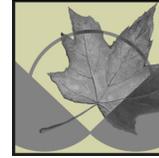


BRIEFING PAPER

trade and investment series



CCPA

CANADIAN CENTRE
for POLICY ALTERNATIVES
CENTRE CANADIEN
de POLITIQUES ALTERNATIVES

Volume 5 Number 1 • June 2004

Public auto insurance and trade treaties

by Steven Shrybman and Scott Sinclair

Summary

New Brunswick, or other Canadian provinces, can establish a public automobile insurance system without being deterred by the North American Free Trade Agreement (NAFTA) or the General Agreement on Trade in Services (GATS). While creating public auto insurance would raise trade treaty issues, the federal government has both the capability and the responsibility to ensure that these are addressed and resolved. The Bernard Lord government's decision to back away from this important public policy initiative in the face of insurance industry threats is regrettable.

NAFTA

The most serious risk of NAFTA disciplines being invoked to challenge the establishment of a public sector insurance plan by New Brunswick is that of a claim for damages by a foreign investor under the Treaty's investment disciplines. While the costs, risk, and notoriety of such a claim may discourage a U.S. or Mexican-based insurance company from invoking NAFTA dispute procedures, the industry has already indicated that it is actively considering this option.

If in fact such a claim is made, it would represent a worrisome international precedent which would seek to expand the scope of foreign investor rights which have to date been recognized under international law. Given the tenor of recent arbitral awards, it would be unwise to discount the possibility that such a claim might succeed.

However, the risks and consequences of such claims, if they materialize, should also not be overstated. A significant number of insurance companies operating in New Brunswick's market may have some difficulty qualifying as foreign investors under NAFTA. Accurate monetary quantification of these risks is also important, but

beyond the scope of this report. Finally, we note that any damages assessed under NAFTA investment rules would be payable by the federal, not the provincial, government.

GATS

In the mid-1990s, Canada made GATS market access and national treatment commitments covering motor vehicle insurance. The GATS market access rule disallows monopolies in sectors where governments have made commitments, unless they are listed as exceptions in a country's schedule. Canada listed an exception for public auto insurance monopolies, but it only protects *existing* public auto insurance systems in certain provinces -- it does not provide the flexibility to create new systems. Furthermore, the GATS governmental authority exclusion cannot be relied upon to exclude New Brunswick's creation of a public auto insurance system.

Consequently, creating a public auto insurance system in New Brunswick would be inconsistent with Canada's *existing* GATS commitments. Nevertheless, New Brunswick can proceed with public auto insurance without being deterred by the GATS. The federal government can simply change its 1997 financial services commitments. There is a special GATS procedure that allows Canada to do so. Canada would be expected to increase its GATS coverage in other sectors to compensate affected WTO member governments for any lost "market access" in insurance. This procedure to modify GATS schedules was recently invoked for the first time by the European Union.

Conclusions

New Brunswick *can* proceed with public auto insurance despite the impediments posed by the services and investment provisions of NAFTA and the GATS. These trade treaty obstacles are navigable.

The debate over New Brunswick's proposed public auto insurance program, and the Lord government's decision not to proceed, underline how the latest generation of services and investment treaties increasingly impede legitimate public policy options. Changes in Canada's existing trade treaty commitments and its objectives in ongoing trade talks are essential to secure stronger protection for public services and to prevent future interference with democratic decision-making.

Background

The Select Committee on Public Automobile Insurance ("the Committee") was appointed by resolution of the Legislative Assembly of New Brunswick on August 5, 2003. The Committee's mandate was "to explore the most suitable form of a public insurance system for New Brunswick should the province conclude that a public system is required." After months of public consultation, expert testimony and deliberations, the Committee submitted its final report in early April 2004.

The Committee unanimously recommended a "made-in-New Brunswick model of public automobile insurance." The key features of the recommended system include "a public system that offers extensive coverage at an affordable rate for all drivers with:

- no reference to age, gender, marital status, territory, payment history or lapses in insurance to determine insurance costs;
- rates to be determined by driving record, vehicle usage, vehicle make and model, optional coverage purchased;
- oversight of the public utilities board for mandatory and optional insurance rates.
- pure, no-fault injury benefits with no option to sue;
- vehicle registration and insurance sold through brokers and agents at a 7% commission;
- mandatory vehicle coverage, additional injury and income replacement benefits, third-party liability coverage and collision, theft and comprehensive sold by the Crown corporation through private sector agents and brokers; and
- additional injury and income replacement benefits and third-party liability coverage are sold by private insurers in competition with the Crown corporation."¹

The proposed system would consist of a basic no-fault mandatory auto insurance, including personal injury protection and third-party liability.

Drivers could also purchase optional additional insurance for collision, theft and comprehensive coverage. Under the new system, the average auto insurance premium is estimated to fall from \$1,212 to \$993.

Public auto insurance would be provided through a new Crown Corporation, the New Brunswick Public Insurance (NBPI), that will be a not-for-profit entity operating at arms-length from the provincial government. Substantial premium savings are expected to be achieved "through lower administrative costs and the not-for-profit mandate of a sole provider Crown corporation." The basic mandatory insurance and optional vehicle damage coverage will be provided exclusively through NBPI. This aspect of the system will be a public monopoly.

Private agents and brokers would continue to play a significant role in the distribution of the public product. The public automobile insurance product will be distributed through private insurance agents and brokers, who will receive a 7% commission for their services. Under the proposals, certain types of optional insurance (e.g., own-vehicle damage, including collision, theft and comprehensive) could be purchased solely from NBPI, while other types (e.g., additional injury benefits, additional third-party liability coverage) could be purchased either from NBPI or from private insurers in competition with it.

As the Committee notes, "insurers writing automobile policies in New Brunswick include Canadian subsidiaries of large United States and Europe headquartered companies."² The creation of the public auto insurance system to offer "services previously provided solely by the private sector"—including foreign investors and service providers—would therefore raise trade treaty issues.

On June 30, 2004 Premier Bernard Lord announced that his government would not adopt the public auto insurance system recommended by the all-party committee. During the debate, the insurance industry assailed the proposed system and threatened trade treaty litigation if New Brunswick went ahead.³

This briefing paper analyses the trade treaty implications of the proposed scheme. This analysis was provided to the New Brunswick government in May, 2004 prior to their decision not to proceed.

Analysis

The international trade implications of creating a public insurance scheme for New Brunswick are briefly described on pp. 20 and 21 of the

Committee's report. We concur with its conclusion that: "It is clear that the NAFTA and the GATS do not expressly prohibit New Brunswick from establishing and maintaining a public automobile insurance regime. Both agreements do, however, contain rules that would apply to the creation of the Crown corporation (NBPI) and its activities."⁴ Our purpose in preparing this report is therefore two-fold.

First, the legal opinions and advice received by the Committee have not to our knowledge been made public. It may be helpful, therefore, to explicate some of the key trade issues that arise in this context for those who are not privy to these confidential documents and advice.

Second, the Committee recommended that the government of New Brunswick work closely with federal officials to design a strategy to ensure that a new public automobile insurance system will be consistent with Canada's international trade obligations. This raises two concerns. The first is that the province not unnecessarily compromise its public policy objectives because of Canada's ill-conceived international trade commitments. The second has to do with the need for action by the federal government, not compromise by the province, to address the constraints imposed by the former's commitments under the GATS.

It would also be wise for New Brunswick to be cautious in dealing with federal trade officials who are the authors of the trade disciplines that are now proving so problematic, and who remain committed to pursuing further trade liberalization objectives.

The following assessment focuses on the two most likely points of conflict with Canada's international trade obligations: 1) the NAFTA investment rules because they can be invoked directly by U.S. and Mexican investors, and 2) Canada's 1997 GATS financial services commitments and the rules on public sector monopolies.

Before addressing these issues, two preliminary comments are warranted. The first concerns provincial prerogatives under the constitution. The other concerns the difficulty of making confident predictions about the effects of trade rules that are unprecedented and untested.

Provincial jurisdiction

As a preliminary matter, it is important to stress that there is no legal, and certainly no constitutional impediment to implementing a provincial public auto insurance scheme. The establishment of a Crown corporation to provide automobile insurance is clearly a matter falling within provincial authority under the Constitution.

Moreover, federal treaty-making power does not accord it the right to alter the division of constitutional powers nor to implement international treaty obligations in areas of provincial competence. Nevertheless, the federal government has the power to make international commitments relating to matters of provincial jurisdiction, even though it may have no constitutional authority to implement them. Indeed, the federal government has done so with respect to numerous matters falling wholly or partially within the constitutional domain of the provinces; auto insurance is one example.

Thus, while the federal government has no authority to compel the provinces to carry out their policy and legislative functions in accordance with Canada's international commitments, it is nevertheless liable under international law for any failure on the part of provincial governments to do so.

Uncertain outcomes

It is also important to qualify any assessment about the likely outcome of claims arising under NAFTA or WTO rules because of the unprecedented, ill-defined, and often untested character of many international trade disciplines, particularly those concerning investment and services. In addition, the principle of binding precedent (*stare decisis*) does not apply in the area of international commercial arbitration or trade adjudication. The potential for inconsistent rulings has already become quite apparent in the decisions of the ad hoc arbitral tribunals convened to determine NAFTA investment claims.

NAFTA analysis

The question we address is this: would the establishment of a public automobile insurance system by New Brunswick expose Canada to damage claims by foreign companies under NAFTA investment rules? Relevant provisions are set in Chapter 11 (foreign investment); Chapter 14 (financial services); and Chapter 15 (competition policy, monopolies, and state enterprises).

While other potential risks exist,⁵ narrowing the focus of concern to foreign investor claims is reasonable in light of the extraordinary right accorded foreign investors under Section B of Chapter 11. These for example, accord U.S. and Mexican-based companies the right to sue Canada for damages arising from any alleged breach by it of the expansive and investor-rights granted by the treaty.⁶

When they arise, such disputes are decided, not by our courts or judges, but by international arbitration panels (Article 1120) operating in accordance with procedures established for resolving international commercial disputes of a private, not public, character.⁷ Furthermore, with the solitary exception of government measures implemented under the Investment Canada Act⁸, there is no exception from the application of these dispute resolution provisions.

While the threshold for qualification is modest, to have standing to bring such a suit the investor must qualify as an investor of another NAFTA party. Neither Canadian nor European-based insurance companies would have direct access to these dispute procedures, although they may have recourse through U.S.-based subsidiaries or related corporations.

While there are few impediments to invoking investor-state procedures, there are reasons that may discourage a foreign investor from pursuing this remedy. First, international litigation is expensive and likely to be protracted. Should the investor succeed, the award may subsequently be tied up in judicial proceedings challenging its validity. Second, to bring an investor-state claim, the disputing investor must waive its right to sue for damages in Canadian courts. Finally, the notoriety of challenging a popular public auto insurance scheme may undermine the company's good will in a market that may still be important.

The right to establish new Crown corporations is explicitly preserved by NAFTA

The Committee states that: "It is clear that the NAFTA and the GATS do not expressly prohibit New Brunswick from establishing and maintaining a public automobile insurance regime." In fact, NAFTA explicitly preserves the right to establish new federal and provincial Crown corporations. Thus Article 1503:1 (State Enterprises⁹) provides that:

Nothing in this Agreement shall be construed to prevent a Party from maintaining or establishing a state enterprise.

The only significant constraint imposed on the exercise of this right is that such Crown corporations act in a manner consistent with NAFTA investment and financial services disciplines where:

[the Crown corporation] 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;

We are aware of no plans to invest New Brunswick's public insurer with such authority.

The right to establish new Crown corporations under Chapter 15 is also to prevail in the event of conflicts with NAFTA investment rules. Article 1112: Relation to Other Chapters, provides:

In the event of any inconsistency between this Chapter [Chapter 11] and another Chapter, the other Chapter shall prevail to the extent of the inconsistency.

There is an argument that this provision precludes investor claims relating to the establishment of a Crown corporation because exposing governments to such claims is inconsistent with explicitly acknowledging their right to establish such a public monopoly. However, it is at least as likely that a tribunal would find the two provisions compatible: Article 1110 doesn't preclude the establishment of a new public insurance monopoly, it simply requires compensation to those foreign investors adversely affected by such a measure.

Potential investor-state claims

The establishment of such a public automobile insurance plan would, in trade jargon, be a measure relating to investments in financial institutions and cross-border trade in financial services.¹⁰ For this reason, NAFTA investment disciplines come into play only to the extent that they are covered by Chapter 14 (Financial Services). Accordingly, the establishment of a public auto insurance scheme can be challenged by foreign investors for violating only certain NAFTA investment disciplines.¹¹ Of these, the most problematic would be a claim that, by creating a public insurance monopoly, the province had expropriated the investments of foreign companies in the business of providing those same insurance products.

NAFTA Article 1110 provides that:

1. No Party may directly or indirectly nationalize or expropriate an investment of an investor of another Party in its territory or take a measure tantamount to nationalization or expropriation of such an investment ("expropriation"), except:

- (a) for a public purpose;
- (b) on a non-discriminatory basis;
- (c) in accordance with due process of

law and Article 1105(1); and on payment of compensation in accordance with paragraphs 2 through 6.

2. Compensation shall be equivalent to the fair market value of the expropriated investment immediately before the expropriation took place (“date of expropriation”), and shall not reflect any change in value occurring because the intended expropriation had become known earlier. Valuation criteria shall include going concern value, asset value including declared tax value of tangible property, and other criteria, as appropriate, to determine fair market value.

3. Compensation shall be paid without delay and be fully realizable.

Article 1110 establishes the right to compensation, at fair market value, in every case that expropriation is deemed to have occurred. This right to compensation represents a substantial departure from Canadian legal principles concerning expropriation, which have always reserved to Parliaments and legislatures the right to determine when and to what extent compensation will be paid when governments expropriate property. Moreover, the broad definition accorded investments under NAFTA, which includes intangible property and virtually all equity, debt and contractual interests in an investment, significantly expands the ambit of interests that might be entitled to compensation in cases of expropriation.

The cases

In considering this problem, the Committee correctly noted that the creation of a provincial Crown corporation offering services previously provided solely by the private sector has never been challenged under the WTO nor NAFTA. But of course no public insurance scheme has been created since the advent of these disciplines. However, some comfort might be taken from the fact that there appears to be no other precedent under international law for such a claim.¹²

The case closest on point was decided many decades ago by the Permanent Court of International Justice.¹³ That case concerned the interests of a British shipping company which the United Kingdom claimed was forced to close

when Belgium acquired the majority of shares of a competitor and then substantially reduced prices for competing services. Belgium also granted subsidies to the company it had acquired, but not its UK-based competitor.

In considering the UK claim on behalf of a foreign investor, the Court rejected the contention that good will is a property right capable, by itself, of being expropriated. It found that a granting of a de facto monopoly did not constitute a violation of international law, stating that “it was unable to see in [claimant’s] original position—which was characterised by the possession of customers—anything in the nature of a genuine vested right” and that “favourable business conditions and good will are transient circumstances, subject to inevitable changes.”¹⁴

Less closely related to the establishment of public auto insurance plans, several NAFTA cases have considered the nature and scope and Article 1110. In at least two of these, tribunals have considered foreign investor claims that sought to characterize government interference with the companies’ market access or market share as expropriation. In neither were these interests deemed sufficient of themselves to found such a claim for expropriation, and no expropriation was found to have taken place.

In the Pope and Talbot case, the tribunal did conclude that “access to the U.S. market is a property interest subject to protection under Article 1110.” But it then went on to add that the “terminology [market access] should not mask the fact that the true interests at stake are the Investment’s assets base, the value of which is largely dependent on its exports business.”¹⁵ In the S.D. Myers case, the Tribunal recognized that “there [were] a number of other bases on which SMDI [S.D. Myers Inc.] could contend that it has standing to maintain its claims including that . . . its market share in Canada constituted an investment,”¹⁶ but the tribunal did not elaborate on this point.

It may be worth noting that the market for auto insurance in N.B. and elsewhere in Canada is subject to government regulation, in particular the obligation to have certain insurance coverage. Private insurance companies have been the beneficiaries of such government intervention in the market, and should not arguably be entitled to damages whenever the nature of that intervention shifts in a way that may be adverse to their interests. Most government measures affect the market, sometimes to the benefit of certain businesses, sometimes not. It is clear from the cases cited that

more is required to found a successful claim for expropriation.

This point was made in another NAFTA case, *Marvin Roy Feldman Karpa v. United Mexican States*.¹⁷ In that case, the foreign investor argued that its investment in a trading company that exported cigarettes had been expropriated when the company was allegedly denied certain tax refunds. The tribunal found that there was no expropriation since:

“the regulatory action has not deprived the Claimant of control of his company, interfered directly in the internal operations of the company or displaced the Claimant as the controlling shareholder. The Claimant is free to pursue other continuing lines of business activity . . . Of course, he was effectively precluded from exporting cigarettes . . . However, this does not amount to Claimant’s deprivation of control of his company.”¹⁸ [emphasis added]

Our understanding is that the foreign companies now selling automobile insurance to New Brunswickers have diversified product portfolios and would, under present proposals, still continue to provide non-monopoly auto insurance services, and other insurance products as well. Both the *Karpa* and *Pope and Talbot* cases suggest that these ongoing business interests may present grounds for resisting a claim for expropriation under NAFTA.

Nevertheless, the *Metalclad* case illustrates the willingness of investor-state tribunals to give NAFTA’s rule on expropriation broad reading. More troubling is a subsequent ruling by the B.C. Supreme Court indicating that such tribunals will be given broad latitude, even where their decisions transgress reasonable limits. The Supreme Court Justice in that case upheld the tribunal’s findings that the state government had expropriated a U.S. company’s investment in establishing a hazardous waste dump (which had never gained local approval or been operated) by creating an ecological preserve that proscribes use of the site for hazardous waste management purposes. This is how the judge described the tribunal’s view of NAFTA’s expropriation provision:

The Tribunal gave an extremely broad definition of expropriation for the purposes of Article 1110. In addition to the more conventional notion of expropriation involving a taking of property, the Tribunal held that

expropriation under the NAFTA includes covert or incidental interference with the use of property which has the effect of depriving the owner, in whole or in significant part, of the use of reasonably to be expected economic benefit of property. This definition is sufficiently broad to include a legitimate rezoning by a municipality or other zoning authority. However, the definition of expropriation is a question of law with which this Court is not entitled to interfere under the International Commercial Arbitration Act.¹⁹

Finally, on the subject of investor-state litigation, the *UPS* case must be noted, because it is the first to invoke NAFTA investment disciplines to challenge the provision of public services by a Crown corporation: *Canada Post*. The *UPS* claim alleges that Canada and Canada Post are in breach of NAFTA obligations concerning National Treatment (1102), Minimum Standard of Treatment (1105), and restrictions concerning the actions of Crown corporations under Articles 1503(2) and 1502(3)(a). The case clearly belies repeated federal government assurances that public services would not be sacrificed to its trade liberalization agenda, but for the moment this case has no immediate relevance to the issue at hand.

In sum: to succeed with a claim under NAFTA, a U.S. or Mexican-based insurance company would have to overcome significant hurdles, including the absence of any precedent in international law, to support its claim. However, given the rulings of investor-state tribunals to date, there is a real risk that such a claim would succeed. Nevertheless, as our review of the relevant jurisprudence indicates, there are substantial grounds for defending New Brunswick’s proposed initiative as being compatible with Canada’s obligations under NAFTA. Obviously, the federal government should be encouraged to vigorously do so.

It is also important to note that there are steps the federal government can take to avert the possibility of a Chapter 11 claim by soliciting the agreement of its NAFTA partners to issue an interpretation under Article 1131, which would be binding on any tribunal established the Chapter, that expropriation will not occur when a Party exercises its authority under Chapter 15 to create a new public corporation. The federal government has previously made similar efforts to contain the scope of this provision, which it could be encouraged to renew.

However, should those efforts fail, damages would be payable by the federal, not provincial government. Given repeated assurances by federal officials that government policy and law concerning public services are unconstrained by international trade deals, the federal government may be seen to have both a legal and moral obligation to save New Brunswick harmless from the adverse consequence of doing no more than exercising its sovereign constitutional authority in the public interest.

GATS analysis

Overview

The GATS issue

In the mid-1990s, Canada made GATS market access and national treatment commitments covering motor vehicle insurance. The GATS market access rule disallows monopolies in sectors where governments have made commitments, unless they are listed as exceptions in a country's schedule. Canada listed an exception for public auto insurance monopolies, but it only protects existing public auto insurance systems in certain provinces; it does not provide the flexibility to create new systems. Furthermore, the GATS governmental authority exclusion is highly qualified and can't be relied upon to exclude New Brunswick's creation of a public auto insurance system.

Moving forward: how to address the GATS issue

Fortunately, in sectors where specific commitments have already been made, a special GATS procedure enables governments to modify their schedules in order to create new public monopolies. If New Brunswick decides to proceed with public auto insurance, Canada could use this special process. Canada would be required to:

- notify the WTO prior to the intended granting of monopoly rights;
- consult with other member governments who believe their service suppliers are affected; and
- negotiate with them to try to arrive at trade-related compensatory adjustment.

If no mutually acceptable agreement is reached, the matter could be referred to WTO arbitration for resolution.

Further ahead: rebalancing trade treaties

New Brunswick, and other provincial governments, *can* proceed with public auto insurance despite trade treaty impediments. Nevertheless, the case of public auto insurance

illustrates how the latest generation of services and investment treaties increasingly impede legitimate and proven public policies, interfering with democratic decision-making. Concerted changes in Canada's existing trade policy commitments and its objectives in ongoing trade talks are therefore essential to secure stronger protection for public services and to prevent future problems.

Analysis

New Brunswick's proposed public auto insurance system raises certain GATS issues. These are dealt with, in turn, below.

Is the creation of a public auto insurance system a "measure affecting trade in service" within the scope of the GATS?

The scope of the GATS is very broad. It applies to all government measures²⁰ affecting trade in services. No measures are excluded *a priori*. Moreover, the GATS applies to measures taken by all levels of government, including provincial and local governments.²¹

The GATS defines "trade in services" broadly to include all the different ways (or "modes") that a service can be delivered internationally. The GATS definition of "trade in services" includes services provided through a "commercial presence," for example, through a branch office of a foreign-owned insurance company established within the territory of another WTO member government. As the Committee Report notes, "insurers writing automobile policies in New Brunswick include Canadian subsidiaries of large United States and Europe-headquartered companies."²² Because the subsidiaries of foreign companies are active in the New Brunswick market, there is "trade" in insurance services, within the meaning of the GATS.

GATS Article I:3 excludes services provided in the "exercise of governmental authority." Such services are further defined as services provided "neither on a commercial basis nor in competition with one or more services suppliers" (GATS Article I:3.c).²³ The scope of this governmental authority exclusion as it applies to financial services, including insurance services, is more precisely defined in the GATS Annex on Financial Services (the Annex).

By this specialized definition, only those insurance services "forming part of a statutory system of social security or public retirement plans" or "other activities conducted by a public entity for the account or with the guarantee or using the financial resources of government" are excluded.²⁴

An argument might be made that the creation of a public auto insurance scheme by New Brunswick falls within the latter category. The GATS Financial Services Annex section 5(i) further defines “public entity” as:

“(i) a government, a central bank or a monetary authority, of a Member, or an entity owned or controlled by a Member, that is principally engaged in carrying out governmental functions or activities for governmental purposes, *not including an entity principally engaged in supplying financial services on commercial terms.* (emphasis added)”

As a legal opinion prepared for the Atlantic Canada Insurance Service Harmonization Task Force observes, to fall within the governmental authority exclusion, New Brunswick’s public insurance monopoly must meet the following conditions:

“(i) the provider is considered to be a “public entity,” i.e. it is owned or controlled by government, it is principally engaged in carrying out governmental functions or activities for governmental purposes, and it is not principally engaged in supplying financial service on commercial terms; (ii) its activities are conducted for the account or with the guarantee or using the financial resources of the government; and (iii) private insurance providers are not permitted to conduct such activities in competition with the public entity.”²⁵

A key condition is “not principally engaged in supplying financial service on commercial terms.” Because NBPI would be a not-for-profit corporation, it could be argued that its services are not supplied “on commercial terms.” On the other hand, because NBPI would charge consumers premiums and would be providing services previously provided by the private sector, it is very likely that a WTO dispute settlement panel would find that the governmental exclusion does not apply.

This narrow view of the governmental authority exclusion is reinforced by the fact that, in 1995, Canada scheduled GATS exceptions (“limitations”) for existing provincial public insurance monopolies.²⁶ These exceptions, further discussed later in this paper, would not be necessary if the GATS governmental authority exclusion applied.²⁷

The GATS governmental authority exclusion is highly qualified and cannot be relied upon to

exclude New Brunswick’s creation of a public auto insurance system. Creating such a public auto insurance monopoly would almost certainly be “a measure affecting trade in services” covered by the GATS.

Canada has made GATS-specific commitments covering motor vehicle insurance.

If the governmental authority exclusion does not apply and the creation of a provincial Crown corporation to provide public auto insurance is a measure affecting trade in services within the scope of the GATS, the next step is to determine which GATS rules would apply and, in particular, whether Canada took specific commitments covering auto insurance.

The most restrictive GATS rules apply only to government measures affecting trade in services in sectors where member governments make specific commitments. These rules are often referred to as “bottom-up,” because they apply only to those sectors that governments expressly agree to cover. The most important bottom-up obligations are “national treatment” (GATS Article XVII) and “market access” (GATS Article XVI).²⁸

A member government’s “specific commitments” are defined in its GATS schedule.²⁹ Examining Canada’s schedule confirms that Canada has taken market access and national treatment commitments with respect to motor vehicle insurance.³⁰

In 1994, Canada listed insurance, including motor vehicle insurance, in its GATS schedule. In February 1998, at the conclusion of further GATS negotiations on financial services, Canada submitted a revised GATS financial services schedule in accordance with the Understanding on Commitments in Financial Services (“the Understanding”).

The Understanding is an “alternative approach” to scheduling that entails more far-reaching GATS commitments applying to financial services. The Understanding applies only to those WTO members who expressly adopt it. Canada’s financial services commitments, including its motor vehicle insurance commitments, are undertaken in accordance with the Understanding.³¹

Canada’s 1998 GATS commitments open the motor vehicle insurance market to foreign insurance companies, provided that they establish a commercial presence within the province where they are selling insurance services.³²

Canada's GATS "limitation" protects existing provincial public auto insurance programs, but not new ones.

When a government makes specific commitments in a sector, it has a one-time opportunity to protect non-conforming measures by inscribing them as "limitations" in its GATS schedule. A limitation is a country-specific exemption.

There is a limitation in Canada's GATS schedule that exempts the provision of motor vehicle insurance by public monopolies in the provinces of Quebec, Manitoba, Saskatchewan, and British Columbia.³³ This limitation protects these public auto insurance programs from challenge as violations of the national treatment and market access provisions of the GATS.

This limitation, however, only exempts the existing public auto insurance monopolies in those four provinces. This reading is reinforced by one of the additional commitments that the federal government assumed in 1998 as part of the Understanding. The Understanding contains a "standstill" provision that reads, "Any conditions, limitations and qualifications to the commitments noted below *shall be limited to existing non-conforming measures* (emphasis added)."³⁴

The Understanding contains another extraordinary provision that stipulates that each member government must list existing financial service monopolies and "shall endeavour to eliminate them or reduce their scope."³⁵ While, in legal terms, this is simply a "best-efforts" obligation, it emphasizes the GATS architects' underlying hostility towards public monopolies.

The GATS disallows monopolies in sectors where a government has made specific commitments.

GATS Article XVI prohibits member governments that have made specific commitments in a sector from maintaining or adopting, in that sector, certain types of measures that the GATS defines as "market access" barriers. All such measures must be inscribed as limitations in a country's GATS schedule or eliminated. In trade policy jargon, they must be "listed or lost."

GATS Article XVI.2 (a) expressly disallows "limitations on the number of services suppliers, whether in the form of numerical quotas, *monopolies*, exclusive service suppliers, or the requirements of an economic needs test (emphasis added)."

It should be noted that Article XVI bans such measures, whether they are discriminatory or not. In other words, even though the creation of a public monopoly would affect Canadian and New Brunswick service providers in exactly the same way

as it would affect foreign service providers, it would still be inconsistent with GATS Article XVI.³⁶

To sum up, GATS Article XVI (Market Access) disallows monopolies in sectors where governments have made specific commitments. Monopolies can only be maintained if they are listed as exceptions in a country's schedule. Because Canada has made specific commitments covering motor vehicle insurance, and its limitation only protects existing public insurance monopolies, the creation of a public insurance monopoly by New Brunswick would be inconsistent with Canada's *existing* GATS commitments.³⁷

Moving forward: how to address the GATS issue

If New Brunswick decides to create a new public automobile insurance monopoly, there are special GATS procedures that the federal government can use to change Canada's GATS schedule. When Canada makes the necessary changes to its schedule, New Brunswick's new public insurance monopoly will be GATS-consistent.

There is a procedure for modifying GATS schedules so that governments can create a monopoly in sectors covered by existing commitments.

There is a procedure by which Canada can modify its commitments covering auto insurance to permit the creation of a public insurance monopoly. In fact, the GATS monopolies article anticipates the situation where "after the date of entry into force of the WTO Agreement, a Member grants monopoly rights regarding the supply of a service covered by its specific commitments."³⁸

In order to modify or withdraw its existing GATS commitments covering auto insurance, Canada would follow the procedures outlined in GATS Article XXI. It must:

- notify the WTO prior to the intended granting of monopoly rights,
- consult with other member governments who believe their service suppliers are affected, and
- negotiate with them to try to arrive at trade-related compensatory adjustment.³⁹

Notification must occur at least three months prior to the intended date of implementation of such modification or withdrawal.⁴⁰ Any other member government that considers that its interests under the Agreement may be affected by the proposed modification has 45 days to submit "claims of interest."

This is then followed by a period (normally three months) of negotiations between the “modifying Member” (in this case Canada) and any “affected Members.” If the modifying Member can reach agreement with all the affected Members on appropriate “compensatory adjustment,” then it can proceed with the modification immediately. Compensatory adjustment refers to new commitments in a country’s GATS schedule to compensate affected members for their lost market access.

If agreement cannot be reached, then any affected Member can refer the matter to WTO arbitration. The mandate of the arbitration panel is to “examine the compensatory adjustments offered [by the modifying Member] or requested [by the affected Member] and to find a resulting balance of rights and obligations which maintains a general level of mutually advantageous commitments not less favourable to trade than that provided for in Schedules of specific commitments prior to negotiations.”⁴¹

Once a modifying Member complies with the findings of the arbitration, then it can proceed with the proposed modification to its schedule. If it refuses to comply with the finding of the arbitration panel, then affected Members can retaliate by “modifying or withdrawing substantially equivalent benefits in conformity with those findings.”⁴²

In short, *Canada can modify its existing schedule to make certain that New Brunswick’s creation of a public auto insurance monopoly is GATS-consistent.* To do so, Canada would negotiate with affected WTO Member governments to come up with new GATS commitments that are substantially equivalent to those being withdrawn.

The special GATS Article XXI procedure has recently been invoked for the first time.

In July 2003, the European Communities (EC) gave notice that it intended to modify or withdraw GATS commitments. The changes relate to the 1995 enlargement of the EC to include Austria, Finland, and Sweden.⁴³ In July 2003, after a long delay, the EC provided a proposed consolidated GATS schedule for the original 12 member countries of the European Communities and the three new members. The consolidated schedule contains several changes, mainly related to the extension of the EC’s existing market access and national treatment limitations to apply to Austria, Finland and Sweden.⁴⁴

GATS Article XXI requires the EC to enter into negotiations with any WTO member government that feels they are affected, in order

to reach agreement on appropriate compensatory adjustments. A number of governments, including the United States and Canada, indicated their claim of interest and requested negotiations with the EC with a view to reaching agreement on any necessary compensatory adjustment. The deadline to agree bilaterally on compensation was June 1, 2004.

After the June deadline, if any affected WTO members are dissatisfied with the EC’s offer of compensation, they can refer the matter to arbitration. Because this is the first time GATS Article XXI has ever been invoked, there are many uncertainties regarding how the level of compensation is to be determined. It would appear to be in New Brunswick’s interest (and in the interests of other provinces that might wish to have public auto insurance in the future) to intervene to ensure that the federal government takes a flexible approach with the EC in establishing the new ground rules for “compensatory adjustment.”

Conclusions

New Brunswick, or indeed other Canadian provinces, can establish a public auto insurance system without being deterred by NAFTA or the GATS. While New Brunswick’s initiative would raise significant trade treaty issues, the federal government has both the capacity and the responsibility to ensure that these are addressed and resolved.

As the Select Committee’s report ably demonstrates, the advantages of a made-in-New Brunswick public insurance system recommend it highly. Regrettably, however, aggressive threats of trade treaty litigation -- and behind-the-scenes lobbying by federal trade officials -- have contributed to the Lord government’s decision to back away from this important public policy initiative.

This case aptly illustrates how the latest generation of services and investment treaties have reached far beyond strictly trade matters to impede proven and legitimate instruments of public policy, such as using monopolies to provide public services. Furthermore, it demonstrates how treaties, negotiated exclusively by the federal government, intrude on matters within provincial jurisdiction. More generally, it underlines how broadly worded trade treaties interfere with democratic decision-making.

Ultimately, despite this setback, the decision whether to create a public auto insurance system still lies with New Brunswick’s citizens. Trade treaties

should not interfere with -- or even influence -- this policy decision. It is a democratic policy choice to be made by the citizens of New Brunswick and their duly elected representatives.

Unfortunately, the rapidly expanding reach of international trade treaties has, very inappropriately, transformed this domestic policy debate into an international trade treaty issue. To avoid this in future, more balanced treaties and trade negotiating agendas are urgently needed.⁴⁵ In the meantime, New Brunswick's citizens should continue to pursue a public auto insurance system -- without being deterred by the federal government's trade treaty commitments.

Steven Shrybman is a Partner at Sack, Goldblatt and Mitchell. Scott Sinclair is a Senior Research Fellow with the Canadian Centre for Policy Alternatives.

The authors thank Morna Ballantyne, Bruce Campbell, Ed Finn, Blair Redlin, and Matthew Sanger for their advice and valuable suggestions on the paper. Jim Grieshaber-Otto ably edited the GATS sections of the paper. Any errors or omissions remain the responsibility of the authors. We are also grateful to Kerri-Anne Finn and Ed Finn for their help in preparing the paper for publication. This study was done by the Canadian Centre for Policy Alternatives (CCPA). We are grateful to the members of the CCPA's Trade and Investment Research Project, including the Canadian Union of Public Employees, for their ongoing financial assistance and support.

Endnotes

¹ Legislative Assembly of New Brunswick, Select Committee on Public Auto Insurance, "Final Report on Public Auto Insurance in New Brunswick," April 2004, p. 26.

² *Ibid.*, pp. 2-3.

³ Luke Eric Peterson, "International treaty implications color Canadian province's debate over public auto insurance," *Investment Law and Policy Weekly News Bulletin*, May 11, 2004, at International Institute for Sustainable Development, www.iisd.org/investment.

⁴ Legislative Assembly of New Brunswick, *op. cit.*, p. 20.

⁵ NAFTA investment rules may be invoked in State to State disputes as well, as might other provisions of NAFTA. In this regard Article 1404 prescribes measures that restrict cross border trade in services, such as the cross border sale of auto insurance by US companies to New Brunswick consumers. But the application of Article 1404 is unlikely because of historic constraints on the cross border sale of such services.

⁶ Under Article 1122 Canada has unilaterally consented to international arbitration for claims arising under the Chapter notwithstanding the absence of any

contractual relationship with the claimant. Nor do investors have any obligation to exhaust domestic remedies before resorting to international dispute resolution [Article 1121].

⁷ These are the regimes established pursuant to the ICSID convention, and UNCITRAL Arbitration Rules, recourse to which is provided by Article 1120.

⁸ Annex 1138.2.

⁹ State enterprises means a Crown corporation established under relevant federal or provincial legislation see Annex 1505.

¹⁰ Article 1401:1.

¹¹ Article 1101.3. This Chapter does not apply to measures adopted or maintained by a Party to the extent that they are covered by Chapter Fourteen (Financial Services). Several Chapter Eleven disciplines are incorporated to Chapter Fourteen, Article 1401:2 provides: Articles 1109 through 1111, 1113, 1114 and 1211 are hereby incorporated into and made a part of this Chapter. Articles 1115 through 1138 [investor-state suit provisions] are hereby incorporated into and made a part of this Chapter solely for breaches by a Party of Articles 1109 through 1111, 1113 and 1114, as incorporated into this Chapter.

¹² Note that existing public auto insurance schemes would have not been vulnerable to such claims under NAFTA because of exemptions relating to existing non-conforming provincial measures.

¹³ Oscar Chinn, 1934 P.C.I.J ser A/B, No. 63. As cited in OECD, DAF/IME/WD(2004)2, *Indirect Expropriation and Governmental Measures Not Requiring Compensation: Criteria to Articulate the Difference*, Mar. 26, 2004.

¹⁴ *Idem.*

¹⁵ *Pope and Talbot, Inc. v. Canada, Interim Award* (June 26, 2000), paras. 96-98. Pope and Talbot challenged Canada's allocation of export quotas under the Canada-US Softwood Lumber Agreement.

¹⁶ *S.D. Myers, Inc. v. Canada, (November 13, 2000) Partial Award*, 232, *International Legal Materials* 408 para 232. S.D. Myers challenged a decision by Canada to close the border to PCB exports to the US for a brief period in the mid 1990s.

¹⁷ ICSID Case No. ARB(AF/99/1, *Award of 16 December 2002*, pp. 39-67.

¹⁸ *Idem*, at p. 59.

¹⁹ *The United Mexican States vs. Metalclad Corporation*, 2001 BCSC 664, reasons for judgement of the Honourable Mr. Justice Tysoe, released May 22, 2001 at para. 99.

²⁰ "Measure means any measure by a Member, whether in the form of a law, regulation, rule, procedure, decision, administrative action, or any other form." GATS Article XXVIII, Definitions.

²¹ GATS Article I:3 (a)(i) reads: "For the purposes of this Agreement: (a) 'measures by Members' means measures taken by: (i) central, regional or local governments and authorities."

²² Legislative Assembly of New Brunswick, Select Committee on Public Auto Insurance, "Final Report on Public Auto Insurance in New Brunswick, April 2004. pp. 2-3.

- ²³ Even if this exclusion could be used for public auto insurance, it arguably would not apply, since the service would be provided on a commercial basis, with NB drivers paying premiums.
- ²⁴ GATS Annex on Financial Services, Article 1 (b). The Annex on Financial services applies to measures affecting the supply of financial services. It was adopted in 1995 at the end of the Uruguay Round and is an integral part of the GATS. The Annex definition of services provided in the exercise of governmental authority also excludes “ activities by a central bank or monetary authority” but this is not relevant to auto insurance services.
- ²⁵ McCarthy Tetrault, Memorandum prepared for the Atlantic Canada Insurance Harmonization Task Force, September 9, 2003
- ²⁶ The McCarthy Tetrault memorandum notes that under “paragraph 1 of the Understanding on Commitments in Financial Services, notwithstanding the provisions of paragraph 1(b) of the Annex on Financial Services, WTO Members are required to list on their schedules pertaining to financial services existing monopoly rights and shall endeavour to eliminate them or reduce their scope. This obligation to list applies to the activities described in paragraph 1(b)(iii) of the Annex above. This could explain why Canada took reservations in respect of public automobile insurance monopolies in British Columbia, Saskatchewan, Manitoba, and Quebec in its GATS Schedule of Commitments, even though they may have been considered to be ‘services supplied in the exercise of governmental authority’ and therefore excluded from GATS disciplines.” This suggestion, however, overlooks that Canada scheduled the reservations for public auto insurance monopolies in 1995, before the 1997 Understanding had been negotiated. See McCarthy Tetrault, p. 5, note 9.
- ²⁷ The federal Department of International Trade (formerly DFAIT) does not appear to believe that the expansion of a public monopoly to areas previously covered by private insurance would be excluded by the GATS governmental authority exclusion. In Q&As on its public web site it states: Question: “What about private health insurance in the GATS?” Answer: “In 1997, Canada made market access and national treatment commitments with respect to private health insurance such as that provided by Blue Cross. Commitments made on private health insurance do not undermine or require us to change our public health insurance system.” Question: “What if the Government decides to expand public health insurance?” Answer: “Should Canadian governments decide to expand public health insurance to areas previously covered by private health insurance, *the GATS has procedures to modify our commitments as necessary.* (emphasis added)” http://strategis.ic.gc.ca/epic/internet/instp-pcs.nsf/en/h_sk00152e.html. Accessed May 1, 2004.
- ²⁸ The GATS also contains certain rules that apply across-the-board to government measures affecting all trade in services. These are often referred to as “top-down” rules because they apply to all government measures and all service sectors. The most important top-down obligations are most-favoured-nation treatment and transparency.
- ²⁹ A government’s GATS schedule forms an integral part of the GATS (GATS Article XX:3).
- ³⁰ Canada, Schedule of Specific Commitments, supplement 4, 26 February 1998.
- ³¹ See Canada, Schedule of Specific Commitments, supplement 4, 26 February 1998.
- ³² Canada’s GATS schedule contains a horizontal limitation applying to all provinces that stipulates that insurance services “must be supplied through a commercial presence.” *ibid.*
- ³³ “Motor vehicle insurance (Quebec, Manitoba, Saskatchewan, and British Columbia): Motor vehicle insurance is provided by a public monopoly.” *Ibid.* Canada lodged the same limitation in its original 1995 GATS schedule.
- ³⁴ Understanding on Commitments in Financial Services, in The Results of the Uruguay Round of Multilateral Trade Negotiations, Legal Texts, World Trade Organization.
- ³⁵ *Ibid.* Article B.
- ³⁶ “Another confusion that sometimes arises is the idea that only discriminatory measures should be scheduled under Article XVI. This is not the case. Article XVI covers all measures that fall within the six categories listed, whether they are discriminatory or not.” WTO, Committee on Specific Commitments, “Revision of Scheduling Guidelines: Note by the Secretariat,” 5 March 1999, S/CSC/W/19. p. 6.
- ³⁷ Provided that the public monopoly is not excluded by the governmental authority exemption as discussed previously.
- ³⁸ GATS Article VIII.4
- ³⁹ GATS Article XXI, paras. 2-4.
- ⁴⁰ WTO, Procedures for the Implementation of Article XXI of the GATS: Modification of Schedules, 29 October 1999. paras. 1-2. S/L/80.
- ⁴¹ *Ibid.* para. 13.
- ⁴² *Ibid.* para. 16.
- ⁴³ The 1994 enlargement increased the EU from 12 to 15 members. On May 1, 2004, an additional 10 countries joined the EU, and it now stands at 25 members.
- ⁴⁴ Interestingly, one of these is a limitation on market access exempting public utility services subject to monopolies or to the granting of exclusive rights to private operators.
- ⁴⁵ Several concurrent shifts are desirable. Those existing trade treaty commitments that pose problems for policy flexibility need to be changed. In order to achieve more effective safeguards in ongoing and future negotiations, Canada’s negotiating goals and strategies should be overhauled. Finally, Canada should champion longer-term changes in the international system to ensure that the protection and expansion of public services does not take a back seat to commercial and investor rights.