement in their territories. See generally, Drew Fagan, "Canada First to Ratify NAFTA:Opposition Sees Early Move into \$ 8 trillion Plan as Loss of Clout", The Globe and Mail, 24 June 1993, Pg. B-1.

being the first trilateral investment promotion and protection agreement, but also for the fact that it happens between two industrialized countries on one hand and a one of the leading developing economies on the other. It is important for Canada because it provides an opportune moment for Canadian investors to fully exploit those sectors of the Mexican economy which have been completely closed to foreign investment in the past. According to an official at the Mexican Embassy in Ottawa: Canada can provide its expertise in environment services, high tech industries (i.e telecommunications technology), industries engaged in raw material processing and pulp.²⁴⁵

Section A of chapter eleven of the NAFTA contains the substantive provisions of the aforesaid agreement relating to FDI. In this chapter an attempt has been made to outline the substantive provisions and provide detailed analysis of the changes, if any, made in the investment policy of Canada. The detailed analysis of Section B of chapter eleven which contains the dispute settlement provisions will be dealt with in Chapter five of this dissertation. The purpose of this Chapter is to determine if there has been any change in the approach of Canada towards foreign investment. Canada had already secured its position vis-a-vis the U.S. (the largest foreign investor in Canada) in the FTA. The added attraction of NAFTA perhaps lies in the third party to this agreement-Mexico, a developing country, deep in debt both internal and external and yearning for foreign capital to lead it out of this economic morass. This chapter will show that Canada has not made any substantial

²⁴⁵. Conversation with Mr. Jorge Juraidini, Embassy of Mexico, 5 July 1993.

changes to its past policies and has been able to secure legally a market for potential investors from Canada.

2. The Negotiations

Investment Canada headed the Canadian team in the negotiations on Chapter 11 of the NAFTA. The basic strategy was that Canada should not give more than what it had already given in the FTA. The mood of the Canadian team was one of being on the defensive. The Canadian team however completely understood that there could be no divorce between trade and investment issues in the negotiations and as a result the team may have made concessions in the investment sphere to attain gains in other areas under consideration in the NAFTA negotiations. The U.S. wanted more than just the liberalised access to FDI that Mexico had provided through the New Regulations²⁴⁶ of 1989 and notably in investor-state dispute settlement mechanism. The U.S. also demanded that Canada agree to an investor-state dispute settlement mechanism, since the foreign investment agreements which Canada had agreed with the certain countries of Eastern Europe and Russia provided for such an arrangement.²⁴⁷ It may be interesting to note that this demand of the U.S. was not of great comfort to Canada because with the countries with which Canada had signed these agreements were capital importing countries and Canada wished to secure its foreign investors against any aggressive and

²⁴⁶. *Supra* note 122, New Foreign Investment Regulations, and the accompanying text.

²⁴⁷. Examples of Various treaties signed by Canada which provide for investor-state dispute settlement mechanism are: Article IX of the Agreement between the Government of Canada and the Government of the Union of Soviet Socialist Republics for the Promotion and Reciprocal Protection of Investments, Moscow, November 20, 1989, Canada Treaty Series 1991/31. Article IX of the Agreement between the Government of the Republic of Poland for the Promotion and Reciprocal Protection of Investments, Warsaw, April 6, 1990, Canada Treaty Series 1990/43. Also see Draft copies of the Agreements signed between Canada and the Republic of Argentina, and Government of the Oriental Republic of Uruguay.

protectionist policies adopted at any time in the future in those countries. Canada understandably was not interested in going too far on investment from the U.S. Canada in turn asked for the exception from any future action against Canadian investment under the national security provisions of EXFA. There was and continues to be amongst Canadian negotiators fear EXFA may be used against Canada in the future. Another objective for Americans negotiators was seeking a full compensation clause against any future nationalisation or expropriation by the Mexican Government. It is reasonable to assume that Canada being a industrialised country and keeping in view its future investment in Mexico supported the Americans on the issue of full compensation.

It is noteworthy that Canadian cultural protection remained one of the many other issues that the Canadian government was adamant in excluding from the NAFTA bargaining table. In perspective not only have Canadians felt threatened by the increased influence of its giant neighbour to the south in the past, but also it is also politically recognised that certain institutions and businesses, such as the Canadian Broadcasting Corporation and publishing companies, are the glue for keeping as diverse a country as Canada together. As a result the Canadian negotiating team felt that if not excluded from the bargaining table, these industries would be initially forced to compete with their American counterparts on purely "bottom line" considerations and in the long run would completely be overtaken by American cable corporation, which could, over time, undermine Canadian unity and identity.

An important consideration for the Canadian negotiating team was also the future scope of Canadian investment in Mexico. although little was at stake in terms of current Canadian investment in Mexico.²⁴⁸

3. Substantive Provisions of the NAFTA Investment Chapter

A. National Treatment

Like the FTA, the underlying feature of the NAFTA investment chapter is its national treatment provisions²⁴⁹ for both investors²⁵⁰ and the investment of investors²⁵¹ of each contracting Party with respect to establishment, acquisitions, expansion, management, conduct, operation and sale or other disposition of investments. Like the FTA, it prohibits, any minimum level of domestic equity or ownership requirement except for nominal qualifying shares for directors as may be required under the laws of each participating country.²⁵² National treatment also mandates that no party can force an investor of another party to divest by reason of

²⁴⁸. *Supra* note 235, and accompanying text.

²⁴⁹ *Supra* note 244, NAFTA, Art.1102, Pg.11-1.

²⁵⁰ *Ibid.* Art. 1102(1), at Pg. 11-1. Article 1139 Definitions: Investor of a party means "a party or state enterprise, or a national or an enterprise of such party, that seeks to make, is making or has made an investment." at Pg. 11-25.

²⁵¹ *Ibid.* Art.1102(2), at Pg. 11-2. Article 1139: Definitions: Investment of an investor of a party means "an investment owned or controlled directly or indirectly by an investor of such party." at Pg. 11-25.

²⁵². *Ibid.* Article 1102.4 (a).

nationality alone²⁵³. Therefore, national treatment is the core element of the investment chapter. Each province or the state of the contracting Party must treat investors of the party or investment of investor of a party in the same manner as it treats the investors and investments of the other provinces or states within the territory of the contracting Party.²⁵⁴

(i) Canadian Reservations to National Treatment

Federally Canada through adopting reservations to national treatment provides that national treatment will not apply to specific sectors of the economy like agriculture,²⁵⁵ investment in all sectors exceeding thresholds,²⁵⁶ business

²⁵³. *Ibid.* Article 1102.4 (b).

²⁵⁴. *Ibid.* Article 1102(3).

²⁵⁵. *Ibid.* Annex-I, Schedule of Canada, Pgs. I-C-1 to I-C-42. Loans under Farm Credit Act, R.S.C. 1985, c.F-2 are reserved only for Canadian Citizens or permanent residents; their farming corporations and cooperative farm associations. Reservations also provides for no phasing out (Phasing out means a commitment to liberalising after certain period, once the agreement comes into operation) of this reservation.

²⁵⁶. *Ibid.* Pg. I-C-2 to I-C-6. Other than the regular \$5/\$50 thresholds set out under the ICA, Para. 3 provides that Investment Canada may review any specific acquisition or new businesses in Canada's cultural heritage or national identity industries if Cabinet authorizes a review in public interest. The Annex grandfathers the ICA and provides for a phasing out. Business acquired by the investors of Mexico or the US the review threshold are higher, but the higher thresholds do not apply to uranium production and ownership of uranium producing properties; financial services; transportation services; and cultural business. Except when Investment Canada while reviewing an acquisition of an investment may ask for specific commitments [notwithstanding Article 1106(1), performance requirements] with regard to establishment, acquisition, expansion, conduct, or operation on an investment of another Party or a non-Party for transfer of technology, production process or other proprietary knowledge to a national or enterprise, affiliated to the transferor, otherwise prohibitions on requiring performance requirements as provided under Article 1106 (1) shall apply to any requirements, commitments or undertakings, that may be imposed by Investment Canada. Annex also explains the parameters of operation of Article 1106 (1) by specifically stating that Article 1106 (1) shall not effect requirements under ICA review mechanism such as: to locate production, carry out

service industry (duty free shops),²⁵⁷ energy,²⁵⁸ fisheries,²⁵⁹ transportation,²⁶⁰ the

research and development, employ or train workers, or to construct or expand particular facilities, in Canada.

The phase out for thresholds provides that for 12-month period beginning the operation of NAFTA the thresholds for Mexico and U.S. investors would be those under Annex 1607.3 of the FTA (direct investment to increase from \$5 Million to \$150 Million). Refer to Supra note, FTA, Article 1607, Para.3 and Annexure 1603.3. Chapter three and the accompanying text. After the operation of initial 12-month of operation of the agreement the thresholds will be determined each year by the formulae provided in Annex I-Canada, at Pg. I-C-6.

^{257.} *Ibid.* Pg. I-C-19. To invest as duty free shop operator there are host of citizenship and residency requirements and this sector is also one where no phase out period is provided.

^{258.} *Ibid.* Pg. I-C-23. No national treatment is required for production licenses issued with respect to "frontier lands" and "offshore areas" outside the provincial jurisdiction in oil and gas sector. This sector also has no phase out period. Also see: *ibid.* Pg. I-C-29, In the uranium mining, since the non-Canadian ownership is limited to 49% at the first stage of production (not beyond that stage) the exception to this limit is only permitted if it is shown that property is Canadian Controlled within the meaning of ICA. Only the Cabinet can approve the increase only if no Canadian participant is available. There is no phase out period under this sub-sector and no increase in non-Canadian ownership is permitted. See generally, Policy on Non-Resident Ownership in the Uranium Mining Sector, 1987.

^{259.} *Ibid.* Pg. I-C-30, Fish harvesting and processing, national treatment is not available to foreign investors in this sector. Any fish processing enterprise that has foreign ownership above 49% are prohibited from holding Canadian commercial fishing licenses, otherwise issued under the Coastal Fisheries Protection Act, R.S.C. 1985, c.C-33. Minister of Fisheries and Oceans has discretionary authority with respect to issuance of licenses under the Fisheries Act, R.S.C. 1985 c.F-14. There is no phase out period for this sector as well. See Generally: Policy on Foreign Investment in the Canadian Fisheries Sector, 1985.

^{260.} *Ibid.* Pg. I-C-32. As far as domestic airlines industry goes Canadian ownership and control is exclusive. The industry which has been exempted from the national treatment under Article 1102 of the NAFTA. The "domestic services"; "scheduled international services" where those services have been reserved to Canadian carriers under existing and bilateral agreements; and "non-scheduled international services" whose services have been reserved to Canadian carriers under the National Transportation Act, 1987, R.S.C. 1985, c.28 (3rd Supp.). Also refer to Air Regulations, C.R.C. 1978, c.2., Aircraft Marking and Registration Regulations, SOR/90-591. The National Transportation Act, 1987 defines "Canadian" as: Canadian citizen or permanent resident, a government in Canada or agent thereof or any other person or entity that is controlled in fact by, and of which at least 75% of the voting interests are owned and controlled by, persons otherwise meeting these requirements. Regulations under the Aeronautics Act R.S.C. 1985, C.A-2, also requires that a Canadian air carrier operate Canadian-registered aircraft. To be qualified to register aircraft in Canada, a carrier must be a Canadian citizen or permanent resident, or a corporation incorporated and having its principal place of business in Canada, its chief executive officer and not fewer than two-thirds of its directors as Canadian citizens or permanent residents and not less than 75% of its voting shares owned and controlled by persons otherwise meeting these requirements. In addition, all commercial air services in Canada require a Canadian operating certificate to ensure their safety and security. An operating certificate for the provision of services restricted to Canadian carriers is issued only to qualified

Crown corporations in all sectors,²⁶¹ and a non-resident may not hold beyond a certain percentage of voting shares in specified Crown corporations under NAFTA²⁶². National treatment under 1102 is also not applicable to certain land regulations.²⁶³ The reservation to the national treatment under Article 1102 is also

persons under the Act and respective regulations. There is no phasing out in this sector.

Ibid. Pg. I-C-34, provides exemption from "Non-scheduled air transport, speciality, industry" within the air transport sector. Ministry of Transportation which issues the operating certificate subject to Canadian Safety requirements being met, prohibits such license to non-Canadians for the provision of aerial construction, heli-logging, aerial inspection, aerial surveillance, flight training, aerial sightseeing, and aerial spraying services.

261. *Ibid.* Pg. I-C-9, Federally owned crown corporations in all sectors of the economy are exempted from national treatment under Article 1102. "Constraints" may be placed on the issue, transfer and ownership of shares in federally incorporated corporations, The object is to permit corporations to meet Canadian ownership requirements, under certain laws set out in the Canada Business Corporations Act Regulations, SOR/79-136, in sectors where ownership is required as a condition to operate or to receive licenses, maintain certain Canadian ownership levels, a corporation is permitted to sell shareholders' shares without consent of those shareholders, and to purchase its own shares on the open market. The term "Canadian" here means as one defined under Canada Business Corporations Act Regulations. Generally refer: Canada Business Corporations Act, R.S.C. 1985, c.C-44., Canada Corporation Act, R.S.C. 1970, C.C-32. There is no phasing out provided under this reservation to national treatment.

262. *Ibid.* Pg. I-C-14, The restrictions for each of these corporations is specified under the respective acts of Parliament such as: Air Canada:25% (Air Canada Public Participation Act, R.S.C. 1985,c.35 (4th Supp.); Canada Development Corporation:25% (Canada Development Corporation Reorganisation Act, S.C. 1985, c.49); Petro Canada Inc. 25%(Petro-Canada Public Participation Act, S.C. 1991, c.10); Canadian Arsenal Limited:25%(Canadian Arsenal Limited Divestiture Authorization Act, S.C. 1986, c.20); Eldorado Nuclear Limited:5% (Eldorado Nuclear Limited Reorganisation and Divestiture Act, S.C. 1988, c.41); Theratronics Limited:49% (Nordian and Theratronics Divestiture Authorization Act, S.C. 1990, c.4.) and Cooperative Energy Corporation:49% (Cooperative Energy Act, S.C.1980-81-82-83, c.108). There is no phasing out period for these specific corporations.

263. *Ibid.* Pg. I-C-12, The Foreign Ownership of Land Regulations are made pursuant to the Citizenship Act, R.S.C. 1985, c. C-29 and Alberta Agricultural and Recreational Land Ownership Act. In Alberta, an ineligible person or foreign-owned or controlled corporations may only hold interest in controlled land consisting of not more than 20 acres. There is no phasing out in this sector.

An "Ineligible person" is:

- (a) an individual who is not a Canadian citizen or permanent resident;
- (b) a foreign government or agency thereof; or
- (c) a corporation incorporated elsewhere than in Canada.

"Controlled land" means land in Alberta but does not include:

- (a) land other than land owned by the Crown;
- (b) land within a city, town, new town, village or summer village; and

provided at both federal and provincial levels against state enterprises of existing governmental entities.²⁶⁴

Apart from the reservations to the national treatment under Annex I of the NAFTA. Pursuant to Article 1108(3)(Reservations and Exceptions)²⁶⁵ there are reservations taken by Canada to specific sectors, sub-sectors or activities for which it may maintain existing or can adopt more restrictive measures. Reservations under Annex-I are different from those under Annex-II because while Annex-I reservations, are reservations taken by contracting Parties against their pre-existing, non-conforming legislative or regulatory measures, reservations under Annex-I either set out commitments for future liberalisation or if they do not provide for any phasing out period for future liberalisation, the contracting Parties may maintain that measure but cannot introduce or adopt new or more restrictive non-conforming measure. Whereas the reservations made under Annex-II are for those

(c) mines and minerals.

²⁶⁴. *Ibid.* Pg. I-C-7, This reservation to Article 1102 provides that if Canada or any province in Canada disposes of its equity interests or assets it may firstly impose limitations on the ownership of such interests or assets. Secondly it may impose restrictions on the ability of owners of such interests or assets which may result in control of these enterprises in the hands of another Party to this agreement or a non-Party or their respective investments. In the process of sale or disposition of such interests or assets both Canada and any province may adopt or maintain measures restricting that the nationality of senior management or members of the board of directors be Canadian. It is further explained in this Annex that any aforesaid measure if is adopted or maintained after the entry into force of this agreement it shall deemed to be an existing measure. This is done to include any prospective measures to be within the meaning of "non-conforming existing measures" as provided under Article 1108.1 (a). "State enterprise" here means an enterprise owned or controlled through interests by Canada or a province and includes an enterprise established after the date of entry into force of this agreement solely for the purpose of selling or disposing of equity interests in, or the assets of, an existing state enterprise or governmental entity.

²⁶⁵. *Supra* note 244, NAFTA, Pg.11-6.

preexisting non-conforming measures, where the contracting Parties can, while maintaining such a measure may also adopt new or more restrictive measures that do not conform with the obligations imposed under Article 1102 (national treatment) and/or Article 1106 (performance requirements) and/or Article 1107 (senior management and board of directors). Reservations taken by Canada under Annex-II are those core sectors of economic activity that Canada did not wish to compromise on in any measure. These reservations to national treatment within the meaning of Article 1102 include aboriginal affairs;²⁶⁶ residency requirements for an investor of another Party to own ocean front land;²⁶⁷ investments of another Party to telecommunications transport networks and telecommunications transport services, radiocommunications and submarine cables;²⁶⁸ government finance and administration;²⁶⁹ minority affairs;²⁷⁰ social services;²⁷¹ and both the air²⁷² and the

266. Reservations for Future Measures, Annex II, Schedule of Canada, Pg. II-1, at pg. II-C-1. Canada reserved its right to adopt or maintain any measures denying investors of another Party and their investments, or service providers of another Party, any rights or preferences provided to aboriginal peoples. See Generally: Constitution Act, 1982, being Schedule B of the Canada Act, 1982 (U.K), 1982, c.11.

267. *Ibid.* Pg.II-C-2.

268. *Ibid.* Pg. II-C-3.

269. *Ibid.* Pg. II-C-7, Canada reserves the right to adopt or maintain any measure relating to the acquisition, sale or other disposition by nationals of another Party of bonds, treasury bills or other kinds of debt securities issued by the Government of Canada, a province or local government. See generally, Financial Administration Act, R.S.C. 1985, c F-11.

270. *Ibid.* Pg. II-C-8. Canada reserved its right to adopt or maintain any measure according rights and preferences to socially or economically disadvantaged minorities.

271. *Ibid.* Pg. II-C-9, Canada reserves the right to adopt or maintain any measure with respect to the provision of public law enforcement and correctional services, and the following services to the extent that they are social services established or maintained for public purpose: income security or insurance, social security or insurance, social welfare, public education, public training, health, and

water transport.²⁷³

The provisions of Annex II provides additional perspective in light of Article 1101(4) which provides:

"Nothing in this Chapter shall be construed to prevent a Party from providing a service or performing a function such as law enforcement, correctional services, income security, or insurance, social security or insurance, social welfare, public education, public training, health, and child care, in a manner that is not inconsistent with this chapter."

As a result, the existing social services rendered by the NAFTA contracting Parties will remain unaffected from foreign investment.

(ii) Mexican Reservations to National Treatment

Like Canada, Mexico has many of its sectors reserved from the national treatment obligation under Article 1102. These are sectors which have been traditionally closed to foreign investors as mentioned earlier in Chapter three of this dissertation.²⁷⁴ An across the board federal reservation is applicable with respect to acquiring property rights over land or water in 100 km. strip along the countries

child care.

²⁷². *Ibid.* Pg. II-C-10, Non-Scheduled Air Transport, Speciality, Industry. Canada reserves its right to adopt and maintain any measure that restricts the acquisition or establishment of an investment in speciality air services to a Canadian national or corporation incorporated and having its principal place of business in Canada, its chief executive officer and not fewer than two thirds of its directors as Canadian nationals, and not less than 75% of its voting interest owned and controlled by persons otherwise meeting these requirements.

²⁷³. *Ibid.* Pgs. II-C-11 to II-C-13.

²⁷⁴. Refer, *supra* note 113 & 130.

borders or in the "restricted zone" (50 km. strip inland from its coasts).²⁷⁵

Mexico maintains its ability to review both direct and indirect investments by investors of another Party in an unrestricted sector if the acquired ownership interest is more than 49% and not less than the applicable threshold. This provision provides phasing out period and thresholds.²⁷⁶ This is different from the previous practice in Mexico because previously all investment were subject to some kind of review process,²⁷⁷ but under the NAFTA review, the process will only apply to the

²⁷⁵. *Supra* note 244, NAFTA, Annex-I, Schedule of Mexico, Pg. I-M-1. Also see, *supra* note 106, Article 27(1), Mexican Constitution. This Article states that: "under no circumstances may foreigners acquire direct ownership of lands and water within a zone of one hundred kilometres along the frontier and of fifty kilometres along the shores of the country."

²⁷⁶. *Ibid.* Pg. I-M-5, For the investors from Canada and the U.S. the thresholds for review will be:

- (a) US\$25 Million, for the three-year period beginning on the date of entry into force of this agreement;
- (b) US\$50 Million, for three-year period beginning three years after the date of entry into force of this agreement;
- (c) US\$75 Million, for the three-year period beginning six years after the date of entry into force of this agreement; and
- (d) US\$150 Million, beginning nine years after the date of entry into force of this agreement.

These thresholds are to be adjusted annually beginning one year after the date of entry into force of this agreement for cumulative inflation and the criteria is set out in this regard by the agreement.

²⁷⁷. *Supra* note 122, presently restrictions on foreign investment apply in the case of 141 activities. These activities are listed in a "classification" that forms part of the May 1989 Regulations to the Foreign Investment Law. The classification is subdivided in these categories:

- Category 1 activities reserved exclusively to the Mexican state (11 activities)
- Category 2 activities reserved to Mexican nationals (33 activities)
- Category 3 activities that allow up to 34% foreign ownership (5 activities)

restricted sectors of the Mexican economy.²⁷⁸ Because Mexican financial thresholds are far below the Canadian thresholds, large Canadian corporations which intend to invest in Mexico will be required to undergo the review process. Unlike in Canada where review of indirect investments have completely been done away with under NAFTA, thresholds in Mexico make no distinction between direct or indirect acquisition of Mexican enterprise. Therefore all but a few small Canadian and American investments made either directly or indirectly will be subjected to review by the Mexicans.

Other reservations that Mexico has taken from national treatment under Article 1102 of the NAFTA include: participation in Mexican cooperative production enterprises;²⁷⁹ licensing of micro industry enterprise;²⁸⁰ agriculture,

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|------------|--|
| Category 4 | activities that allow up to 40% foreign ownership (8 activities) |
| Category 5 | activities that allow up to 49% foreign ownership (26 activities) |
| Category 6 | activities that require prior authorization for majority foreign ownership (58 activities) |

Foreign investment below specified limits in categories 3 through 6 is automatically approved as long as it satisfies the criteria set out. For criteria 100% foreign ownership in an unclassified sector and below the above stated percentage, see *supra* note 126. Foreign investment above these limits is possible, but is subject to review and prior approval but the National Commission on Foreign Investment [hereinafter NCFI]. In such cases, the NCFI must be satisfied that the investment will: serve as a complement, not as a supplement, to domestic ownership; promote exports and contribute positively to the balance of payments; create jobs and improve the remuneration of employees; contribute to the development of less economically developed regions; and bring in technology and/or undertake research and development in Mexico.

²⁷⁸. *Ibid.*

²⁷⁹. *Supra* note 244, Pg. I-M-7.

²⁸⁰. *Ibid.* Pg. I-M-8, "Micro industry enterprise" is defined as one with up to fifteen workers and with sales of amounts periodically determined by the Secretary of Commerce, Fomento industrail.

livestock, forestry and lumber activities;²⁸¹ communications especially cable entertainment;²⁸² telecommunications;²⁸³ transportation and telecommunication, postal service;²⁸⁴ construction in general;²⁸⁵ construction contracting in petroleum and gas sectors;²⁸⁶ educational services;²⁸⁷ distribution, storage, or sale of liquified petroleum gas;²⁸⁸ retail outlets of gasoline and diesel including lubricants;²⁸⁹ fishing

²⁸¹. *Ibid.* Pg. I-M-9, Land for agriculture, forestry, and livestock can only be owned by a Mexican national or a Mexican enterprise. Such enterprises can however issue share to investors of another Party but only up to 49%.

²⁸². *Ibid.* Pg. I-M-15. Investors of another Party or their investments either directly or indirectly are only permitted up to 49% of the ownership of an enterprise in Mexico, undertaking Cable television system. Phasing out is only permitted by discussion only after 5 years of coming into force of this agreement.

²⁸³. *Ibid.* Pg. I-M-18, Investors from Canada and the U.S may have 100% ownership in Mexican establishment that provides any enhanced or value added service other than videotext or enhanced packet switching services and only 49% if investing in the latter two. Beginning 1 July 1995, the 49% ownership restriction will be replaced with 100% ownership in enterprises providing videotext or enhanced packet switching services.

²⁸⁴. *Ibid.* Pg. I-M-20, Complete federal reservation in communication (telecommunication and postal service) and transportation sectors from Article 1102. No phase out period is provided in this sector.

²⁸⁵. *Ibid.* Pg. I-M-21, certain classified sectors under the construction industry are reserved from Article 1102, but it may be phased out in period of 5 years to increase the ownership of Investor or investments of another Party to 100%, subject to the thresholds set out at Pg. I-M-4.

²⁸⁶. *Ibid.* Pg. I-M-23. Also see. Schedule of Mexico, Annex III, Pg. III-M-1.

²⁸⁷. *Ibid.* Pg. I-M-25. Foreign investment above 49% of the ownership interest requires prior approval. There is no phase out.

²⁸⁸. *Ibid.* Pg. I-M-27. Retail sale storage, distribution of liquified petroleum restricted only to Mexicans or Mexican owned enterprises. There is no phase out.

²⁸⁹. *Ibid.* Pg. I-M-28. Reserved exclusively for Mexicans. There is no phase out.

on the high seas, coastal areas and fresh water fishing;²⁹⁰ auto parts industry;²⁹¹ manufacture of certain goods like artificial explosives, fireworks, firearms and cartridges;²⁹² extraction and exploitation of certain classified minerals;²⁹³ newspaper publishing;²⁹⁴ legal services;²⁹⁵ commercial public notaries;²⁹⁶ retail commerce in firearms, cartridges and ammunition;²⁹⁷ air transportation;²⁹⁸ speciality air services;²⁹⁹ aircraft building, assembly and repair;³⁰⁰ construction and operation of

²⁹⁰. *Ibid.* Pg I-M-29. Investor of another Party can only own directly or indirectly up to 49% ownership interest in an Mexican enterprise engaged in : coastal fishing, fresh water fishing and fishing in exclusive economic zone. There is no phase out.

²⁹¹. *Ibid.* Pg. I-M-31, 49% restriction on ownership either directly or indirectly in an "enterprise of the auto parts industry" may not be applicable if investors or investment of investors of another party can be branded as "national suppliers" as set out in Annex 300-A, Pg. 3-A-1 of the agreement or meets the requirements as set out in Appendix 300-A.2, Pg. 3-A-4. Phase out period is 5 years to obtain 100% ownership in this sector.

²⁹². *Ibid.* Pg. I-M-39. Ownership restriction in this sector is 49%, with no phase out period.

²⁹³. *Ibid.* Pg. I-M-40, 49% ownership restriction is to phase out in 5 years to increase the Party investors ownership to 100%. However the sector will remain under the review process according to the thresholds set out on Pg. I-M-4.

²⁹⁴. *Ibid.* Pg. I-M-42.

²⁹⁵. *Ibid.* I-M-46.

²⁹⁶. *Ibid.* Pg. I-M-49. and Pg. I-M-50.

²⁹⁷. *Ibid.* Pg. I-M-52.

²⁹⁸. *Ibid.* Pg. I-M-55.

²⁹⁹. *Ibid.* Pg. I-M-57.

³⁰⁰. *Ibid.* Pg. I-M-59.

airports, heliports, provision for navigation services;³⁰¹ investments in establishment or operation of bus or truck station or terminals;³⁰² investment in providing local bus services, school bus services and taxi or other collective transportation;³⁰³ customs broker enterprise³⁰⁴ and classified sectors of water transportation.³⁰⁵

Annex II, "Schedule of Mexico"³⁰⁶ sets out those sectors of Mexican economy which are reserved from Article 1102 with regard to an option to adopt or maintain any measures in the future. These sectors of Mexican economy are: all sectors of financial services;³⁰⁷ entertainment services under communications sector;³⁰⁸ telecommunications services related to aeronautics and air navigational services;³⁰⁹ telecommunications transport network;³¹⁰ postal services, telecommunications and

³⁰¹. *Ibid.* Pg. I-M-60.

³⁰². *Ibid.* Pg. I-M-63.

³⁰³. *Ibid.* Pg. I-M-66.

³⁰⁴. *Ibid.* Pg. I-M-74.

³⁰⁵. *Ibid.* Pg. I-M-78 and I-M-81.

³⁰⁶. *Ibid.* Pg. II-M-1.

³⁰⁷. *Ibid.*

³⁰⁸. *Ibid.* Pg. II-M-2.

³⁰⁹. *Ibid.* Pg. II-M-3.

³¹⁰. *Ibid.* Pg. II-M-4.

rail roads;³¹¹ professional³¹² and social services.³¹³ Most of the aforesaid sectors are those which are constitutionally restricted against foreign control. These reservations from Article 1102 (national treatment) are different from those taken by Mexico under Annex-I (reservations to national treatment), because Mexico under these reservations can not only maintain the existing reservation, but can also reserve a right to introduce or adopt a more restrictive measure in these sectors in the future.

(iii) U.S. Reservations to National Treatment.

U.S. has also listed its reservations to national treatment under Article 1102 in: atomic energy;³¹⁴ telecommunications (enhanced or value added services);³¹⁵ agricultural chemicals such as pesticides and agricultural chemicals not

³¹¹. *Ibid.* Pg. II-M-6.

³¹². *Ibid.* Pg. II-M-10.

³¹³. *Ibid.* Pg. II-M-11.

³¹⁴. *Ibid.* Annex-I, Schedule of the United States, Pg. I-U-1. Atomic Energy Act of 1954, 42 U.S.C. 2011 *et seq.*, requires that license be acquired to transfer, manufacture, produce, use or import any facilities that produce or use nuclear materials and such a license may not be issued to any entity known or believed to be owned, controlled or dominated by alien, a foreign corporation or a foreign government. (42 U.S.C. 2133,2134). There is no phasing out period in this sector.

³¹⁵. *Ibid.* Pg. I-U-5.

classified elsewhere;³¹⁶ mining;³¹⁷ public administration;³¹⁸ air transportation;³¹⁹ classified air transportation;³²⁰ land transportation;³²¹ customs brokers³²² and all sectors under the securities act.³²³

Under Annex-II (reservations to national treatment obligations), U.S. has reserved its right to adopt or maintain measures: in all sectors related to residency

³¹⁶. *Ibid.* Pg. I-U-6.

³¹⁷. *Ibid.* Pg. I-U-7.

³¹⁸. *Ibid.* Pg. I-U-11, Investment insurance and loan guarantees provided by Overseas Private Investment Corporation (U.S) are not available to alien, foreign enterprises or foreign controlled domestic enterprises. There is no phase out period for this reservation.

³¹⁹. *Ibid.* Pg. I-U-13, This reservation pertains to (a) scheduled air transportation, (b) air courier services, (c) non-scheduled air transportation. This reservation provides no phase out period.

³²⁰. *Ibid.* Pg. I-U-15, The specified classification under this sector pertains to aerial crop planting, cultivating and protection; forestry services, air taxi services for sightseeing, aerial advertising, commercial photography, aviation clubs services and sports clubs, educational purposes and surveying. This reservation also does not provide for any phase out.

³²¹. *Ibid.* Pg. I-U-18, Phase out period for this reservation is provided vis-a-vis Mexico. The Interstate Commerce Commission of the U.S. which is required to provide interstate or cross-border bus or truck services in the U.S. has placed a moratorium on grant of new operating authority for Mexicans. but this moratorium is not applicable to charter or tour bus service because of the Memorandum of Understanding between the U.S. and Mexico on Facilitation of Charter/Tour Bus Service, signed on December 3, 1990. Moratorium works as an investment restriction for providing bus or truck services in the U.S. by persons of Mexico. Only 3 years after the date of signature of NAFTA, the U.S. will permit a person from Mexico to provide truck services for transportation of international cargo between points in the U.S. After 7 years of coming into force of this agreement that the bus services will be allowed between points in the U.S. Moratorium will however remain in effect for truck services by persons of Mexico between points in the U.S. for transportation of goods other than international cargo.

³²². *Ibid.* Pg. I-U-21.

³²³. *Ibid.* Pg. I-U-22. Foreign firms, except for certain Canadian issuers, may not use the small business registration forms under the Securities Act of 1933 to register securities that the firm issues and do not qualify to use the less costly standards under the rules. Reservation is also maintained under Securities Exchange Act of 1934, 15 U.S.C. 781. There is no phasing out period in this reservation.

requirements for Canadian investors in the U.S ocean front land;³²⁴ cable television;³²⁵ telecommunications transport networks and services and radio communications;³²⁶ social services;³²⁷ minority affairs;³²⁸ professional legal services;³²⁹ newspaper publishing³³⁰ and water transportation.³³¹

B. Most Favoured Nation Treatment

The core element of treatment under NAFTA is the national treatment under Article 1102. But if the situation arises that in a particular sector of the Party there are only foreign investors, then the question arises as to what should be the standard of treatment accorded to the investor or investment of another Party to the

³²⁴. *Ibid.* Annex-II, Schedule of United States, Pg. II-U-1.

³²⁵. *Ibid.* Pg. II-U-2, U.S reserves its right to adopt or maintain limits on ownership equivalent to those maintained against U.S. investors enterprise engaged in the operation of cable television system in such other country.

³²⁶. *Ibid.* Pg.II-U-3.

³²⁷. *Ibid.* Pg. II-U-5. Like Canada, U.S. also reserves its right to adopt or maintain any measure related to public law enforcement and correctional services and the following services to the extent they are social services established for a public purpose: income security or insurance, social security or insurance, social welfare, public education, public training, health, and child care.

³²⁸. *Ibid.* Pg. II-U-6.

³²⁹. *Ibid.* Pg. II-U-7.

³³⁰. *Ibid.* Pg. II-U-8, U.S reserves its right to ownership in this sector to the extent its own investors face the equivalent treatment in another country.

³³¹. *Ibid.* Pg. II-U-9.

agreement. In such circumstance it is Most Favoured Nation treatment [hereinafter the MFN treatment] required of each Party to the agreement.³³² Another angle of the MFN clause in Chapter Eleven, is the obligation of each party to accord investors or investment of investors of another party treatment no less favourable than that it accords, in like circumstances, to investments of investors of any other Party, but also to a non-Party to the agreement. An example is the air transport sector where "non-resident" participation is restricted in Air Canada corporation to 25%³³³ and this is denial of national treatment; yet if Canada allows Swiss or the British to have 45% stakes in Air Canada, then in that situation Mexican and U.S investors will automatically have a right to MFN treatment.

This Article is further qualified by Article 1104 (Standard of Treatment) which requires each Party to the agreement to accord better of the treatment required by Articles 1102 (national treatment) and 1103 (the MFN treatment). Therefore the dominant criterion is the one under Article 1104, which clearly mandates "better" of the two treatments set out in Articles 1102 and 1103.

As it has been stated above, if a particular sector of contracting Party is reserved against national treatment under Article 1102, investor or investment of investor of the Party would be still required to render MFN treatment by the contracting Party except in cases unless the sector is also reserved from the MFN

³³². *Ibid.* Article 1103:Most-Favoured-Nation Treatment.

³³³. *Supra* note 260, NAFTA, and the accompanying text.

treatment in the Annex I or II or IV of the NAFTA.³³⁴ For example in the Uranium sector Canada reserves against both the national treatment and the MFN

³³⁴ *Ibid.* Annex I, "Schedule of Canada", Canada has taken reservations to MFN treatment in addition to national treatment under Article 1103 in the following sectors: Uranium mining (Pg. I-C-29); air transportation (Pg. I-C-32) and fisheries (Pg. I-C-30). Annex I, Schedule of Mexico, Mexico has taken exception to MFN treatment in addition to national treatment in following sectors: fishing (Pg. I-M-29); professional and specialised services (legal services) (Pg. I-M-46) and water transportation (Pg. I-M-78). Annex I, Schedule of the United States, U.S. has taken reservations to MFN treatment in addition to national treatment in the following sectors: mining (Pg. I-U-7); public administration (Pg. I-U-11); scheduled or non-scheduled air transportation (Pg. I-U-13); air transportation for crop planting, forestry, advertising etc.(Pg. I-U-15); land transportation like trucking, charter bus service, courier services etc(Pg. I-U-18) and all sectors under the securities Act (Pg. I-U-22).

Under Annex II, which provides reservations taken by the Party with respect to specific sectors, sub-sectors or activities for which it may maintain existing or adopt new or more restrictive, measures that do not conform with the obligations imposed. Schedule of Canada provided reservation to MFN treatment in addition to national treatment in the following sectors: aboriginal affairs (Pg. II-C-1); telecommunications transport networks and services, radiocommunications and submarine cables (Pg. II-C-3); non-scheduled air transport speciality industry (Pg. II-C-10) and water transportation (Pg. II-C-11 & II-C-13). Schedule of Mexico provides following sectors under this Annex: entertainment services (Pg. II-M-2); telecommunications (Pg. II-M-3); telecommunications transport networks (Pg. II-M-4) and professional legal services (Pg. II-M-10). Schedule of the United States provides reservations to MFN treatment in following sectors in addition to reservations to national treatment: residency requirement in all sectors (Pg. II-U-1); cable television (Pg. II-U-2); telecommunications transport networks and services and radiocommunications (Pg. II-U-3); legal services (Pg. II-U-7); newspaper publishing (Pg. II-U-8) and water transportation (Pg. II-U-9).

Annex IV provides for exceptions to the MFN treatment. Three Parties to the agreement have almost taken same reservations to the MFN under Article 1103. It provides that Canada, the U.S and the Mexico takes exception to Article 1103 for treatment accorded under all bilateral or multilateral international agreements in force or signed prior to the date of entry into force of this agreement. All the three countries also provide for all international agreements in force or signed after the date of entry into force of this agreement, they will take exception to Article 1103 for treatment accorded under those agreements involving:

- (a) aviation;
- (b) fisheries;
- (c) maritime matters, including salvage; or
- (d) telecommunications transport networks and telecommunications transport services (this exception does not apply to measures covered by chapter Thirteen (telecommunications) or the production, sale or licensing of radio or television programming. [Words in Italics do not form part of the Canadian reservation against Article 1103 (MFN Treatment) under Annex-IV, Schedule of Canada, Pg. IV-C-1])

With respect to state measures not yet set out in Annex I pursuant Article 1108(2), all the three countries take exception to Article 1103 for international agreements signed within two years of the date of entry into force of this agreement.

treatment,³³⁵ another example is the fisheries sector.³³⁶

Exceptions to MFN treatment are fairly limited under the NAFTA. This is important, because once Canada has a reservation against the MFN treatment for a particular sector of the Canadian economy, it means that the particular sector continues to remain within the exclusive jurisdiction of Canada to make any policy changes vis-a-vis U.S. or Mexico unless Canada at its own instance liberalises a particular sector of the Canadian economy.

An important difference between the FTA and NAFTA also lies in the fact that there was no MFN treatment provision in the FTA. In answer to a question as to why MFN treatment was not provided for in the FTA, Mr Gilles Gauthier, a trade policy analyst at the Department of Finance, Ottawa, Canada explained

"Why it wasn't in the FTA.....[is because the] primary focus was on providing preferential access to the U.S. investors, so the MFN dimension didn't quite fit that framework. Whereas here we are talking about much more total set of obligations and complexities also in the various restrictions vis-a-vis Mexico.....exceptions to the national treatment that are grand fathered by the agreement [NAFTA] made a compelling case, perhaps that we should at least complement national treatment with the MFN treatment."³³⁷

³³⁵. *Supra* note 244, NAFTA, Annex-I, Schedule of Canada, Pg. I-C-29.

³³⁶. *Ibid.* Pg. 1-C-31.

³³⁷. Conversation with Mr. Gilles Gauthier, Trade Policy Analyst, Department of Finance, International Economics Relations Division, (Ottawa, Canada: June 7, 1993).

C. Minimum Standard of Treatment

Both national treatment and the MFN treatment are relative standards, the obligation set out in Article 1105 of the NAFTA is an absolute obligation to provide minimum standard of treatment. Article 1105 states that "each Party shall accord to investments of investors of another Party treatment in accordance with international law, including fair and equitable treatment and full protection and security." For example, according to Article 1105(2)³³⁸ in case of a civil strife or armed conflict in the territory of one of the contracting Party to NAFTA. If a contracting Party decides not to pay any compensation to its local investors, NAFTA investors or the non-NAFTA investors. Such a contracting Party does not contravene the obligations under Article 1102 (national treatment) or 1103 (MFN treatment), yet such a contracting Party is required to pay the minimum compensation for rebuilding the infrastructure if mandated by the law of such a contracting Party. But the aforesaid obligation is not applicable to any existing measures relating to subsidies or grants.³³⁹

³³⁸. *Ibid.* NAFTA, Article 1105(2) states: "Without prejudice to Paragraph 1 and notwithstanding 1108(7)(b), each party shall accord to investors of another Party, and to investments of investors of another Party, non-discriminately treatment with respect to measures it adopts or maintains relating to losses suffered by investments in its territory owing to armed conflict or civil strife."

³³⁹. *Ibid.* Article 1105(3) states: "Paragraph 2 does not apply to existing measures relating to subsidies or grants that would be inconsistent with Article 1102, but for Article 1108(7)(b)". Article 1108(7)(b) reads: "Article 1102, 1103 and 1107 do not apply to: "....(b)subsidies or grants provided by a party or a state enterprise, including government-supported loans, guarantees and insurance."

D. Performance Requirements

Article 1106 prohibits imposition of trade related performance requirements by the Parties to the NAFTA. The important difference between FTA provisions³⁴⁰ on performance requirements and the NAFTA provisions³⁴¹ is that the latter applies not only to the investment of an investor of another Party, but also to that of non-Party to the agreement. As a result, Canada, Mexico and the U.S. will not be permitted to impose the trade related performance requirements³⁴² or enforce undertakings related to the "establishment", "acquisition", "expansion", "management", "conduct or operation of an investment" against Party or non-Party

³⁴⁰. *Supra* note 203, FTA, Article 1603.

³⁴¹. *Supra* note 244, NAFTA, Article 1106.

³⁴². *Ibid.* Article 1106 prohibits against imposition of the following requirements:

- (a) to export a given level or percentage of goods and services;
- (b) to achieve a given level or percentage of domestic content;
- (c) to purchase, use or accord a preference to goods produced or services provided in its territory, or to purchase goods or services from persons in its territory;
- (d) to relate in any way the volume or value of imports to the volume or value of exports or to the amount of foreign exchange inflows associated with such investment;
- (e) to restrict sales of goods or services in its territory that such investment produces or provides by relating such sales in any way to volume or value of its exports or foreign exchange earnings;
- (f) to transfer technology, a production process or other proprietary knowledge to a person in its territory, except when the requirement is imposed or the commitment or undertaking is enforced by a court, administrative tribunal or competition authority to remedy an alleged violation of competition laws or act in a manner not inconsistent with other provisions of this agreement; or
- (g) to act as exclusive suppliers of goods it produces or services it provides to a specific region or world market.

investors. For example, if Mexico is imposing requirements on foreign investors to export to prescribed level or percentage of goods and services. On NAFTA coming to effect, Mexico would be under an obligation not to impose such a requirement on the foreign investor, aside from investor from Canada and the U.S.

One of the traditional Canadian concerns regarding the excessive presence of foreign investment in Canada has been the technology transfer. The Gray report recommended "untying" investment packages to ensure that technology licenses were obtained³⁴³ and as consequence when the FIR Act was introduced, one of the criteria required in an investment to meet the "significant benefit to Canada" test was the effect of the acquisition or establishment on "technological development".³⁴⁴ In 1985, while liberalising its policies towards FDI, the Conservative government maintained the "technological development" criteria under the ICA to determine the "net benefit to Canada" test of any acquisition or establishment of new business in Canada.³⁴⁵ Under the FTA, restriction on the imposition of performance requirements were limited to only trade related requirements, which means that Investment Canada can obtain an undertaking from the U.S. investor with regard to local employment, technology transfer, research and development, improvements in productivity. There has been some change in the Canadian policy over

³⁴³. *Supra* note 38, Gray Report, Pg.440.

³⁴⁴ *Supra* note 8, FIR Act, Section 2(2).

³⁴⁵. *Supra* note 79, ICA, Section 20 (c) states: "For purpose of Section 21, the factors to be taken into account are:...(e) the effect of investment on productivity, industrial efficiency, technological development, product innovation and product variety in Canada."

technology transfer under the NAFTA. Investment Canada in connection with a review of an acquisition of an investment can only require or enforce only commitment or undertaking with regard "to technology transfer, a production process or other proprietary knowledge" to the affiliates of transferor in Canada.³⁴⁶

Neither Mexico nor the U.S. can impose technology transfer requirements unless the same is imposed or enforced by a local court, administrative tribunal or competition authority to remedy an alleged violation of the competition laws or to act in a manner not inconsistent with other provisions of the NAFTA. The objective of permitting performance requirements for technology transfer is that in merger cases, competition authorities may impose a restriction in allowing a merger to take place conditional upon transfer of certain technology or under the licensing arrangement to preserve competition within Canada, Mexico or the U.S.³⁴⁷

Article 1106(2) clarifies that if a Party to NAFTA imposes through a measure, requirement of certain technology to be used to fulfil the health, safety or environmental measures applied to investors or investment of investors of another Party in its territory, the same shall not be considered violation of obligation under

³⁴⁶. *Supra* note 244, NAFTA, Article 1106(1)(f) read with Annex I, Schedule of Canada, Para. 11 and 12, Pg. I-C-2. Paragraph 11 states: "Notwithstanding Article 1106(1), Canada may impose requirements, or enforce any commitment or undertaking in connection with the establishment, acquisition, expansion, conduct or operation of an investment of an investor of another Party or of a non-Party for the transfer of technology, production process or other proprietary knowledge to a national or enterprise, affiliated to the transferor, in Canada, in connection with the review of an acquisition of an investment under the Investment Canada Act."

³⁴⁷. *Supra* note 94, Competition Act, & the accompanying text.

Article 1106 (1)(f). Article 1106 (2) also further clarifies that this provision will operate according to application of Article 1102 (National Treatment) and Article 1103 (MFN Treatment) of the NAFTA.

Regardless of its reservation against 1106(1)(f) in the NAFTA, Canada may continue to require undertakings with respect to location of production, research and development, employment or training of local workers, construction or expansion of particular facilities in Canada by virtue of another reservation.³⁴⁸

Article 1106(5) further clarifies that the prohibition of trade related requirements set out in Para.1 and 3 of Article 1106 does not apply to any other requirements such as local employment, local production, research and development, improvements in productivity, training of workers.

Article 1106 (1)(C) also consolidates into binding obligation the GATT decision on the U.S action against Canada on mandatory local sourcing.³⁴⁹

Article 1106(3) is unique. It prohibits introduction of trade distorting subsidies

³⁴⁸. *Supra* note 244, NAFTA, Annex-I, Schedule of Canada, Pg. I-C-5, Para.12 states: "Except for requirements, commitments or undertaking relating to technology transfer as set out in paragraph 11, Article 1106 (1) shall apply to requirements, commitments or undertakings imposed or enforced under the Investment Canada Act, Article 1106 (1) shall not be construed to apply to any requirement, commitment or undertaking imposed or enforced in connection with a review under the Investment Canada Act, to locate production, carry out research and development, employ or train workers, or to construct or expand particular facilities in Canada."

³⁴⁹. *Supra* note 175, GATT Decision, & the accompanying text.

practices by a Party to the agreement.³⁵⁰ This is consistent with the underlying objective of entering the trilateral free trade agreement which is to exclude trade distortion. The words "receipt" or "receipt of an advantage" in Article 1106(3) should be read as synonymous with "subsidy" for easier understanding of the provision. A subsidy giving rise to trade distortion is prohibited under NAFTA.³⁵¹ Basically Article 1106(3) has been enshrined in the Investment Chapter to avoid the possible use of a "subsidy" as a tool to increase the inflow of investment, where the subsidy would have trade distorting effects and consequently undermine the concept of free trade-which is something basic to the agreement.

Article 1106(3) should not be understood as having prohibited subsidies as such. This is reflected in Paragraph 4 of the same article, which permits a Party to continue to subsidize investments according to any other legitimate economic criteria³⁵² which are not trade distorting and do not fall within the conditions set

350. *Supra* note 244, NAFTA, Article 1106(3) reads: "No Party may condition the receipt or continued receipt of an advantage, in connection with an investment in its territory of an investor of an Party or 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;
(c) to relate in any way the volume or value of imports to the volume or value of exports or to the amount of foreign exchange inflows associated with such investment; or
(d) to restrict sales of goods or services in its territory that such investment produces or provides by relating such sales in any way to the volume or value of its exports or foreign exchange earnings."

-- 351. For Example the Maquiladoras in the Mexico, where Mexico would grant tax credit of 50% for establishing an investment if it achieved a given level of domestic content or if it exported a certain percentage of its total production.

352. *Supra* note 244, NAFTA, Article 1106(4): "Nothing in Paragraph 3 shall be construed to prevent a Party from conditioning the receipt or continued receipt of an advantage, in connection with an investment in its territory of an investor of a Party or of a non-Party, on compliance with a requirement to locate production, provide a service, train or employ workers, construct or expand

out in Article 1106(3).

It is permissible under Article 1106(6) if not applied arbitrarily and unjustifiably by a Party, to adopt or maintain a measure pertaining to imposition of requirements of "domestic content" and preferential purchase of goods produced by producers within the territory of a Party (these are otherwise prohibited by Para.1(b) (c) & 3(a)(b) of Article 1106 because they are trade related performance requirements), if such measures pertain to securing compliance with the laws and regulations not inconsistent with provisions of NAFTA: to protect human life, animal and plant life; measures necessary for conservation of living and non-living exhaustible natural resources.³⁵³

Apart from maintaining its position on performance requirements, Canada has also made complete reservations and exceptions to Article 1106 and those under Annex-I include: automotive industry,³⁵⁴ crude petroleum and natural gas industries.³⁵⁵ Annex II exceptions to Article 1106 are: aboriginal affairs,³⁵⁶ minority

particular facilities, or carry out research and development, in its territory."

³⁵³. *Ibid.* Article 1106(6). Permissible environmental measures are stated:
"(a) necessary to secure compliance with laws and regulations that are not inconsistent with the provisions of this agreement;
(b) necessary to protect human, animal or plant life or health; or
(c) necessary for the conservation of living or non-living exhaustible natural resources."

³⁵⁴. *Ibid.* Annex-I, Schedule of Canada, Pg. I-C-17.

³⁵⁵. *Ibid.* Pg.I-C-25 & I-C-28.

³⁵⁶. *Ibid.* Annex II, Schedule of Canada, Pg. II-C-1.

affairs³⁵⁷ and water transportation.³⁵⁸ Subsidies may continue to be used in these areas.

³⁵⁷. *Ibid.* Pg. II-C-8.

³⁵⁸. *Ibid.* Pg. II-C-11 and II-C-13.

E. Senior Management and Board of Directors

It was early as 1957 that the Gordon report recommended that;"more Canadians in top management and technical positions could influence purchasing" and "more representations of Canadians on Board of Directors".³⁵⁹ One of the recommendations of the Watkins report included "that Canadian participation be ensured in the decision making process of multinational enterprise.....".³⁶⁰ Similar recommendations were also made in the Gray report.³⁶¹ This recommendation of the Gray report was later translated into the FIR Act.³⁶² However, by 1978, observers noted that Canadian ownership and control had lost its priority.³⁶³ Nevertheless the MacDonald report recommended against restrictions on importing "managerial know-how";³⁶⁴ yet in 1985, when ICA was enacted, Canada maintained the criteria under the FIR Act, in the review process to determine "net benefit to Canada"

³⁵⁹. *Supra* note 11, Gordon report, Pg. 392.

³⁶⁰. *Supra* note 25, Watkins Report, Pgs. 411-413.

³⁶¹. *Supra* note 38, Gray report, Pgs. 453-54.

³⁶². *Supra* note 8, FIR Act, Section 2(2). This section provides as one of the criteria for determining "significant benefit to Canada": "the degree and significance of the participation by Canadians in the business enterprise.....".

³⁶³. "Cabinet is More Willing to Sell Businesses to Foreigners:Survey" Toronto Star, July 22, 1978, Pg.A.1. The survey exclaimed:".....the classic Canadian trade-off:Canadian control can be fostered by restricting foreign access-but at a cost of higher prices and few jobs in the short run, can be fostered-at the cost of permitting foreign investment."

³⁶⁴. *Supra* note 68, MacDonald report, Pg. 235.

test.³⁶⁵ The Canada Business Corporation Act and almost all provincial companies legislation require that a majority of a Corporation's directors be Canadian residents.³⁶⁶

This traditional Canadian policy continues in both letter and spirit in Article 1107 of the NAFTA. Article 1107 provides that no Party may require that an enterprise of that Party may require an investment of the investors of another Party to appoint in senior management positions individuals of any particular nationality.³⁶⁷ But a Party may:

"require that a majority of the board of directors, of an enterprise of that Party that is an investment of an investor of another Party, be of a particular nationality, or resident in the territory of the Party, provided that the requirement does not materially impair the ability of the investor to exercise control over its investment."³⁶⁸

One may however argue how important it is that directors of a subsidiary of foreign parent be Canadian? Many large companies are effectively controlled by their management, not by their own directors. To withstand against criticism from Canadian nationalists, who may still believe that Canadian owners or managers will be more responsive to Canadian needs and policies and to conform to current

³⁶⁵. *Supra* note 79, ICA, Section 20.

³⁶⁶. Canada Business Corporations Act R.S.C. 1985, c. C44, as Amended, s. 105(3).

³⁶⁷. *Supra* note 244, NAFTA, Article 1107(1).

³⁶⁸. *Ibid.* Article 1107(2).

Canadian requirements, the Canadian team at the NAFTA negotiations also sought to carve out various reservations and exceptions to Article 1107.³⁶⁹ For example in the air transportation sector, the Aeronautics Act,³⁷⁰ and its regulations, require that a Canadian air carrier be only eligible for registration as an aircraft in Canada, if among other requirements having met, the chief executive officer and no fewer than two-thirds of its directors are Canadian citizens or permanent residents and not less than 75% of its voting share owned and controlled by Canadians. It is for this reason that Canada has made reservations in the air transportation sector against Article 1107 of the NAFTA.³⁷¹

F. Miscellaneous Provisions

a. Transfers

Article 1109 of NAFTA provides for free transfer of all profits, proceeds of sales, capital gains etc.,³⁷² in a freely usable currency.³⁷³ However Parties to NAFTA

^{369.} *Ibid.* Annex I, Schedule of Canada, Following reservations were made under Investment Canada Act (Pg. I-C-2 and I-C-7); Canada Business Corporations Act, R.S.C. c.C 44 (Pg. I-C-10); Business Service Industries like Customs Brokerage and Brokers (Pg. I-C-18); Air Transportation (Pg. I-C-32 and I-C-34). Under Annex II, Schedule of Canada in the: Aboriginal Affairs (Pg. II-C-1); Telecommunication Transport Networks and Services (Pg. II-C-3); Minority Affairs (Pg. II-C-8); Social Services (Pg. II-C-9); Non-Scheduled Air Transportation, Speciality, Industry (Pg. II-V-10) and Water Transportation (Pg. II-C-11 and II-C-13).

^{370.} R.S.C. 1985, c.A-2.

^{371.} *Supra* note 244, NAFTA, Annex-I, Schedule of Canada, Pg. I-C-32 to I-C-33.

^{372.} *Ibid.* Article 1109.

^{373.} *Ibid.* Article 1109(2).

may prevent a transfer through "equitable, non-discriminatory and good faith application of laws" if it relates to protection of creditors rights, bankruptcy, criminal or penal offenses.³⁷⁴ Similar obligation exists under Article 1606 of the FTA.³⁷⁵

b. Expropriation and Compensation

The expropriation and compensation provisions under NAFTA provide for protection against any overt or covert attempts made to nationalize or expropriate an investment of an investor of a Party except for a public purpose; on a non-discriminatory basis; in accordance with due process of law.³⁷⁶ The expropriation and compensation provisions also provides for the "fair market value" to be paid to the claimant. Since compensation under NAFTA is to be paid without delay and is fully realizable, it meets the traditional customary law standard of "full compensation" and vindicates the assertion of the rest of the developed world for "prompt, adequate and effective" compensation.³⁷⁷ The expropriation and compensation clauses reflect the already accepted position of Canada on this issue under the FTA.³⁷⁸

³⁷⁴. *Ibid.* Article 1109(4).

³⁷⁵. *Supra* note 9, FTA, Article 1606(1) & (2).

³⁷⁶ *Supra* note 244, NAFTA, Art. 1110(1), Pg. 11-8.

³⁷⁷. *Supra* note 210, FTA, Article 1605.

³⁷⁸. *Ibid.*

4. Analysis of the NAFTA Investment Provisions

"Let us look at what is wrong with the agreement [NAFTA]. It is obviously a good deal for the multinationals, companies that are not interested in sovereignty, that are not interested in the borders, but will flow back and forth everywhere in the world wherever they can get the best bang for their buck, wherever they can make the most money for their corporate friends and for individuals they represent. What is bad about this deal is that it does not protect small business and it does not protect workers. It does not protect the sovereignty of Canada."³⁷⁹

Certainly the objectives, however noble, of any international arrangement must be the harmonious economic well-being of all Parties involved in the negotiations of such agreement. But it is equally significant to determine that whatever concessions Canada has made in the negotiations, are balanced against the overall economic gains to Canadians. One difference between the NAFTA and the FTA is the absence of a MFN treatment clause in the FTA. The FTA grand fathered provisions under Annex 1607.3 and the existing policies precluding any change in the review process in uranium mining and oil and gas industries. Sensitive industries like banking, telecommunication, publishing, broadcasting and energy which were also excluded from the national treatment under the FTA are also excluded under NAFTA.

NAFTA, Annex-IV also provides four sectors³⁸⁰ with respect to which if any future international agreement is entered into by Canada, it can derogate from the MFN treatment. Annex-IV also provides that with respect to state measures not

³⁷⁹. Mr. Robert D. Nault, Debates of House of Commons, 25 May 1993, 34th Parl., 3rd Session, Vol.132.

³⁸⁰. *Supra* note 244, NAFTA, Annex-IV, Schedule of Canada, Aviation; fisheries; maritime matters, including salvage; telecommunications transport networks and telecommunications transport services. This exception does not apply to measures covered by chapter Thirteen (Telecommunication).

mentioned in Annex-I pursuant to Article 1108(2),³⁸¹ Canada takes reservation from Article 1103 (MFN treatment) for any international agreement signed within two years of entry into force of the NAFTA.

A. Review by Investment Canada

Any review process undertaken by Investment Canada is not subject to the dispute settlement mechanism set out in Section-B of the NAFTA.³⁸² This clearly is the achievement for the Canadian negotiating team because otherwise the acquisition of big businesses in Canada by the U.S. and the Mexican investors would have led to a challenge under Section-B of Chapter Eleven on frivolous or more technical issues related with the review process in Canada.³⁸³ This leaves complete

³⁸¹. *Supra* Note, NAFTA, Article 1108 (2) reads "Each Party may set out in its Schedule to Annex I, within two years of the date of entry into force of this agreement, any existing non-conforming measure maintained by the state or province, not including a local government."

³⁸². *Supra* note 244, NAFTA, Chapter Eleven, Section-B, Articles 1115 to 1138 deals with settlement of disputes between a Party and the investor of another Party. Article 1138:Exclusions:

1. Without prejudice to the applicability or non-applicability of the dispute settlement provisions of this section or chapter Twenty (institutional Arrangements and Dispute Settlement Procedures) to other actions taken by a Party pursuant to Article 2102 (National Security), a decision by a Party to prohibit or restrict the acquisition of an investment in its territory by an investor of another Party, or its investment, pursuant to that article shall not be subject to such provisions.
2. The dispute settlement provisions of this section and of Chapter Twenty shall not apply to matters referred to in Annex 1138.2.

³⁸³. *Supra* note 244, NAFTA, Chapter 11, Section-B, Annex 1138.2:Exclusions From Dispute Settlement, it states: "A decision by Canada following review under the Investment Canada Act, with respect to whether or not permit an acquisition that is subject to review, shall not be subject to the dispute settlement provisions of Section b or of Chapter Twenty (Institutional Arrangements and Dispute Settlement Procedures). This exemption is also in case of review made by National Commission on Foreign Investment (Mexico) with its new thresholds as set out in Annex I, Schedule of Mexico, Pg.I

discretion with Investment Canada to determine whether a particular acquisition meets the "net benefit to Canada" test. The authority of Investment Canada has certainly been limited because of the total exclusion of indirect acquisitions of Canadian businesses by U.S or Mexican enterprises. Review of indirect investments is completely excluded under Para.10 of Annex I of Schedule of Canada³⁸⁴. But the thresholds of review of direct acquisition which were increased to \$ 150 million in the FTA remain unchanged. But neither the review threshold of \$150 million for direct acquisitions nor the revision of the thresholds on an yearly basis after 1994 will apply to sensitive sectors like: uranium production and ownership of uranium producing properties; oil and gas³⁸⁵; financial services; transportation services; and

M-4.

³⁸⁴. *Supra* note 244, NAFTA, Annex-I, Schedule of Canada, Pg. I-C-6.

³⁸⁵. Investment Canada Act has recently been amended. According to Investment Canada Act, 1993, S.C.35, Assented on 23 June 1993 (Bill C-89), Section 14.1(8)(a) now reads as following:

"This section does not apply in respect of an investment to acquire control of a Canadian business that:

- (a) *Engages in the development or production of oil or natural gas and owns an interest in proven reserves of oil or natural gas in Canada;*
- (b) engages in the production of uranium and owns an interest in a uranium producing property in Canada;
- (c) provides any financial service;
- (d) provides any transportation service;
- (e) is a cultural service."

The part of the provision in Italics has been repealed by the amendment act. Also see, NAFTA Implementation Act, 1993, C.44, Section 178(6). As a result of this amendment oil and gas stands liberalised to foreign investment.

cultural businesses.³⁸⁶ As a result FTA position is altered to the extent that only the review of direct acquisition worth \$150 million or more remains intact (subject to phase out) and requirements of minimum domestic ownership and performance requirements can still be obtained from American and Mexican investors and their investments by Investment Canada.

The rationale given by Investment Canada of dropping review of indirect acquisition of control, is that since such large takeovers would take place outside Canada review by Investment Canada would give extraterritorial effect to Canadian law. It is also argued by Investment Canada that the Canadian share in these large corporations being minimal, the exercise of reviewing such non-Canadian investments is futile.³⁸⁷ But an important rider of dropping this threshold is that an indirect acquisitions of a Canadian business with assets worth \$150 million, where more than 50% of the value of the assets of all entities the control of which is being acquired either directly or indirectly, will still be subject to review by Investment Canada.³⁸⁸

Canadian government has lately unveiled its policy objectives in the

³⁸⁶. *Supra* note 244, NAFTA, Annex-I, Schedule of Canada, Pg. I-C-4, Para.8.

³⁸⁷. Conversation with Ms. Emmy Verdun, Director of Policy, Investment Canada,(Ottawa, Canada: 12 July 1993).

³⁸⁸. *Supra* note 79, ICA, Section 14(1)(c).

Canadian magazine industry to further strengthen the cultural industry.³⁸⁹ A notification to Investment Canada under section 12 of the ICA is required if a non-Canadian³⁹⁰ wishes to establish a new business.³⁹¹ Under the new policy, expansion of existing foreign magazine publishing enterprises, would be treated as a new investment, rather than an extension of an existing business. This would subject the existing non-Canadian enterprises engaged in magazine publishing in Canada, to undergo the ICA review process to demonstrate its "net benefit to Canada".³⁹²

One may also argue that once Canada agreed to the "preferential access" to the U.S. investors (largest single nationality group of investors in Canada) under the FTA there is no reason why it could not enter into a trilateral agreement with Mexico as a third party and provide the same treatment to the Mexicans with no fear of Canadian businesses being swallowed up by Mexican investors. Therefore it was an effective strategy employed by the Canadian negotiators to start on a defensive note, sticking to the thresholds already in place under the FTA and not going

³⁸⁹. *Ibid.* Section 14.1(9).

³⁹⁰. *Ibid.* Section 3 defines "non-Canadian" to mean "an individual, government or an agency thereof or an entity that is not a Canadian."

³⁹¹. *Ibid.* Section defines "new Canadian business" as: "new Canadian business, in relation to a non-Canadian, means a business that is not already being carried on in Canada by the non-Canadian and that, at the time of its establishment,

(a) is unrelated to any other business being carried on in Canada by that non-Canadian, or
(b) is related to another business being carried on in Canada by that non-Canadian but falls within a prescribed specific type of business activity that, in the opinion of the Governor-in-Council, is related to Canada's cultural heritage or national identity."

³⁹². Richard Siklos, "Ottawa Moves To Bar Canadian Titles", *The Financial Post*, 20 July 1993, Pg.3. Also see, William Watson, "Politics Illustrated:Tories's Magazine Decision" *The Financial Post*, 23 July 1993, Pg.11.

overboard in the process.

B. Investment Impetus After The FTA

The impact of FTA seems to be emerging in terms of investment. Corporations like Dow Chemicals Company Inc.,³⁹³ Ford Motor Company,³⁹⁴ American Telephone and Telegraph Company (AT&T),³⁹⁵ Kraft General Foods Canada Inc.,³⁹⁶ Union Carbide Canada Ltd,³⁹⁷ Pratt & Whitney Canada Inc.,³⁹⁸ propose to invest in projects worth billions of dollars in Canada, create more jobs and introduce modern technological means to upgrade their existing facilities in Canada. One of the significant factor in making Canada their choice as a host

³⁹³. Investing in Canada, A Newsletter on Canada's Investment Climate, Vol.6, No.1, Summer 1992, Pg.7. Dow Chemical invested \$ 800 million in Alberta. The project consists of the construction of a fractionation plant and related underground storage facilities to supply raw material for a new world scale ethylene facility. At the same time, Dow plans to double the size of its polyethylene plant on the existing site. The expanded facility will export half of its production, primarily to the U.S. and the Pacific Rim. The implementation of the FTA played a major role in convincing the company to proceed with the project.

³⁹⁴. *Ibid.* Ford is proposing to invest \$ 800 million in the project to manufacture a new generation of Cars and engines.

³⁹⁵. *Ibid.*

³⁹⁶. *Ibid.* Kraft proposes to invest \$74 million in capital project and expand plants in Ontario & Quebec. The company stated that one of the reasons it is making this investment is because of the FTA.

³⁹⁷. *Ibid.* Union Carbide will invest some \$ 200 million by 1994 and modernize its existing manufacturing facility in Montreal.

³⁹⁸. *Ibid.* Pratt & Whitney (aircraft manufacturers) proposes to invest \$ 346 million to build two plants in Quebec and another in Alberta. Both plants combined will employ up to 100 workers.

country for investments has been the FTA.³⁹⁹ The proposed new investment in Canada introduces fresh capital in economy aside from new technology,⁴⁰⁰ more jobs and manufacturing skills in high-tech industries, for example manufacture of communications equipment in Canada by AT&T will create 50 new jobs.⁴⁰¹

Both in 1990 and in 1991, gross international investment flow into Canada were approximately Can.\$ 9 billion. In 1990, Canada enjoyed a net flow of direct investment of Can.\$ 6.6 billion. In 1991, the net inflow was Can. \$ 5.9 billion, despite the slow down in the international economy. Since mid-1980s, the U.S. investment in Canada has increased from Can.\$ 58 billion to Can.\$ 83.7 billion. Of this growth, some Can.\$ 12 billion or 57% has been financed by the reinvestment of profits and some Can.\$ 10 billion has come from new capital inflows.⁴⁰²

To advance the argument about the growing optimism among foreign investors to invest in Canada after the FTA, one may look at the increases in capital

³⁹⁹. *Ibid.* Pg.6, The newsletter states: "The above decisions by global and U.S. companies are a measure of the confidence business decision makers have in Canada. One of the objectives of the government in entering into the FTA three years ago was to provide decision makers with greater certainty and predictability when choosing Canada as an investment site. The above numbers are a good indication of their responses".

⁴⁰⁰. John Knubley, Foreign Investment & Technology, Investing in Canada, Vol.4, No.3, Winter 1990, Pg. 5. According to Knubley:"As a small country, Canada is undoubtedly a large net beneficiary from foreign direct investment and it will likely to remain so. Canada can benefit from productivity gains arising out of the acquisition process and from so called R&D spill-overs that are transferred through foreign affiliates to Canadian industries"

⁴⁰¹. *Supra* note 392. Pg.7.

⁴⁰². *Supra* note 392, Historical Statistics. Also see, *supra* note 13.

expenditures over one single year after the FTA was introduced. Canadian manufacturers increased their capital expenditure from Can.\$ 17.7 billion in 1988 to Can.\$ 20.3 billion in 1989, an increase of 14.7%. Much of this spending increase is for plant and equipment, indicating businesses confidence in the future, and their recognition that improved productivity is necessary to compete in American and overseas markets.⁴⁰³

The aforementioned figures suggest a trend towards enhanced investment climate as a result of the NAFTA.

C. Technology Transfer

Canada's ability to require commitments with regard to technology transfer from investor from the U.S. and Mexico⁴⁰⁴ is expected to enhance its technology base. This is significant because existing level of technological activity and development by large Canadian controlled firms is much lower (11%) than that performed by non-Canadian controlled large firms (16.9%) in Canada. Of the 16.9% of the Canadian technological activities undertaken by foreign controlled firms,

⁴⁰³. Geoff Nimmo, "Investment Barometer", Investing in Canada, Vol.4, No.3, Winter 1990, Pg.6.

⁴⁰⁴. *Supra* note, NAFTA, Article 1106(1)(f) read with Annex-I, Schedule of Canada, Pg. I-C-2, Para.11 & 12.

14.2% were from the U.S and 2.6% from the U.K.⁴⁰⁵

According to Chris Bresson; Centre for Research on the Development of Industry and Technology, University of Quebec, Montreal:

"Entry of foreign subsidiaries at an early stage of the technological cycle offers better chances for success than at a later stage when the technology is relatively standardized. It took 40 to 50 years for a Canadian aircraft industry to consolidate itself. We are only reaping the benefits from foreign subsidiaries coming to the country in the 1920s."⁴⁰⁶

Quote suggests that the consistent Canadian policy to seek technology transfer performance requirements has resulted in establishing a technology base in Canada. Since, FDI continues to be major source of technology transfer,⁴⁰⁷ Canadian negotiators success in carving out an exception on technology transfer, without yielding similar commitments to Mexico and the U.S. is likely to result in developing high-tech enterprises in Canada.⁴⁰⁸

405. Pari Patel & Keith Pavitt, "The limited Importance of Large Firms in Canadian Technological Activities" in D. McFetridge, *Foreign Investment, Technology and Economic Growth* (Calgary:University of Calgary Press, 1991) Pgs. 79-84.

406. *Supra* note 400, Investing in Canada, Pg.5.

407. *Supra* note 405, D.McFetridge, Pg.364. Richard G.Lipsey describes:"Within any TNC, there is a continual flow of technology transfers, through the five mechanisms listed by Blomstrom:documentation, education and training, exchanges of technical personnel, development and transfer of specialized equipment, and trouble shooting.....TNCs provide the main channel of international technology transfer, portfolio investment and other arm's length relations (such as licensing) are not good substitute for FDI.....the more modern and complex the technology, the less likely it is for TNCs to accept any arrangements other than wholly owned subsidiaries."

408. Investment Canada, 1993-94 Estimates, Part III, Expenditure Plan, Investment Canada argues:"International investment has become a major force of globalization, and indispensable to trade expansion and technology transfer. International investment flows grew three times faster than trade flows between 1985-90. Research conducted by domestic and international investment typically makes

D. Canada-Mexico Nexus and Impact on Trade and Investment

President Salinas of Mexico, unlike previous governments of Mexico, was betting on the gains from free trade to give to his country much needed economic growth. A number of state-run industries have been privatised. Anticipating strong demands from other Parties to NAFTA, Mexico initiated selective changes to its foreign investment regulations,⁴⁰⁹ but kept in place restrictions on the activities of foreign investors in important industries in the manufacturing sector.⁴¹⁰ Nevertheless companies such as Canada's Spar Aerospace Ltd., which sells communications system, have promoted the benefits of doing business in Mexico. Other Canadian corporations appear equally impressed.⁴¹¹

to productivity performance and overall competitiveness. The benefits to Canada include market access, technology transfers and international management expertise."

⁴⁰⁹. Even though sectors remain restricted, noteworthy liberalization has taken place in:

- (a) in the telecommunications sector (formerly reserved exclusively to state), foreign investment is now allowed up to 49%;
- (b) in the petrochemical sector, 14 petrochemicals have been reclassified from "basic" (reserved exclusively to the state) to "secondary" (minority foreign participation permitted); 539 petrochemicals have been reclassified from "secondary" to "tertiary" (open to 100% foreign participation);
- (c) in the insurance industry the permissible level of foreign investment has been raised from 15% to 49%;
- (d) in the banking sector, it remains closed to major foreign control, but permissible limit of foreign participation is fixed at 30%;
- (e) in the mining sector, (formerly reserved exclusively for the Mexicans by virtue of Article 27), one million of the three million hectares of land reserved to state are now open to foreign exploitation and development. 100% temporary foreign ownership is allowed in those mining and minerals industries where previous permissible foreign investment was 49%.

⁴¹⁰ UNCTC, Foreign Direct Investment and Industrial Restructuring in Mexico, U.N.Doc.ST/CTC/SERA/18 UNCTC Current Studies (1992).

⁴¹¹. "The opportunities are boundless", says Doug Clark, General Manager of Northern Telecom's Mexican Operations. Christian Allard, "Mexico for Sale: Gringo's Welcome", Canadian Business, Toronto, November 1990, Pg.74. Also see: "Bombardier Wins Mexican Contract" The Globe and Mail, July 9, 1993, Pg.B2.

Considering Mexican reservations to MFN treatment being considerably few,⁴¹² Canadian investors have an opportunity to invest in telecommunications,⁴¹³ construction industry,⁴¹⁴ agriculture, livestock, forestry and lumber activities,⁴¹⁵ auto parts industry⁴¹⁶ and extraction and exploitation of certain classified minerals.⁴¹⁷ Considering the liberalisation in these sectors coupled with binding commitment from Mexico over expropriation of foreign property under NAFTA is expected to generate confidence and opportunity⁴¹⁸ amongst Canadian and the U.S. investors to invest in Mexico.

One concern which is put forward by the critics of NAFTA is an anticipated

⁴¹². *Supra* note 344, NAFTA, MFN Reservations (Mexican).

⁴¹³ *Supra* notes 280 & 283, NAFTA, Pgs.I-M-8 & I-M-18.

⁴¹⁴. *Supra* note 285, NAFTA, Pg. I-M-21.

⁴¹⁵. *Supra* note 244, NAFTA, Pg.I-M-9.

⁴¹⁶ *Supra* note 291, NAFTA, Pg.I-M-31.

⁴¹⁷. *Supra* note 293, NAFTA, Pg. I-M-40.

⁴¹⁸ According to a study conducted to determine economic implications of NAFTA on Canada: "Investment requirements to bring the Mexican economy to North American standards will be huge, owing to the present low level of capitalization in Mexico: its ratio of capital to labour is only one-fifth of the Canadian and the U.S. levels. This implies that Mexico will have to import large amounts of capital goods from both the U.S. and Canada. This would lead to potentially large current account deficits for Mexico and corresponding surpluses for Canada and the U.S. In addition, since Mexico now has higher tariffs than Canada, the elimination of these tariffs under NAFTA will increase Canada's competitive edge. Thus, contrary to the concerns of many critics of NAFTA, the increase in exports will outpace the increase in Canada's imports from Mexico. Canada would participate in the development of Mexico by exporting capital goods, technology and know-how that Mexico need to upgrade its production facilities, and thus benefit further from an increasing Mexican living standard." The North American Free Trade Agreement, An Economic Assessment from a Canadian Perspective, Publication of Department of Finance, Ottawa, Canada, (November 1992).

displacement of manufacturing plants resulting in direct job losses in Canada or future trend toward investing in Mexico at the cost of cutting into Canadian share of international investment. One may argue that Canada continues to be attractive place because of its skilled labour; its relatively "good" treatment of foreign investors in the past compared to Mexico; availability of capital, technology and management and general infrastructure already in place.⁴¹⁹ It is hard to believe that industry based on natural resources will be displaced and an important rider is that most of this industry is either Canadian owned or is in form of crown corporations especially in the mining sector: uranium production; transportation; oil and gas; water transportation; financial services; broadcasting and cable; agriculture.⁴²⁰

Responding to a question whether displacement in inflow of foreign investment in Canada is likely to be due to NAFTA, Ms Susan Bincolletto, International Economic Relations Division, Department of Finance, Ottawa, Canada replied:

"Investment policy is not the only reason why you would invest there [Mexico]. You will have to look at the political environment. Are wages really big determinant in deciding where to invest! you could say the same on environment standard and lack of enforcement..... but to what extent does that factor really effect the decision..... are they not more interested in other factors such as just political stability, exchange rate, interest rate, tax, there are many macro-economic issues

⁴¹⁹. "Mexico-Canada: Forging A New Relationship", Secretariat of Trade, Commerce and Industrial Development, Embassy of Mexico, (Ottawa, Canada: March 1993). Mexico wishes to attract foreign capital because it has no capital base, whereas due to general financial infrastructure already in place in Canada, its ability to provide financial assistance to foreign businesses makes Canada a attractive place to invest.

⁴²⁰. *Supra* note 216, "The Top 1000: The Definitive Report on Corporate Canada", Pgs.113-136.

that are important and that effect the location decision of the multinationals...."⁴²¹

According to Geoff Nimmo, Senior Policy Analyst, Investment Research and Policy Division, Investment Canada:

"low wages are only one of the factors that a company considers when making a locational decision. Factors that are equally important are the economy's overall efficiency, the educational level of the labour force, the quality of management, the efficiency of the transportation system, and the political stability. Canada become an attractive location when these factors are entered into the equation since it offers skilled labour force, a highly competent and motivated managerial class, a moderate economic structure, an efficient financial system and a political stable environment."⁴²²

Considering the mandate of Investment Canada⁴²³ and outward looking policy of Canada.⁴²⁴ Since 1985, NAFTA must be viewed as an opportunity for

⁴²¹. Recorded Conversation with Ms. Susan Bincolletto, International Economic Relations Division, Department of Finance, Ottawa, Canada, 29 June 1993.

⁴²². Geoff Nimmo, "Canada-U.S.A.-Mexico: A new FTA?" in Investing in Canada, A Newsletter on Canada's Investment Climate, Vol.4, No.3, Winter 1990, Pg.3.

⁴²³. *Supra* note 77, Statement of Sinclair Stevens then Minister of Regional Industrial Expansion presenting Investment Canada Bill in the Parliament, Chapter. Two.

⁴²⁴. House of Commons Debates, 29th Parliament, 1st Session, 3 April 1973, Pgs. 2920-2921. Statement of Mr. Sinclair Stevens who introduced ICA in 1985, but had opposed FIRA legislation on the grounds that it was negative nationalism said:

"To summarize, most Canadians are in favour of economic nationalism, but the question is: what is economic nationalism? to some, it is the taking of positive economic steps to strengthen Canada's position at home and abroad, and that is Progressive Conservative policy. To others, it is the welcoming of foreign or Canadian investment funds and technology to achieve these ends with proper safeguards to protect Canadian industry. To others, however, economic nationalism means being insular and defensive in outlook. They would tend to discourage or restrict the investment of foreign funds and technology, even if it meant a lowering of the standard of living of average Canadian. There are therefore, positive nationalists and negative nationalist.....I believe we in Canada are capable of it if given the leadership. Canada historically has been an internationally oriented country. We have done well with such orientation. we can do

Canadian investors to invest in Mexico, now that legal protection will be in place to minimize any future political risks in Mexico. In a recently published Mexican report on Canadian-Mexican relationship describes opportunities for Canadian investor in sectors like: agriculture, forestry, mining, aerospace and defence electronics industries, automotive, chemicals, pharmaceutical and plastics, information technologies, energy and energy related industrial equipment, financial services, industrial equipment because of Canada's strong technological base.⁴²⁵

Considering the various factors mentioned in this section, one may say that Canada has successfully pursued its investment policy. While arresting trends of depleting investment flows to Canada.⁴²⁶ Canada has created opportunities (under the FTA/NAFTA) to allow its investors to invest abroad.⁴²⁷ In pursuance to such efforts, Canada has under NAFTA and earlier under the FTA, been successful to protect Canadian ownership in the key sectors like the transportation, uranium mining, financial services, cultural enterprise and fisheries.

Also the outward looking approach imbibed in the ICA has the potential to be

better. Multi-nationalism is an integral part of our past success and an essential ingredient for our future success in achieving a rising standard of living..... Canada could become a pioneer in the frontiers of business".

⁴²⁵. *Supra* note 419. "Mexico-Canada: Forging a New Relationship", Pgs.35-40. The report also gives detailed sectoral trade flows between various provinces in Canada and Mexico.

⁴²⁶. *Supra* note 68, MacDonald Report, Pg.233. FDI in Canada in 1985 was Can.\$ 87.2 billion. In 1990 it was Can.\$ 125.3 billion.

⁴²⁷. Canadian direct investment increased from Can.\$54.1 billion to Can.\$ 86.7 billion in 1990.

used to the optimum in the NAFTA. The opportunity to invigorate the Canadian economy with Canadian businesses competing in the Mexican markets may also turn the prophetic words of Larry Schneider into a concrete reality for Canada:

"I think that with the inclusion of Mexico and the elimination of these non-truths I have highlighted from the debate we will find that Mexico to NAFTA is quite a bit like Portugal was to the European Economic Community. Portugal was deemed to be a backward country from a technological point of view. What did the rest of the European Economic Community have to gain? They gained the evolution and development of an economy of a country that is now contributing towards consumerism in the European Economic Community. The contribution of the Mexican people and economy will do the same thing for as Mexico becomes a stronger trading partner its expectation for a higher standard of living will grow and that in turn will make its people better consumers."⁴²⁸

⁴²⁸. House of Commons, 34th Parliament, 3rd Session, Vol 132, n 254 B, 25 May 1993, Pg. 19705.

Investor-State Dispute Settlement

1. General

As Canada sought policy changes to attract foreign investors in order to boost inflow of FDI, it must be realised that the changes to the structure and operation of the global economy, particularly the cross-border role of TNCs has given rise to a number of new international investment issues that are not amenable to the traditional methods of solving disputes. One such issue is the resolution of investment disputes between a foreign investor and the host state. A central issue with regard to investment disputes between a state and an investor is the inequality between the legal powers and personality of the parties to investment agreements, under the international law. Therefore, recourse to international or transnational arbitration, beyond the interference of the courts of a host state, increases the confidence⁴²⁹ and security of the investor. Thus investor-state dispute settlement by international arbitration is often perceived as a necessary concomitant to the long term foreign investments involving parties with different interests and legal powers.⁴³⁰

⁴²⁹ Chong Su Yun, "The Convention on the Settlement of Investment Disputes-Commentary and Forecast" (1969) 11 *Malaya Law Review* 287, Pg.289.

⁴³⁰ Report of the Executive Directors on the Convention on the Settlement of Investment Disputes Between States and Nationals of other States, 18 March 1965, Para. 13, reproduced in Documents Concerning the Origins and Formulation of the Convention. Vol. 2, Part 2, Pg.1069.

The purpose of this chapter is to determine the policy issues pertaining to investor-state dispute settlement mechanism, particularly in Canada, Mexico and the U.S. An attempt will be made to state the policy of each contracting Party to NAFTA to understand how far they have come about on this issue with signing of the NAFTA. Although, the focus of this chapter is limited to examining the policy initiatives, an endeavour is made to describe briefly the operation of dispute settlement mechanism under NAFTA.

Arbitration has acquired increasing significance in the settlement of international investment disputes. A number of reasons contribute to this: the efficacy of arbitration, its confidentiality, the expertise involved, and the means for resolving those disputes, which are a source of political confrontation between states.⁴³¹ However, arbitration is frequently seen as a rather delicate political matter and recourse thereto has met with some reluctance on the part of states. In early 1970s countries like Mexico asserted their right to exercise overriding control over foreign investment and emphasized the role of their own municipal courts consistent with long standing Calvo Doctrine.⁴³² Such an emphasis seems less

⁴³¹. Libyan expropriation of the American owned oil companies and the Iranian nationalisation of crude oil and petroleum manufacturing industry which led to an extended political confrontation between the governments of the U.S and Iran until both agreed through Algiers declaration to set up jointly the Iran-U.S. Claims Tribunal. See generally, The Declaration of the Democratic and Popular Republic of Algeria (19 January 1981), reprinted in (1983) 1 Iran-U.S. CTR, at Pg. 3; The Declaration of the Government of the Democratic and Popular Republic of Algeria Concerning the Settlement of Claims by the Government of the United States of America and the Government of the Islamic Republic of Iran (19 January 1981), reprinted in (1983) 1 Iran-U.S. CTR, Pg. 9.

⁴³². UNGA. Res. 3201, (S-VI) of 1 May 1974, Declaration on the Establishment of a New International Economic Order, Sec. 4(e)(g), reproduced in (1974) 13 International Legal Material 715 and Res, 3281(XXIX) of 12th December 1974, The Charter of the Economic rights and Duties of States,

prevalent today. This is, at least partly, due to the fact that the refusal to submit to investor-state arbitration may discourage much needed foreign investment. This, in case of Canada, has not been true, but then in case of Canada the issue of expropriations or nationalizations never arose as it did in most developing countries.

The Secretary General of the United Nations in his Report of July 7, 1983 stated:

"Arbitration is the prevalent mode for the settlement of the disputes that inevitably arise. Its function is to motivate the parties to reach an agreement among themselves in order to avoid the intervention of third parties and, eventually to provide a neutral forum for settling and deciding disputes. Major petroleum producers have successfully insisted on the jurisdiction of their national courts. similar policies are adhered to in most Latin American countries. In other countries, arbitration, either under the auspices of the international Chamber of Commerce (ICC) or the World Bank's International Centre for the Settlement of Investment Disputes(ICSID), is the rule."

2. Perspectives of NAFTA Parties on Investor-State Dispute Settlement Mechanism

A. The Mexican Position

Perhaps before going to the Mexican position on the investor-state dispute resolution one may look into the Calvo doctrine which has been the traditional position of the Latin American countries including Mexico. The Calvo Doctrine is that no state may intervene, diplomatically or otherwise, against another sovereign to enforce its citizens private pecuniary claims. It is usually embodied in a contractual stipulation by which an alien, corporate or private, agrees to obligate to local law by renouncing the right to call upon its government for protection in all matters arising out of a contract. This form of contractual renunciation of diplomatic protection is known as a "Calvo Clause".⁴³³

The Mexican Constitution mandated the exclusion of diplomatic protection under Article 27. Article 27, dealing with land and property ownership, is the most important constitutional provision for foreign investors in Mexico. All land, water, and other natural resources found in Mexican territory are the original property of the Mexican state;⁴³⁴ Accordingly, all minerals and other resources may be exploited

⁴³³. Calvo doctrine comes after the name of Argentinean diplomat and jurist Carlos Calvo (1824-1906). See generally, Alden F. Abbot "Latin America and International Arbitration Conventions: The quandary of Non-Ratification", (1978) 17 Harvard International Law Journal 131; James C. Baker and Lois J. Yoder "ICSID and the Calvo Clause: a Hindrance to Foreign Direct Investment in LDC's" (1989) 5 Ohio State Journal on Dispute Resolution 75.

⁴³⁴. *Supra* note 106, Constitution of Mexico, Article 27, Para. 3, 4, 5.

only with a concession from the federal executive branch of Mexico.⁴³⁵ These concessions can be issued only to Mexican individuals, companies incorporated under the laws of Mexico, or foreigners who consent to the Calvo Clause⁴³⁶ which provides that foreigners will deem themselves Mexican citizens with respect to all acquisitions of land and water. Foreigners must further agree not to request the protection of their native governments under penalty of forfeiture of the licence in Mexico. Foreigners and Mexican corporations with foreign equity can acquire direct ownership of land only by previously securing an authorization from the Ministry of Foreign affairs.⁴³⁷ This requirement forces foreign investors to agree expressly to the constitutions Calvo clause, as explained earlier in this chapter.

In response to the frequent circumvention of foreign ownership limits, the FIL Act 1973 imposes criminal sanctions of up to 9 years of imprisonment for Mexican individuals who allow foreign investors to avoid prescribed restrictions on

⁴³⁵. *Ibid.* Para.6

⁴³⁶. *Ibid.*

⁴³⁷. *Ibid.* Article 27. ".... only Mexicans by birth or naturalization and Mexican companies have the right to acquire ownership of Lands, water, and their appurtenances, or to obtain concessions for the exploitation of mines or of waters. The state may grant the same right to foreigners, provided they agree before the Ministry of Foreign Relations to consider themselves as nationals in respect of such property, and bind themselves not to invoke the protection of their government in matter relating thereto; under penalty, in case of non-compliance with this agreement, of forfeiture of the property acquired to the nation....". Article 27 of the Mexican constitution, read in conjunction with Article 17 of the FIL Act of 1973, which provides that: "Foreigners shall obtain prior permission from the Ministry of Foreign Affairs to acquire real estate and to constitute or modify companies, said permission shall be subject to legal provisions in force and rulings made by the National Commission of Foreign Investment." Investment Laws of the World: Mexico, (Dobbs Ferry, New York: Oceana Publication 1989) Binder VI, Pg. 20.

foreign ownership.⁴³⁸ The typical perpetrators are the "name lenders" who, for a fee, will appear nominally as the shareholders in place of the foreign investors who beneficially own the stock. Another enforcement tool is found in Article 5 of the FIL Act 1973, which provides that foreign investors participation in corporate management cannot exceed their corresponding equity holdings.⁴³⁹ The new regulations in 1989 continues its Calvo clause policies under Article 31.⁴⁴⁰ Before any final legislation is enacted to implement NAFTA, the Mexican position on Calvo doctrine remains the same and an investor is only allowed to sue before the national court and under the law of Mexico if its agreement with Mexican authorities so stipulates. But in no circumstance can a foreign investor invoke the

⁴³⁸. *Supra* note 119, FIL Act 1973, Article 31 states:

"Imprisonment for up to nine years and fines up to 50,000 Pesos shall be applied to whoever simulates any action that permits the enjoyment or use in fact by the individuals, corporate bodies, or economic entities to which Article 2 of this law refers, of properties or whose acquisitions are subject to requirements or authorizations that have not been fulfilled or obtained".

Article 2 states: "For purposes of this Law, Foreign investment shall be considered as that which is undertaken by:

I-Foreign Corporate companies;

II-Foreign individuals;

III-Foreign economic entities without legal personality;

IV-Mexican business enterprises with majority of foregoing capital or in which foreigners are empowered, by the title, to control the management of the business enterprise.

Foreign investment in the capital of business enterprises, in the acquisitions of properties, and in all other operations to which this law refers, shall be subject to the provisions of said law".

⁴³⁹. *Ibid.* Article 5 of the FIL Act 1973 states: "The participation of foreign investment in the administration of the business enterprise may not exceed its share of the capital."

⁴⁴⁰. *Supra* note 122, New Regulations, Article 31. Article 31 states: "Whenever the 'clauses excluding foreigners' is not provided, an express agreement shall be stipulated and form an integral part of the bylaws so that the present or future foreign partners of the companies in question formally agree with foreign relations department to be considered as Mexicans with respect to the shares of such companies that they acquire or hold as well as the property, rights, concessions, participation or interests owned by such companies or to the rights and obligations derived from the agreements to which such companies are parties with Mexican authorities and not to invoke the protection of their governments, under the penalty for failure to comply with same of forfeiting the capital interested they have acquired in favour of the Mexican nation."

protection of its host government to resolve dispute with Mexico due to the undertakings that may have been taken by such an investor in relation to the Mexican authorities.

B. The Canadian Position

Investor-state dispute settlement mechanism through arbitration has been a feature of the bilateral investment agreements signed between Canada and certain Eastern European countries.⁴⁴¹ Apart from providing the settlement of investor-state disputes through ad-hoc arbitration under the rules of the United Nations Commission on International Trade Law [hereinafter UNCITRAL],⁴⁴² the bilateral investment promotion and protection agreements to which Canada is a Party

⁴⁴¹. For instance, Agreement between the Government of Canada and the Government of the Republic of Hungary for the Promotion and Reciprocal Protection of Investments, (Ottawa, October 3, 1991). A typical investor-state dispute settlement provision under the investment agreement undertaken by Canada is Article IX of the Canada-Hungary agreement states:

(1) Any dispute between one contracting Party and an investor of the other contracting Party relating to the expropriation mentioned in Article VI of this agreement shall, to the extent possible, be settled amicably. If the dispute has not been settled amicably within a period of six months from the date on which the dispute was initiated, it may be submitted by the investor to arbitration in accordance with paragraph (3) of this Article.

(2) Any dispute that may arise under this agreement between one contracting Party and an investor of the other contracting Party, other than a Dispute mentioned in paragraph (1) of this article, shall, to the extent possible, be settled amicably within a period of six months from the date on which the dispute was initiated, it shall be submitted to arbitration in accordance with paragraph (3) of this Article, upon agreement between that contracting Party and the investor.

(3) In those cases, the disputes shall then be settled in conformity with either:

(a) the arbitration rules of the United Nations Commission on International Trade, as adopted in Resolution 31/98 of the United Nations General Assembly on 15 December 1976, or

(b) the rules of the Convention on the Settlement of Investment Disputes between States and the Nationals of Another States of 18 March 1965, when both Contracting Parties are bound by it."

Also see: Article IX of the Agreement Between the Government of Canada and the Government of the Union of Soviet Socialist Republics for the Promotion and Reciprocal Protection of Investments, November 20, 1989, Canada Treaty Series 1991/31. Also see Agreement between the Government of Canada and the Government of the Oriental Republic of Uruguay for the Promotion and Protection of Investments(Signed Only) and also agreement with Republic of Argentina.(Courtesy:External Affairs, Ottawa, Canada)

⁴⁴². UNCITRAL, (New York:United Nations Publication 1986), Sales No. E.86.V.8.

provides for investor-state dispute settlement under the International Centre for Settlement of Investment Disputes [hereinafter ICSID]. This organization is part of the World Bank group formulated through a multilateral Convention on 18 March 1965.⁴⁴³ The Convention established a centre to provide facilities for conciliation and arbitration of investment disputes between contracting states and the nationals of other contracting states in accordance with the provisions of the Convention. According to 1992 Annual Report published by ICSID, as of 30 June 1992 there were 113 signatories to the ICSID Convention.⁴⁴⁴ All G-7 countries⁴⁴⁵ except Canada are contracting states to the ICSID convention.⁴⁴⁶ This also raises another interesting point that in spite of framing binding investor-state dispute resolution mechanism with some of the Eastern European countries, Canada had never entered into a binding investor-state dispute settlement mechanism with the U.S., its largest supplier of foreign capital. When this issue was raised with Mr. Ray Boomgardt, Deputy Director, Economic Trade Law Division, External Affairs, Canada, He replied:

"No, the Canada-U.S relationship was not the leading consideration in terms of our Investment Protection Agreements. In fact one of the big decisions we had to make in the investment

⁴⁴³. Convention on the Settlement of Investment Disputes between States and Nationals of other States. ICSID Basic Documents, (Washington D.C:International Centre for Settlement of Investment Publication 1985) ICSID/15.

⁴⁴⁴. ICSID:1992 Annual Report, (Washington D.C.:ICSID Publication 1992) Pg. 4 and Annex-I.

⁴⁴⁵. G-7 is the group of seven most industrialised economies in the world and consists of nations like Canada, France, Germany, Italy, Japan, U.K and the U.S.

⁴⁴⁶. *Supra* note 444, ICSID Annual Report, Annex I, Pgs.12-14.

protection agreements was whether or not have investor-state dispute settlement, and we decided that in case of Eastern Europe we needed that because there we didn't think our investors would have confidence. Certainly we didn't see why they would have confidence. If they [Canadian investors] had concerns, they would extend to the review mechanism available within those states,.....[Where] courts not having judicial independence and so on. That was important reason for adopting investor-state dispute settlement mechanism."⁴⁷

One may argue that it is understandable that putting such a mechanism in place in the 1960-70s when Canada had extremely high U.S. investment would have meant incurring of liability for Canada and continuous harassment at the hands of the TNCs, that may have dragged Canada to an international arbitration for every time Canada took initiatives to introduce new measures to regulate or review acquisitions by U.S. investors. Membership in International bodies like ICSID which does not have term "investment" defined under the ICSID convention would have meant a variety of issues being espoused by American investors. Although such situation would have arisen only if Canada were to agree to an ICSID clause with the U.S. investors. But, that would have exposed Canadian government to pressure, to agree to such clauses. The political sensitivity towards U.S. investors during the FIRA years would have added to the quandary of the Canadian government, specially in the face of mounting pressure to curtail foreign control of Canadian businesses. It may seem surprising that despite the continuing high presence of U.S.

⁴⁷. Recorded Conversation with Mr. Ray Boomgardt, Deputy Director, Economic Trade Law Division, External Affairs, Canada, 8 July 1993.

investment,⁴⁴⁸ Canadian negotiators accepted investor-state dispute settlement with the U.S. under NAFTA.

There were several reasons for Canada refusing to accept investor-state dispute settlement. One troubling issue was investments in different provinces of Canada by the U.S. investors in fixed assets, for example manufacturing plant situated on real property owned by such an investors in the province and if the same were expropriated who would incur the liability. When Canada adheres to an international convention or treaty, the federal government is liable under its international obligations to meet any liability that may occur as a result of expropriation undertaken by a province of Canada. Another angle to the liability issue is: since Canada is a federal state, and any international agreement entered into by Canada that affects individual rights, can only come to effect if an implementing legislation is passed by an appropriate legislature in Canada.⁴⁴⁹ It is interesting to note that in Canada an international treaty will have a binding effect only if the

⁴⁴⁸. *Supra* note 13, Historical Statistics, Table 30.

⁴⁴⁹. Peter W.Hogg. Constitutional Law of Canada, (Toronto: Carswell Thompson Professional Publishing 1992). Vol.1, Pg. 11-5. Unlike the U.S, where under Article 6 of the Constitution of the United States all treaties become part of the "Supreme Law of the Land". Any treaty which does not demand change in the internal law of Canada does not require that an implementation legislation be passed by the Parliament of Canada. But those treaties which require change in internal law of Canada (these are normally those which effect the individual rights like property rights, or contravene existing law) need implementing legislation by the appropriate legislature in Canada. The legislative powers under the Constitution Act 1867 are distributed between the federal and the provincial governments and this distribution is provided under Section 91 (Legislative Powers of the Parliament) and Article 92 (Legislative Powers of Provincial Legislatures) also refer to Articles 92A to 95 of the Constitution Act 1867. Also refer, Albert P. Blaustein and Gisbert H. Flanz, Constitution of the Countries of the World, (Dobbs Ferry, N.Y: Oceana Publication, Inc. 1990) Binder XX (Constitution of the United States of America) Pg.9.

legislature of the provinces in Canada have ratified an international agreement entered into by the Government of Canada over an issue that is subject matter of provincial jurisdiction.⁴⁵⁰ But, in the event an expropriation is effected by a province, the Government of Canada will be liable under its international obligations. Thus the issue of fixing of responsibility and the possible share in liability remain undetermined and fairly perplexed. Issues like these had kept Canada from adopting investor-state dispute resolution mechanism under the ICSID or otherwise.

U.S. negotiators wanted Canada to accept investor-state dispute settlement mechanism since it was doing so with certain Eastern European countries. Why Canada accepted investor-state dispute settlement with Eastern European countries and not with the U.S., its largest investment partner, because in case of Eastern Europe there was minimal potential of claims being made against Canada. The bilateral protection signed by Canada with Eastern European countries were basically for encouraging Canadian investors to invest abroad. It is suggested that the federal-provincial liability issues can be resolved between provinces and the federal government through an agreement. But, there exists no such agreement. We have earlier seen under chapter four that the U.S continues to maintain high presence of

⁴⁵⁰. A.G. Canada vs. A.G. Ontario (Labour Conventions) 1937 A.C. 326. Also refer to Supra note, Hogg, Pg. 11-11.

FDI in Canada. There seem no concrete answers to these questions.⁴⁵¹

Another objective was to secure a non-partisan dispute settlement mechanism⁴⁵² due to the influence of the Calvo Doctrine on the Mexican legal framework. This mechanism is accepted under NAFTA, despite low Canadian FDI in Mexico.

C. The U.S. Perspective

The U.S., being a principal capital exporting country, has always sought binding investor-state dispute settlement mechanisms through agreements between the investor injured and the state responsible for the injury,⁴⁵³ and particularly

⁴⁵¹. Recorded conversation with Ms. Emmy Verdun, Director, Investment Policy, Investment Canada, 18 June 1993. On the question why Canada accepted the investor-state dispute resolution now under NAFTA vis-a-vis the U.S and does that mean Canada does not fear of the U.S. investors dragging Canada to an international fora, Ms Verdun remarked: "That issue was an issue that we faced in the NAFTA and we decided that we are willing to accept investor-state dispute settlement even with the U.S....recognising that large number of American investors in Canada."

⁴⁵². *Ibid.* Ms. Verdun explains:

"Investor-state dispute settlement was another key goal, particularly of the Americans and again it was because of concern that foreign investors in Mexico did not receive the same kind of protection that they receive in Canada and the U.S. Mexican legal framework is very different from ours [the Canadian and the U.S.] certainly was some concerns about the delays and the cost and perhaps even the impartiality of it [Mexican legal framework]. Investor-state arbitration ensure that there is another route to go."

⁴⁵³. RESTATEMENT OF THE LAW (THIRD), The Foreign Relations Law of the United States, Volume 3, 713, (Washington D.C:American Law Institute Publishers 1987) Pg. 216. Also see Pg. 220.

through the ICSID mechanism.⁴⁵⁴ The U.S. also opposes the efforts made by certain nation states to eliminate the host state right to espouse claims for its nationals for an economic injury suffered due to the hostile acts of the host state, under "Calvo Clause".⁴⁵⁵ The U.S. model of the bilateral investment agreement was designed in early 1980s and one of its primary goals was to eliminate the involvement of the U.S. government in and put in place effective remedies to be availed by the

⁴⁵⁴. Richard J. Smith, Director of the Office of Investment Affairs, Department of State, in an address to Vanderbilt University on April 9, 1976, reproduced in (1976) Digest of United States Practice in International Law (Washington D.C). Pg. 445., Mr Smith said:

"More broadly, we favour agreement in advance on dispute settlement mechanisms applicable to the full range of contentious issues capable of arising between host governments and foreign investors, and subsequent resort to them as required by the parties legal obligations. In such cases, failure to meet such arbitral or other obligations of itself may constitute a denial of justice in violation of international law. We particularly encourage the use of the facilities of International Centre for settlement of Investment Disputes (ICSID), a member of the World Bank group and major existing international institution intended specifically to help resolve investment disputes."

⁴⁵⁵. *Supra* note 453, Restatement of the Law, Pg.219. Also see: Statement of Mr. R. Bartlett Moon, Alternate U.S. representative in a statement to the Permanent Council of the Organization of American States (OAS) at Washington on March 10, 1976. Mr. Moon described the U.S. position regarding diplomatic protection to American nationals Abroad and protection of foreign investment as follows:

"With regard to the Calvo Doctrine or.... to the treatment of nationals of one country living in another, whether those nationals be private citizens or corporate enterprises, there are four principles.... that guide the views of my delegation. First, we believe that all sovereign states have the right to supervise and regulate the activities of foreign citizens in their territory, consistent with the minimum standards of justice called for by international law. Second, we believe that private citizens must respect the laws of the nations in which they operate, and that they must conduct themselves as good citizens of these nations, refraining from improper interference in their internal affairs. Third, we believe that any citizen who makes illegal payment or performs other illegal acts cannot look to the United States to protect him from legitimate law enforcement actions by the responsible authorities of either the host country or the United States government. And finally.....in this regard, the United States government will provide appropriate diplomatic protection to American nationals abroad who are not treated fairly in accordance with international law, and we believe any country has the right to exercise this policy."

investors at their own instance. This approach was adopted as explained, as one for "depoliticization of investment disputes".⁴⁵⁶ Vandevelde further explains that as and when U.S. investors were expropriated they would look to an already preoccupied U.S. government, for intervention in such matters on their behalf and "this would disrupt sensitive negotiations on some other foreign policy matter of greater importance. The desire, then, was to create an effective remedy for U.S. investors that would require no government intervention of any kind."⁴⁵⁷ Obviously due to large U.S. investment in Mexico the consideration in the mind of the U.S. negotiators must have been to put in place a legal regime so that the U.S. investors are protected through a binding legal regime both in terms of substantive provisions for compensation of any economic injury that may be caused by expropriation and nationalization, as well as through an impartial forum where American investors could seek redress. It may have been concerns about the future that guided the Canadian negotiators because if anything they needed to secure its investment in the U.S. because its investment in Mexico is negligible compared to other South American Countries.⁴⁵⁸ But the U.S. has existing interests to protect.

⁴⁵⁶. Kenneth J. Vandevelde, National Law Center, The George Washington University in Proceedings of The 86th Annual Meeting, The American Society of International Law, Washington, D.C. April 1-4, 1992. Pg. 535. Also see. Kenneth J. Vandevelde, "The Bilateral Investment Treaty Program of the United States" (1988) 21 Cornell International Law Journal 201.

⁴⁵⁷. *Ibid.*

⁴⁵⁸. *Supra* note 13, Statistics Canada-Historical Statistics, Table 9, Pg.67. Canada's FDI in Bahamas stands at \$ 2,085 million; Brazil at \$ 1,354 million compared to only \$188 million in Mexico.

3. Investor-State Dispute Mechanism Provisions Under NAFTA

NAFTA establishes two main dispute resolution mechanisms relevant to FDI:

1. Chapter Eleven (Investment), Sub-Section B-Settlement of disputes between a Party and an investor of another Party.
2. Chapter Twenty-Institutional arrangements and dispute settlement provisions for resolving disputes among the parties.

Chapter Eleven dispute settlement provision have been dealt with in this section of the Chapter.

(i) Who Can Make a Claim ?

An investor of a Party may submit to arbitration under either the ICSID Convention⁴⁵⁹ or the Additional Facility Rules⁴⁶⁰ or the UNCITRAL Arbitration

⁴⁵⁹. *Supra* note 443.

⁴⁶⁰. ICSID Additional Facility, (Washington D.C: 1979) Document ICSID/11. Article 2(a) provides that the Secretariat of the Centre is Authorized to undertake conciliation or an arbitration proceedings for settlement of legal disputes where either the state party to the dispute or the state of the disputing investor is not party to the ICSID convention. Also see. Alan Broches, "The Additional Facility of the International Centre for Settlement of Investment Disputes" (1979) IV Yearbook of Commercial Arbitration 373.

Rules,⁴⁶¹ all claims that another state Party has violated obligations under the agreement, thereby causing loss or damage to the investor or an enterprise owned or controlled by the investor.⁴⁶² One innovative feature of this chapter is that an investor of a Party can also claim on behalf of an enterprise of another Party⁴⁶³ for the breach of certain obligations under Chapter Eleven and Fifteen resulting in loss of damage to the investor of the Party.⁴⁶⁴ For example, investor A, a Canadian, owns or controls corporation B which is incorporated under the laws of the U.S and the U.S. acts in derogation of the provision of chapter Eleven, still investor A could submit to arbitration a claim under chapter Eleven on behalf of corporation B.

(ii) When Can Claim be made ?

An investor of a party can make a claim when a contracting Party has breached:

- (a) binding obligation under Section A, Chapter Eleven.
- (b) obligations under Article 1503(2) (State Enterprises).⁴⁶⁵

⁴⁶¹. *Supra* note 442.

⁴⁶². *Supra* note 244, NAFTA, Article 1116 and Article 1117.

⁴⁶³. *Ibid.* Article 1139 states: "Enterprise of a Party means an enterprise constituted or organised under the law of a Party, and a branch located in the territory of a Party and carrying out business activities there."

⁴⁶⁴. *Ibid.* Article 1117.

⁴⁶⁵. *Infra* note 504.

(c) article 1502(3)(a) (Monopolies and State Enterprises).⁴⁶⁶

Claim must be made within three years of first acquiring the knowledge of loss or damage resulting from the breach of the above said obligations by the Party to NAFTA.⁴⁶⁷

(iii) What are the Mechanism Available to make the Claim ?

Disputing investor⁴⁶⁸ may submit claim for arbitration under:

- (a) the ICSID Convention;
- (b) the additional facility rules of ICSID; and
- (c) the UNCITRAL Arbitration Rules.

The claims for arbitration shall be processed according to the above-said Convention or Rules except to the extent those rules are modified by Section B, chapter eleven.

Two of the NAFTA Parties, Canada and Mexico, are in fact not yet ICSID contracting states, Arbitration under the ICSID convention however stands as an alternative that can be resorted to once either of those two countries join ICSID.

⁴⁶⁶. *Infra* note 505.

⁴⁶⁷. *Supra* note 244, NAFTA, Article 1116(2)

⁴⁶⁸ *Infra* note 470, Article 1139.

Until then, ICSID additional Facility arbitration or UNCITRAL arbitration would be available for dispute between U.S. investors and either Canada or Mexico and vis-a-versa. In respect of disputes between Mexican investors and Canada, or between Canadian investors and Mexico, only UNCITRAL arbitration would be available.⁴⁶⁹

(iv) Notice of Intent to Submit the Claim to Arbitration

Section B of chapter Eleven encourages the disputing Parties⁴⁷⁰ to settle the claim through negotiation or consultation.⁴⁷¹ But if the negotiations fails then the disputing investor notifies in writing the disputing Party its intention to submit a claim to arbitration. Disputing Parties having failed to settle the claim through consultation or negotiation,⁴⁷² may proceed to invoke the arbitration mechanism. This initiation of the arbitration process starts with disputing investor delivering written notice of intent⁴⁷³ to submit claim to arbitration at least 90 days before the claim is submitted.

⁴⁶⁹. *Supra* note 244, NAFTA, Article 1120.

⁴⁷⁰. *Ibid.* Article 1139: "disputing Parties means the disputing investor or the disputing Party." "disputing investor means an investor that makes a claim under Section B." "disputing Party means a Party against which a claim is made under Section B." "disputing party means disputing investor of the disputing Party"

⁴⁷¹. *Ibid.* Article 1118: Settlement of a Claim through Consultation and Negotiation.

⁴⁷². *Ibid.*

⁴⁷³. *Ibid.* Under Article 1119, the written notice of intent shall specify: (a) name and address of the disputing investor or an enterprise (in case of Article 1117); (b) the relevant obligation under NAFTA, alleged to have been breached; (c) issues and factual basis for the claims and relief sought including amount of damages claimed.

(v) Consent for Arbitration

Subsequent to the notice, to pursue claim for arbitration under any of the mechanism mentioned under section (iii), the disputing investor must do the following:

- (a) deliver a written consent to such an arbitration to the disputing Party.⁴⁷⁴
- (b) deliver a written waiver of right to make claim at any national tribunal or court under the national law of any NAFTA parties except for proceedings initiated to seek injunctive, declaratory relief.⁴⁷⁵

Written waiver shall not be required in those situations, where a disputing Party has deprived a disputing investor of its enterprise.⁴⁷⁶

(vi) Number and Appointment of Arbitrators

A tribunal comprising of three arbitrators, one arbitrator from each party and the presiding arbitrator appointed by agreement of the disputing Parties shall

⁴⁷⁴. *Ibid.* Article 1121(1)(a) & (3), also see Article 1122(1) &(2)

⁴⁷⁵. *Ibid.* Article 1121(1)(b) & Article 1121(2)(b)

⁴⁷⁶. *Ibid.* Article 1121.

conduct the arbitration proceedings.⁴⁷⁷ In those cases where Parties fail to appoint an arbitrator or the disputing parties are unable to agree on a presiding arbitrator under Article 1123, the Secretary General of the ICSID shall serve as an appointing authority.⁴⁷⁸ The Secretary General will exercise complete discretion in appointment of an arbitrator, upon receiving a request for such an appointment from either of the Parties at dispute. The Parties to the agreement are required to maintain a roster of 45 presiding arbitrators meeting the requirements for such an appointment under the ICSID Convention and the UNCITRAL Rules.⁴⁷⁹ Persons named in the roster must be experienced in international law and investment matters.⁴⁸⁰ It is from the above stated roster that the Secretary General is to appoint the presiding arbitrator, provided that the presiding arbitrator shall not be national of the disputing Party or a national of a Party of the disputing investor.⁴⁸¹ The requirement of appointing only the non-nationals may be waived if each individual member of the tribunal has been appointed by agreement between disputing Party & disputing investor in

⁴⁷⁷. *Ibid.* Article 1123.

⁴⁷⁸. *Ibid.* Article 1124(1) & Article 1139-"Secretary General".

⁴⁷⁹. According to Article 14(1) of the ICSID Convention, the qualifications to serve on the Panel of Arbitrators are: "Person designated to serve on the Panels shall be persons of high moral character and recognised competence in the field of law, commerce, industry or finance, who may be relied upon to exercise independent judgement. Competence in the field of law shall be of particular importance in the case of persons on the Panel of Arbitrators." Article 6(4) of UNCITRAL Rules require: "In making the appointment authority shall have regard to such considerations as are likely to secure the appointment of an independent and impartial arbitrator."

⁴⁸⁰. *Supra* note 244, Article 1124(4).

⁴⁸¹. *Ibid.* Article 1124(3).

writing.⁴⁸²

(vii) Consolidation of Claims

One of the many interesting and innovative features of the NAFTA investor-state dispute settlement provisions is the provision that when two or more claims submitted to arbitration have a question of law or fact in common, the claims "in the interests of fair and efficient resolution of claims" can be consolidated and determined by a three member arbitral tribunal operating under the UNCITRAL rules⁴⁸³ except as modified by Section B of Chapter Eleven. In contrast to role of the Secretary General of ICSID in respect of other arbitrations under the dispute settlement provisions, according to which the Secretary General will appoint arbitrators only if a tribunal cannot be constituted through appointments by the parties,⁴⁸⁴ in the "consolidation" cases the Secretary General exclusively appoints each member of the tribunal.⁴⁸⁵ The appointees of the Secretary-General in the "consolidation" cases are normally to be drawn from the roster of potential arbitrators,⁴⁸⁶ established by the NAFTA parties.

⁴⁸². *Supra* note 443, ICSID Convention, Article 39. Also see, *supra* note 460, Additional Facility Rules (Article 7 of Schedule C) and NAFTA (Article 1125).

⁴⁸³. *Supra* note 244, NAFTA, Article 1126.

⁴⁸⁴ *Ibid.* Article 1124.

⁴⁸⁵. *Ibid.* Article 1139: "Tribunal means an arbitration tribunal established under Article 1120 or 1126."

⁴⁸⁶ *Ibid.* Article 1124(4). This Article states: "On the date of entry into force of this agreement, the parties shall establish, and thereafter maintain, a roster of 45 presiding arbitrators meeting the qualification of the Convention and rules referred to in Article 1120 and experienced in international

The NAFTA provisions envisage that the Secretary-general will, if called upon to appoint the presiding arbitrator in the other types of arbitration under the provisions, also generally make appointments from this roster. Appointing the members of the tribunals that will hear consolidated claims and presiding arbitrators in other cases from an established, limited roster of arbitrators is meant to contribute to continuity and uniformity in the application of the pertinent NAFTA provisions.

(viii) Governing Law

The governing law of the tribunal constituted under Article 1120 and Article 1126 are the provisions of the NAFTA; applicable rules of international law and the interpretation provided by the Commission⁴⁸⁷ on any provision of this chapter shall be binding on the Tribunal established under Article 1120 or 1126 of NAFTA⁴⁸⁸. This a big leap forward by Mexico which had in the past demanded that the foreign investor dispute its claims before the national court or tribunal and under its national law.

law and investment matters. The roster members shall be appointed by consensus and without regard to nationality."

⁴⁸⁷ *Ibid.* Article 201(1):General Definitions, Commission means "the Free Trade Commission established under Article 2001(1)"

⁴⁸⁸ *Ibid.* Article 1131.

(ix) Interim Measures

A Tribunal may issue interim orders for two purposes:

- (1) to preserve rights of the disputing Parties;
- (2) to ensure that the tribunals jurisdiction is made fully effective, including an order to preserve evidence in the possession or control of a disputing party or to protect the tribunal's jurisdiction.

Interim measures issued under Article 1134 must not result in an order of attachment or any measure constituting breach of obligations under the investment chapter.⁴⁸⁹

(x) Interpretation of Annexes

Another innovative feature of the investor-state dispute settlement provisions of the investment chapter is that if a disputing party makes a request of interpretation of Annexes (I, II, III, IV) which a disputing Party may be using as means of derogating from the provisions of this chapter, the tribunal constituted under Article 1120 and 1126 must request the Commission for an interpretation. The Commission in turn must submit in writing its interpretation within sixty days

⁴⁸⁹. *Ibid.* Article 1134.

of receiving such a request.⁴⁹⁰ Such a interpretation, when received from the Commission, will be binding on the tribunal or if the commission fails to deliver its interpretation within 60 days the tribunal must decide the issue.⁴⁹¹

(xi) Final Award and Enforcement

The final award of the tribunal may provide relief in form of "monetary damages" or "restitution of property" or any interests thereof to the investor or the enterprise of the Party under Article 1117(1).⁴⁹² Tribunal may also award costs in accordance with the applicable arbitration rules. The award rendered by the Tribunal shall be binding on the disputing parties and each Party is to ensure its enforcement in its territory.⁴⁹³ Regardless of any annulment or appeal proceedings which may otherwise be initiated by the disputing parties,⁴⁹⁴ investor-state dispute settlement provision under investment chapter for seeking redress before an arbitral panel constituted under Article 2008, if the disputing Party fails to abide by the Final award delivered by the Tribunal, can be initiated on request by a Party whose investor was

⁴⁹⁰. *Ibid.* Article 1132(1).

⁴⁹¹ *Ibid.* Article 1132(2).

⁴⁹². *Ibid.* Article 1135.

⁴⁹³. *Ibid.* Article 1136(1) & (4).

⁴⁹⁴. *Ibid.* Article 1136(3).

Party to Arbitration.⁴⁹⁵ Notwithstanding initiation of any proceeding at the instance of the Party whose investor was Party to arbitration, such an investor may still seek the enforcement of award under the ICSID Convention, the New York Convention or the Inter-American Convention.

⁴⁹⁵. *Ibid.* Article 1136 (5).

4. Exclusions from the Investor-State Dispute Settlement Mechanism

A decision by Investment Canada (Annex-I, Pg. I-C-2) or the FIC of Mexico (Annex-I, Pg. I-M-4) following a review with respect to whether or not to permit an acquisition that is subject to review, has been excluded from the dispute settlement mechanism set out in chapter Eleven or chapter Twenty (Institutional Arrangements and Dispute settlement procedures).⁴⁹⁶ Also excluded from the dispute settlement provisions of Chapter Eleven and Chapter Twenty are the decisions by a Party to prohibit or restrict the acquisition of an investment in its territory by an investor of another Party or its investments if the same are taken for reasons of national security. Article 2102 defines national security as:

- 71. Subject to Article 607 (Energy-National Security Measures) and 1108 (Government Procurement-Exceptions), nothing in this agreement shall be construed:
 - (a) to require any Party to furnish or allow access to any information the disclosures of which it determines to be contrary to its essential security interests;
 - (b) to prevent any Party from taking any actions that it considers necessary for the protection of its essential security interests;
 - (i) relating to the traffic in arms, ammunition and implements of war and to such traffic and transactions in other goods, materials, services and technology undertaken directly or indirectly for the purpose of supplying a military or other security establishment;
 - (ii) taken in time of war or other emergency in international relations; or
 - (iii) relating to the implementation of national policies or international agreements respecting the non-proliferation of nuclear weapons or other nuclear explosive devices; or
 - (c) to prevent any Party from taking action in pursuance of its obligations under the United Nations Charter for the maintenance of international peace and security."

One of the arguments made in chapter three of this dissertation is the possible use of aforesaid provision by the Americans against Canadian and Mexican

⁴⁹⁶ *Ibid.* Article 1138 read with Annex 1138.2, Pg.11-29.

investors by invoking the provision of the EXFA under the umbrella of protection of the aforementioned provision. As mentioned earlier Canada sought an exemption from the national security provisions of the U.S., but was unsuccessful in securing such an exception. For example, a Canadian acquisition of a U.S. or Mexican business can be blocked without requiring either the U.S. or the Mexican governments to disclose the information on which they may base their decision to reach a conclusion of disallowing a Canadian investor. Therefore, there is a likelihood of blocking Canadian investment on grounds of national security interests, without furnishing any information to such an investor or the contracting Party to which such an investor belongs.

In chapter three of this dissertation, an attempt has been made to show that U.S. does not resist from pressing national security clauses and laws to achieve its foreign policy objectives or to safeguard its technology interests. While response to such issues are rather lukewarm with some quarters.⁴⁹⁷ Although on a rather optimistic note Ms Verdun described that she was not aware of any case where a Canadian company was harmed by the Exon-Florio. But on a question that Canada was seeking an exemption from the EXFA at the negotiating table, Ms Verdun

⁴⁹⁷. In an transcript of a interview with Ms. Verdun, Director, Investment Policy, Investment Canada, Ms. Verdun was part of the Canadian negotiating team on the investment Chapter at the NAFTA negotiations. In answer to the question that what she felt were the deficiencies of the NAFTA with regard to investment Chapter, Ms. Verdun Replied:

Ms. Verdun: "It's [NAFTA] not perfect. We still have cases where we feel we will be harassed by the U.S."

Author: Harassment from things like the Exon-Florio Amendment?

Ms. Verdun: "Well so far Exon-Florio has been interpreted in the narrow sense by the Americans. Yes, there is potential there for abuse."

replied:

Ms. Verdun: "Well we have quite close a relation with the U.S and we have number of defence agreements where we are contractors and suppliers of the defence products to the United states.....We argued with the Americans that we should get an exemption from Exon-Florio, but again obviously it [U.S] did not come about....national security is a very sensitive issue and the Americans were not ready to budge on that"

Author: Is there a likelihood of it [Exon-Florio] being misused?

Ms. Verdun: "There is an potential obviously."⁴⁹⁸

The U.S. has in the past used national security against its allies like Japan.⁴⁹⁹ Another official at the External Affairs Canada described the Japanese case [Fujitsu-Fairchild]⁵⁰⁰ as "truly preposterous", and seemed less optimistic regarding the consequences of the failure to procure national security exception at the NAFTA negotiations.⁵⁰¹ The transcript of the conversation provides some reflection on the degree of apprehension that Canada has against any future misuse of the national security exception by the U.S.:

Author: Do you think there is likelihood that the Americans might use it [Exon-Florio] against Canadian investors, taking cue from the way they [U.S] were going after the Chinese and the Japanese?

Mr. Boomgardt: "Clearly, I think its [Exon-Florio] a complete carve out.....There would be

⁴⁹⁸. *Ibid.*

⁴⁹⁹. *Supra* note 151. Jane Sneddon Little, Pgs.53/58.

⁵⁰⁰. *Ibid.*

⁵⁰¹. *Supra* note 447, Mr. Ray Boomgardt.

temptation to use and block something.....It is hard to imagine that they would ever be able to use rationale they used in the Chinese case [MAMCO Divestiture] and apply that to Canada.....[But] you never know how national security might be used, its a complete unknown, they [the U.S] have total exemption, there is huge discretion!"⁵⁰²

There is also a Mexican exception to submission of a claim to arbitration under Article 1120.⁵⁰³ Annex 1120.1 provides that an investor of another party may not allege, both before a Mexican court or administrative tribunal and under Section B of Chapter Eleven, that Mexico has breached its obligation under Section A of chapter Eleven or Article 1503(2) (State Enterprises)⁵⁰⁴ or Article 1502(3)(a)(Monopolies and State Enterprises),⁵⁰⁵ where such a monopoly has acted in a manner inconsistent with the Party's obligation under Section A. This means that

⁵⁰². *Ibid.* Also see *supra* note 158, Jim Mendenhall, MAMCO divestiture and the accompanying text.

⁵⁰³. *Supra* note 244, NAFTA, Annex 1120.1, Pg. 11-26.

⁵⁰⁴. *Ibid.* Article 1503(2) describes state enterprise as:
"Each Party shall ensure, through regulatory control, administrative supervision or the application of other measures, that any enterprise that it maintains or establishes acts in a manner that is inconsistent with the Party's obligation under Chapters Eleven (Investment) and Fourteen (Financial Services) wherever such enterprise exercises any regulatory, administrative or other governmental authority that the party has delegated to it, such as the power to expropriate, grant licenses, approve commercial transactions or impose quotas, fees or other charges."

⁵⁰⁵. *Ibid.* Article 1502(3): "Each Party shall ensure, through regulatory control, administrative supervision or the application of other measures, that any privately-owned monopoly that it designates and any government monopoly that it maintains or designates: (a) acts in a manner that is not inconsistent with the Party's obligation under this agreement wherever such a monopoly exercises any regulatory, administrative or other governmental authority that the Party has delegated to it in connection with the monopoly good or service, such as the power to grant import or export licenses, approve commercial transactions or impose quotas, fees or other charges;"
Article 1502(1) describes that "Nothing in this agreement shall be construed to prevent a Party from designating a Monopoly"

if a U.S or Canadian investor has opted for or agreed to submit a claim before a Mexican court, they may not subsequently seek investor-state dispute settlement under Section B of Chapter Eleven. Under Annex 1120.1 (b) where an enterprise of Mexico that is a juridical person, owned and controlled either directly or indirectly by an investor of another Party, alleges before a Mexican court or administrative Tribunal, the violation by Mexico of its obligation under Section A of chapter Eleven or Article 1503(2) or Article 1502(3)(a). Such an investor forecloses any allegation of breach under the provisions of investor-state dispute settlement mechanism set out under the Investment chapter. But these exceptions to Article 1120 do not apply if Mexico as a consequence of its action deprived a disputing investor of control by expropriating or nationalizing the enterprise.⁵⁰⁶

This acceptance of investor-state dispute settlement is now in form of legislation awaiting, that other the two contracting parties ratify the agreement. Certainly putting in place legal principles of investor-state dispute resolution will enhance the confidence of the U.S. and Canadian investors, but that again is of limited use for Canadians vis-a-vis Mexico. The gain certainly has been substantial for the large presence of U.S. investors in Mexico and Canada and to the Mexican in terms of attracting foreign investment.

⁵⁰⁶ *Ibid.* Article 1121(4)(b).

Conclusions

The concern expressed by the MacDonald report over dipping foreign investment in Canada and its consequential impact on Canadian economy⁵⁰⁷ certainly influenced Canadian government policy towards foreign investment. Therefore, instead of insulating Canadian businesses from American enterprises except for in a limited manner by providing thresholds, Canada made cautious reverses in its investment policy. After 1985, Canada sought foreign investment and has made cautious efforts to secure its own fair share of global capital.⁵⁰⁸ This, of course, is entirely consistent with a general international liberalisation and values. However, such efforts in the past were considered as incurring economic loss to Canada.⁵⁰⁹

⁵⁰⁷. *Supra* note 68, MacDonald Report.

⁵⁰⁸. "Canada Chases Trade, Investment: Pavilion Visitors will Learn National Lore with the Aid of A Talking Moose", *The Globe and Mail*, Report on Business, 13 July 1993, Pg. B-19. Canada is proposing to have largest pavilion at EXPO 93, in Korea to help "showcase Canadian advancement in technology and to stimulate trade and investment flows". Also See. Timothy Pritchard, "Car Makers Oppose Government Aid for Hyundai Plant: Earlier Benefits Still a Sore Point", *The Globe and Mail*, 24 June 1993, Pg. B-5.

⁵⁰⁹. House of Commons, 29th Parliament, 1st Session, 3 April 1973, Pg. 2932. Mr. Lorne Nystrom, an NDP M.P. from Yorkton-Melville in the debate over FIRA remarked:

"I suggest that another source of revenue for Canadian investment would be some of the funds that are now invested by Canadians in other countries. Canada itself is somewhat imperialistic in economic terms. If you go down to Latin america, or Countries such as Trinidad, Tobago and Jamaica, you see a high incidence of Canadian ownership and investment. I remember being in Jamaica two years ago, picking up a newspaper and seeing a headline reading: "Jamaicanize the economy: get rid of Canadian ownership", I remember being in Britain, standing on the street corner and seeing two or three Canadian-based multinational corporations".

That Canada in the 1970s, introduced restrictive measures against growing U.S. investment may have well served the purpose of diminishing the ownership and control of American businesses over key sectors of Canadian economy. But the same approach or perspective may not be economically feasible proposition for Canada of the 1990s, when it has large Canadian ownership of businesses well placed outside the country. It is arguable that it is fair to Canadian owned corporations to compete in the global economy specially when they have sufficient capital and technology base of their own. The Conservative government certainly encouraged Canadian corporations to be more assertive and there is no doubt that there lies massive scope for Canadian investment outside. Mr. Clive Didierserre, Vice-President of Can-Ad International, a Toronto based Canadian company suggests:

"My Advice to Canadian companies is to get off their rears and get in here-as long as they are prepared to go through the troubles third world countries have".⁵¹⁰

Today, Canada's indifference to still relatively large presence of U.S. investment in Canada seems to have faded away or is relatively subdued.⁵¹¹

510. Michael Bociurkiw, "On-Scene Effort Lands Power Deal: Canadian Group's \$85 million Barge Project Will Ease Philippine Energy Crisis", The Globe and Mail, 28 June 1993, Pg. A-6.

511. Terence Corcoran, "Thank God Supermarkets Can't Fly", The Globe and Mail, 23 June 1993, Pg. B-2., In Mr. Corcoran view:

"Canadian economic policy making has come a long way from a dozen years ago, when the national angst meter was at frenzy level over corporate concentration and foreign investment. Today, fear of corporate concentration has all but disappeared, mainly because most of the old dinosaurs we supposedly lowered under-Edper, Canadian Pacific, O & Y and others-turned out to be concentration of inept management with limited control over their subsidiary companies, let alone the economy. Foreign investment, long portrayed as a curse that needed to be regulated as if it were a

Post NAFTA factors that are required to be considered are, whether Canada can in the future continue to use the review mechanism, especially because of the competing agenda of countries globally to enhance the capital inflows. In this scenario would it be feasible for Investment Canada to ask a foreign investor to require improvements in productivity or not allow investment in certain sectors. One important factor that requires consideration by the international community is the enormous power and choice available to the foreign investor, who may decide to invest only where least government intervention prevails.

There is also a need to raise the issue of "national security" with the U.S. and seek concrete definition or parameters of its usage. Such an effort is already under way at the OECD. Canada should play a lead role on this issue because of the degree to which Canadian economy is meshed with that of the U.S.

Canada has certainly come a long way from the protectionism of the 1960s. The legislative measures taken in mid-1980s to change the image of Canada as a country open to business and the conscious efforts now being made to attract foreign investment is likely to bring real "net benefit to Canada".

contagious disease, is now welcomed. In fact, any suggestion that foreign investors might be turning away from Canada is often viewed with alarm and sign that Canada is unworthy".

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